Date 11 June 2021

Response to consultation on Air Passenger Duty (APD)

Background

- The Local Authority Pension Fund Forum (LAPFF) is a voluntary association of 83 local authority pension funds and seven LGPS pools, with combined assets of approximately £300 billion. It exists to promote the investment interests of member funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest.

Response

- LAPFF welcomes the opportunity to respond to this important consultation. In this section we outline our overall position before addressing the consultation questions in the following section. LAPFF's response focuses on the issues from a long-term investor perspective and the need to address climate change.
- This has been brought into sharper focus with the COVID19 pandemic, which could be considered a dress rehearsal for the required transformation in capital markets to address climate change. Indeed we have learned from companies' responses to the pandemic that changes that previously would have been thought to take several years in planning and implementation, could be undertaken within a matter of days, weeks or months.
- LAPFF has long recognised the imperative to address climate change as a systemic investment concern for our members. It poses material financial risks across all asset classes with the potential for loss of shareholder value. LAPFF recognised the conclusions of the October 2018 Intergovernmental Panel on Climate Change (IPCC) report[1] that reaching net zero emissions by 2050 gives a 50% chance of staying within 1.5 degrees rise in global average temperature. For a 67% chance of staying within 1.5C, there was by January 2018, a budget of 420 gigatons of CO2 left to emit globally. Given that around 42 gigatons of

[1] https://report.ipcc.ch/sr15/pdf/sr15_spm_final.pdf

CO2 are emitted annually, at current rates the budget would be gone by around 2028.

- LAPFF's main engagement objective is for companies to align their business models with a 1.5 degrees scenario and to push for an orderly net-zero carbon transition in a manner consistent with a just transition.
- Emissions from air transport are a significant contributor to economic and investment risk. Globally aviation accounts for around 2.5% of global carbon dioxide emissions, but its overall climatic impact is greater representing 3.5% of 'effective radiative forcing' which is a closer measure of its warming impact[2]. And in the UK, as the Committee on Climate Change has noted, aviation emissions rose 88% from 1990 levels to 7% of UK greenhouse gas emissions in 2018[3] and now represent around 10% of the UK's total carbon dioxide emissions[4]. Further it is expected that aviation will grow to be the biggest source of UK emissions by 2050[5].
- LAPFF has engaged with a US listed airline in the past two years on electric flights, lobbying and emission reductions, and considers that airlines not focused on emissions reductions face higher risks as government regulation becomes tighter. We consider that the necessary rapid decarbonisation of the economy requires all partners to work together. This includes government setting the clear and consistent policy direction and regulatory standards. LAPFF therefore supports clearly identified legislative framework on transport and carbon reductions, so that companies will be able to make the necessary decisions and financial commitments to provide the short and long-term solutions to decarbonising the economy that are needed.
- Our experience engaging with companies is that, without strong and timely regulation, achieving the UK's ambitions for reducing emissions will be slower and less effective as some companies tend only to meet minimum regulatory requirements. In this context, LAPFF strongly advocates for no reduction in air passenger duty (APD) and further that, the government should review the current position of tickets being VAT free and aviation fuel incurring no duty. This would ensure there would be no reduction in aviation tax as a whole.
- In respect of international flights, the government could progress cooperation with countries that already tax airline fuel and other countries that can agree multilaterally to implement a fuel tax on flights between them, or on other measures for aviation tax.

[2] https://ourworldindata.org/co2-emissions-from-aviation#:~:text=Aviation%20accounts%20for%20around%202.5,to%20climate%20change%20is%20higher.&text=Overall%2C%20the%20warming%20effect%20is,of%20these%20impacts%20were%20included.
[3] Sector-summary-Aviation.pdf (theccc.org.uk)
[4] https://www.aef.org.uk/what-we-do/climate/
[5] https://www.bbc.co.uk/news/business-49808258

- LAPFF further considers that the government should take the opportunity to support the development of UK leadership in electric flight and propose a ban on fossil fuel powered private jets from using UK airports from 2025 onwards, for review in its consultation later this year on how the aviation sector will deliver its contribution to net zero. This consultation could also consider a proposal for electric-only domestic flights by the same date. These measures should be taken in consideration of the need to mine materials for electric airplanes in a manner that respects human rights and broader social impacts.
- The government has set clear ambitions regarding both levelling up and net zero emissions, which is evident across policy areas including in the Union Connectivity Review. These major government agendas should not be viewed in isolation and measures to level up should not come at the expense of net zero ambitions. The danger of focusing on APD alone is that it will overlook the climate impact of a tax cut and how that revenue could support other, more sustainable ways of regional connectivity, and risks government having to revisit the issue in the near future, creating uncertainty.

