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COMMISSION STAFF WORKING PAPER

An analysis of a possible contribution based on airline tickets as a new source of financing development

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1. INTRODUCTION

1.1. Responding to the ECOFIN Council

The ECOFIN Council of 7 June 2005 discussed the issue of a possible contribution based on airline tickets to raise the funds necessary for the achievement of the targets set for Official Development Assistance (ODA). At this occasion the Finance Ministers renewed their invitation already made to the Commission in April and May to come forward with a technical analysis of this issue.

The Commission has to give an active response to the ongoing debate. It is important to reflect on new and different means to finance development, which will imply public solidarity and contribution.

The present staff working paper is responding to the ongoing debate and aims at providing an objective analysis of a coordinated implementation of a solidarity contribution based on airline tickets for ODA financing. It does not represent a Commission position on the mechanism to be used; neither does it contain a Commission proposal for a specific mechanism. Obviously, in the limited time available, the Commission services have not been able to carry out any impact assessment nor any consultation. Should the Commission be invited to make concrete proposals or should it decide to present specific measures, these would follow the Commission's internal procedure under the better regulation initiative.

1.2. The development policy background

In March 2002, the international community adopted the "Monterrey Consensus" at the International Conference on Financing for Development, defining a comprehensive global agenda for sustainable development. The EU contributed significantly to the overall positive outcome of the Conference by acting collectively at Monterrey, on the basis of explicit commitments concerning both the volume and the quality of aid endorsed by the European Council in Barcelona on 14 March 2002.

The Council of 23-24 May 2005 endorsed the recommendations of the Commission Communication on "Accelerating progress towards attaining the MDGs" new collective EU target of 0.56 % ODA/GNI by 2010, which would result in additional annual € 20bn ODA by that time. First, Member States which have not yet reached a level of 0.51 % ODA/GNI undertook to reach, within their respective budget allocation processes, that level by 2010, while those that are already above that level undertook to sustain their efforts. Secondly, Member States which joined the EU after 2002 and that have not reached a level of 0.17 % ODA/GNI, will strive to increase their ODA to reach, within their respective budget allocation processes, that level by 2010, while those that are already above that level undertook to sustain their efforts. Lastly, Member States undertook to achieve the 0.7% ODA/ GNI target by 2015 whilst those which have achieved that target committed themselves to remain above that target; Member States which joined the EU after 2002 will strive to increase by 2015 their ODA/GNI ratio to 0.33%.

The Council conclusions indicated its intention to continue considering the most promising options for innovative sources of financing for development in order to increase the resources available in a sustainable and predictable way, and noted the intention of some Member States to introduce a solidarity levy on airline tickets.

In September 2005, the UN High-Level Event will take stock of the progress made by UN Members on the implementation of the global agenda of the Millennium Development Goals (MDG) drawn from the Millennium Declaration of 2000. In preparation for this event, various initiatives have been developed with the aim of estimating the financing resources needed to reach the MDGs, as well as identifying the modalities through which such resources might be mobilised. ODA in 2004 totalled US$78 billion; the financing gap deemed necessary to meet the MDGs has been estimated at some additional US$50 billion a year.

In preparation for the September UN High-Level Event, further work has continued on financing this agenda. Major documents produced in this connection include the “Landau Report” submitted to the President of France in September 2004, which reviewed a wide range of proposals including both “front-loading” of aid through an International Finance Facility and a number of options for international taxation; the Quadripartite Report (sponsored by the Presidents of Brazil, Chile, France and Spain) and presented at the UN in New York by President Lula in September 2004; and most recently the "Technical group on innovative financing mechanisms – Action against hunger and poverty", bringing together Algeria, Brazil, Chile, France, Germany and Spain, which is working on a coordinated position for the UN High Level Event. All of these reviews include among the more promising options the possibility of taxing aviation. Lastly, in a draft outcome document prepared by the Presidency of the General Assembly for the High-Level Event, the implementation of a pilot project of an international solidarity contribution on plane tickets to finance the fight against HIV/AID and other pandemics is welcomed.

In the run-up to the UN High-Level Event, civil society organisations have also taken an active interest in international taxation options: most recently over 40 NGOs and civil society networks, representing over 100 organisations in all, issued a statement on 18 May calling for a mandatory tax on air tickets as a visible European initiative to give political momentum to the process.