Detailed response

The government's initial policy position on domestic APD

1. *Do you agree with the government's initial policy position that the effective rate of domestic APD should be reduced? In your view, what would be the positive and negative effects of such a change, particularly in light of the government's objectives for aviation tax?*

   No. The price signal of reducing domestic APD would be to encourage more flights in the UK. This would be in stark and direct opposition to the UK government's own climate change target to reduce emissions by 78% by 2035 compared to 1990 levels. Given that the government's objectives for aviation tax are to support union and international connectivity, resources would best be directed to support good rail connectivity. It is notable that both France and Spain have already signalled that they are likely to suspend domestic flights that can be done by direct train in less than 2.5 hours. Equally, it should be noted that pure electric flight is already in commercial operation for short haul in some parts of the US (west coast) and shortly to be in some parts of the US east coast (by 2023). This could be used for connectivity domestically including to the Highlands and Islands, in addition to the ferry operations that already exist.

2. *What evidence can you provide about the impact of an effective reduction in the domestic rate of APD on Union and regional connectivity?*

   Regional connectivity should be a focus of a broader review of the role of transportation within the UK, not the main purpose of one mechanism, the

APD. The consequence should not be to provide additional advantage to carbon-emitting air travel over more sustainable options. Indeed, for the connectivity to regions such as the Highlands and Islands, electrification of air travel has been promoted by the Scottish Government who are aiming to make the Highlands and Islands the 'world's first net zero aviation region' by 2040[6] with Regional carrier LoganAir expecting its first fully electric planes to enter service on short Orkney routes in 2021[7]. Additionally, most of the popular domestic flight routes can be serviced by existing rail links.

3 *How would a reduction in the effective rate of domestic APD affect airlines? Will the benefits be passed onto consumers in ticket prices or retained by airlines?*

LAPFF is not able to comment on what individual companies would do, if this were to take effect. Flying often is priced more cheaply than the same journey by train. This is due in part to generous tax breaks given to the aviation industry, which amounted to around £7bn per year before Covid[8] If benefits were to be passed onto consumers, the price disparity between flights and lower-carbon forms of transport would be further increased. Policies should be designed to make it easier for consumers to choose lower-carbon transport, rather than the reverse.

LAPFF does observe that the aviation industry received £11 billion from the UK taxpayer during the Covid crisis[9] and questions why the benefits should not be considered in terms of a more coherent domestic transport policy, with an emphasis on low carbon surface transport.

4 *Which domestic air routes, if any, are likely to be introduced/restart following any effective reduction in the domestic rate of APD, and what wider benefits would these routes provide?*

LAPFF is not able to comment on the specific and direct financial implications to the airlines involved. The climatic disbenefits are evident.

5 *Which existing domestic air routes, if any, would benefit from an increased number of services following any effective reduction in the domestic rate of APD, and what wider benefits would these routes provide?*

Any airlines considering implementing electric flights, would be able to add a reduction in the domestic rate of APD into their pricing structure for electric flights. The UK could take its lead from countries such as Iceland and Norway, which aim to turn all domestic flights electric by 2040[10].

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[6] https://www.pressandjournal.co.uk/fp/news/politics/ holyrood/1833622/nicola-sturgeon-unveils-plan-tocreate-emission-free-airways-over-the-highlandsand-islands/
[7] Electric planes will connect Highlands and islands | Scotland | The Times
[8] https://neweconomics.org/2020/06/crisis-support-to-aviation-and-the-right-to-re train
[9] Written questions and answers - Written questions, answers and statements - UK Parliament
[10] https://www.bloomberg.com/news/articles/2020-12-13/nordic-nations-set-pace-in-electric-planes-after-green-cars-push?srnd=hyperdrive

6 *By how much would you estimate that the number of passengers currently flying domestically increase?*

Given the context of the rapid emission reduction required by the government's 2035 climate change target, one would expect any proposed changes to the APD should be to reduce the number of passengers, unless these were on electric flights. The focus should be on an integrated transportation policy, including improvements to widely available rail connections, and ensuring the reliability and affordability of surface transport.

7 *What could the environmental impact of reducing the effective domestic rate of APD be? How could any negative impacts be mitigated?*

The climatic impact is likely to be an increase in passenger numbers, in domestic airline flights and thus an increase in carbon emissions. Negative impacts could be mitigated by only allowing a reduction in the effective domestic rate of APD for electric flights. This would support UK industry leadership in electric flight.

8 *What could the impact of reducing the effective domestic rate of APD be on other modes of transport (e.g. road/rail)?*

It is likely to make these comparably more expensive, thus discouraging passengers to choose these as a travel option. This is in direct opposition to any measures for the UK to reach its climate change target to reduce emissions by 78% by 2035 compared to 1990 levels. Given that only half of the UK's rail network is currently electrified[11], the taxation system should not be set up to reward companies offering the most carbon-intensive form of transport with advantageous tax breaks.

9 *If the effective rate of domestic APD is reduced, would you favour the introduction of a return leg exemption or a new domestic rate? What would you see as the comparative risks and benefits of these options?*

LAPFF considers both options would work to the detriment of the governments' own emission reduction targets for 2035.

10 *Is there an alternative approach to reducing the effective rate of APD on domestic flights, that you think would be more appropriate than either of the options identified?*

Yes. The APD cannot be considered in isolation. Measures to support union and regional connectivity should be a focus of the broader Union Connectivity review of the role of transportation within the UK, not the main purpose of one mechanism, the APD. Examining APD in isolation risks

[11] https://www.networkrail.co.uk/running-the-railway/looking-after-the-railway/track/third-rail/

underplaying the environmental risks and the alternative ways of supporting more sustainable modes of transport.

A cut in APD risks being a blunt instrument with considerable deadweight loss to the exchequer (lost revenue which could support greening the transport system and on economic development more broadly) and potentially having a greater impact on personal rather than business travel and thus a marginal impact on regional growth. As such, changes should be subject to an impact assessment regarding regional growth but also on carbon emissions and tax revenues/value for money. This should be compared with the benefit-cost ratio of other investments which aim to both level up and decarbonise the economy.

A return leg exemption

11 *What are your views on the way a return leg exemption could operate as set out in paragraph 2.8? What are the benefits and risks of this proposal? What amendments would you suggest, if any?*

LAPFF would view this as an inconsistency, as it is the same distance and the same carrier. The risks include sending a signal to the market that the government does not intend to regulate consistently, i.e. the return flight with a different carrier would be subject to the APD.

12 *Do airlines currently differentiate between single and return tickets in their booking systems and, if so, how?*

13 *What evidence could airlines provide to HMRC to demonstrate that a passenger was travelling on a return ticket?*

14 *If the return leg exemption were to be introduced, how quickly could airlines integrate it within their operating systems to allow them to them to provide evidence to HMRC on their APD liabilities?*

LAPFF is not best placed to comment on these, but presumably in line with current evidence provided to HMRC.

15 *Are there any particular considerations around the application of a return leg exemption to business jets, in light of how business jets are operated?*

The carbon impact is the primary consideration to be borne in mind. It is estimated that a typical private jet passenger journey emits around ten times as much as an economy class flight, this represents about 40 times as much carbon per passenger as regular commercial flights[12] and around 150 times as much as an equivalent journey made by high-speed rail[13]. Given that industry estimates suggest 40% of private jet movements are 'empty leg'

[12] https://www.theguardian.com/environment/2019/oct/27/super-rich-fuelling-growing-demand-for-private-jets-report-finds?CMP=share_btn_tw
[13] https://s3-eu-west-1.amazonaws.com/media.afreeride.org/documents/Jet+Set+Go+Summary.pdf

journeys, the only application of an exemption that should be considered is to only provide this for electric flights. Further, given that most private jet journeys within Europe are over distances that could be completed by fully electric flight (if not by rail) and this aviation market segment is most amenable to rapid electrification, LAPFF considers that the government should take the opportunity to support the development of UK leadership in electric flight and propose a ban on fossil fuel powered private jets from using UK airports from 2025 onwards. This could exclude certain uses such as air ambulance flights or disaster relief operations. This should be put for review in the government consultation later this year on how the aviation sector will deliver its contribution to net zero. This consultation could also consider a proposal for electric-only domestic flights by the same date. These measures should be taken in consideration of the need to mine materials for electric airplanes in a manner that respects human rights and broader social impacts.

A new band for domestic flights

16 *Do you agree with the government's initial position that a new domestic band would be the most appropriate approach to reducing the rate of APD on domestic flights?*

No. LAPFF considers that measures to encourage carbon-free flights are to be encouraged, but that this should include consideration of other measures such as airline fuel charges and air mile levies.

17 What are your views on the way a new domestic rate could operate as set out in paragraph 2.11? What are the benefits and risks of this proposal? What amendments would you suggest, if any?

LAPFF considers that regulatory policy for airlines should be determined within the context of coherent government policy, both on transportation and on climate. It should not be determined for the convenience of HMRC and airlines as set out in the consultation 'because it would be simpler for HMRC and airlines to administer'.

18 If a new domestic rate were to be introduced, how quickly could airlines integrate it within their operating systems to allow them to them to provide evidence to HMRC on their APD liabilities.

This is up to airlines to comment on, but again should be within the context of their R&D capex investment into zero carbon aircraft and how 'market ready' they are to introduce such flights as well as to make provisions for providing 'evidence to HMRC'.

International Distance Bands

19 *Do you agree with the government's initial policy position that the number of APD distance bands should be increased? In your view, what would be the positive and negative effects of such a change, particularly in light of the government's objectives for aviation tax?*

LAPFF considers the most effective way to implement the government's objectives for aviation tax would be to implement duty on aviation fuel, thus aligning with the objectives for the commitment to net zero emissions by 2050 (and the reduction of 78% by 2035) as well as ensuring 'that the aviation sector makes a fair contribution to public finances.' Such a levy would do away with the difficulties of determining number of bands required and cut-off points and would be most directly aligned with the emissions connected to the flights. Studies have shown that cost is a vital factor when people are deciding how to travel abroad. Indeed, the low cost of flights to Europe is a primary motivator for people to choose plane travel rather than trains. This in the context that nine out of the ten most popular countries visited by people who live in the UK are within Europe and could be reached without flying[14].

20 *What could the impact on the environment of a change to the banding structure?* [sic] *How could any negative environmental impacts be mitigated?*

The primary 'impact on the environment' is that of the contribution to carbon emissions and the adverse climatic impacts. Given the short time frame in which to address the required stringent emission reductions, the rates for duty on fuel or other measure of taxation should be set so that the changes would not decrease lower overall aviation tax revenue and to support the development of appropriate technology to ensure a transition to zero-carbon flight. LAPFF's engagements with US car makers have shown how regulation of the auto industry in terms of emission regulation and fuel economy standards has spurred the development of technology to meet these standards.

21 *What evidence can you provide about the impact of an increase in the number of APD distance bands on international connectivity?*

Unless the associated rates are provided, it would be difficult to provide evidence for this.

22 *Which of the policy options for increasing the number of international distance bands do you think is most appropriate? Please explain your answer.*

[14] Fare Competition, 2021, https://bit.ly/3pbpcVz.

Under the assumption that the rates would increase 'by strengthening the principle that those that fly further incur a higher rate of APD', implementing a tax on aviation fuel would best support all three of the government's objectives for aviation tax.

23 *Is there an alternative banding structure that could better meet the government's objectives as outlined in paragraph 1.1?*

Apart from applying duty on airline fuel, or other measure such as an air mile levy, until there is a globally applicable carbon tax, many of these issues would better be deferred until the government consults on how the aviation sector will deliver its contribution to net zero later this year.

24 *If a new international distance band structure were to be introduced, how quickly could airlines integrate it within their operating systems to allow them to them to provide evidence to HMRC on their APD liabilities?*

This is more of a matter for comment by airlines and the measure chosen. As previously it should be within the context of their R&D capex investment into zero carbon aircraft and how 'market ready' the companies are to introduce such flights as well as the associated provisions for providing 'evidence to HMRC'.

Frequent flyer levy

25 *Do you agree with the government's assessment that APD should remain as the principal tax on the aviation sector? Would you propose any alternative tax measures which could further align the aviation tax framework with the government's environmental objectives?*

No, LAPFF does not consider APD should remain the principal tax on the aviation sector. The lack of a tax on aviation fuel is striking and it is unclear from this consultation document as to why a kerosene tax is not considered appropriate as a principal tax for the aviation sector. Many states, including the US and Japan, tax domestic jet fuel. There have been initial discussions in Europe about implementing an EU-wide kerosene tax and other non-EU countries can agree multilaterally to implement a fuel tax on flights between them.

An alternative measure would be an 'Air Miles Levy' which makes distance flown progressively more expensive. This measure arises from an October 2019 report commissioned by the UK Committee on Climate Change[15].

Additionally, LAPFF would encourage the government in its consultation later this year on how the aviation sector will deliver its contribution to net zero, to consider a frequent flyer levy. This is promoted by the government's

[15] www.theccc.org.uk/publication/behaviour-change-public-engagement-and-net-zero-imperial-college-london/

own advisory body, the Committee on Climate Change and is in recognition that 70% of UK flights are made by just 15% of the population.

The UK citizens' assembly, set up by six government select committees in 2020 to represent a spectrum of views from all over the UK, came to a consensus[16] that government should be harnessing the Covid crisis to limit support for high-carbon industries. They also supported higher taxes on frequent fliers, and investment in clean aviation technology. The conclusions from this grouping can be taken as an indication of what form of aviation tax would be considered fair and acceptable by the public in the UK. In drafting a potential air miles or frequent flyer levy, the government should ensure not to penalise genuine zero-carbon technologies and retain an appropriate challenge to so-called 'sustainable aviation fuels' or the use of off-setting.

The Forum is committed to a just transition to a net zero economy. This means achieving net zero carbon emissions should not come at the expense of certain groups or communities. Any tax measures proposed in line with the government's environmental objectives, should also bear this in mind.

[16] https://www.bbc.co.uk/news/science-environment-54087176