1.3. Council's progressive focus on a possible contribution based on airline tickets for development

On the basis of the Commission Staff Working Paper[1] "New Sources of Financing for Development: a Review of Options", the Council, in April and May 2005, exchanged views on a range of fiscal instruments, aimed at yielding additional resources for ODA. The Staff Working Paper looked in detail at the idea of a kerosene tax, a flight departure tax, as well as a currency or financial transaction tax. In addition, the possibility of increasing rates of existing taxes, such as VAT and excise duties on motor fuels, was also examined.

Considering that aviation is less affected by Community indirect taxation instruments than other sectors, the Council has focused on aviation-related measures as possible means to

[1] SEC(2005)467 of 05.04.2005.

increase financial resources for ODA. Two main instruments had been contemplated: kerosene taxation and flight departure levies. Kerosene taxation has not been retained in the present context of ODA financing because of legal and economic considerations. Actually, many bilateral Air Services Agreements (ASAs) with third countries are still obliging the contracting Parties to exempt kerosene supplied to Parties' aircrafts[2]. Furthermore, when third country carriers have access to intra-Community routes[3], the fuel used for these services is exempted from taxation as long as the bilateral agreements are not amended. The amendment of bilateral ASAs between Member States and third countries allowing for the taxation of kerosene would therefore be necessary for the taxation of kerosene on all intra-Community flights. Finally, after in-depth discussions, the informal Council meeting of 14 May called for a continued examination of innovative sources of financing for development, including the implementation of a contribution on airline tickets.

The EU *acquis* does not prevent Member States from undertaking such an initiative on an individual basis. Alternately, it could be done on a coordinated basis. There could be clear advantages in terms of neutrality and administrative simplification to a common approach in all EU Member States, leaving the possibility of choosing between the introduction of a mandatory or a voluntary measure to be decided at national level. Where the principle of a voluntary contribution is retained, a mechanism would have to be established offering passengers the possibility of paying their contribution or not. This staff working paper only analyses the case for coordinated implementation.

Resources raised by this mechanism should clearly serve development objectives.

This analysis is not intended to deal with potential measures to reduce the climate change impact of aviation. Therefore this paper is without prejudice to the Communication that the Commission is currently preparing on reducing the climate change impact of aviation to be adopted later in 2005, which will consider the use of economic instruments such as the taxation of kerosene and emissions trading, with the objective of improving environmental performance.

2. OPTIONS FOR IMPLEMENTING THE CONTRIBUTION FOR DEVELOPMENT

2.1. The possible structures of the contribution

Three kinds of decisions would have to be taken on the implementation of a contribution scheme. **First, each Member State would have to decide whether it wants to take action at national level or not**. **Secondly, for** the Member **States wishing to act, a choice** would have to be made **between a mandatory instrument**, similar to a flight departure tax, **and a voluntary contribution** proposed to passengers. **Thirdly**, in the Member States **where** the principle of a **voluntary contribution is retained, a mechanism would have to be selected**, offering the possibility to the passengers to pay or not their contribution.

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2 Bilateral agreements between Member States have been largely replaced by the 'Third Package' of measures adopted in 1992 (Council Regulations (EEC) No 2407/92, 2408/92, 2409/92) Following the adoption of Directive 2003/96 on energy taxation, taxation of fuel could in theory be applied now between Member States.

3 By using the so called 5th freedom rights under its bilateral ASA with Member States.

An independent decision by an airline company to initiate a donation scheme by its passengers is beyond the scope of the present paper, which focuses on the possible structures of a contribution implemented at national level.

2.1.1. Mandatory contribution for ODA

Three Member States currently impose flight departure taxes[4]: Denmark (5 or 10 euros per passenger, depending on airport and plane sizes), Malta (23 euros; 46 euros as of 1st August 2005), and the United Kingdom (from 8 to 64 euros, depending on travel class and destination).

For those Member States willing to apply a mandatory measure, a common structure could be established along the lines used for existing flight departure taxes. Its main features would be:

– The event generating the obligation to pay would consist in the carriage from a Community airport of chargeable passengers on chargeable aircraft.

– The contribution would be collected by the operators of chargeable aircraft.

One consequence of the decision on the mandatory or voluntary nature of the contribution is a different treatment with a view to the classification as ODA. Voluntary contributions would probably not be accounted for as *official* development aid, whereas a compulsory contribution could be regarded as ODA.

A mandatory contribution should bear in mind the peripheral character of some Member States.

2.1.2 Voluntary contributions for financing development

As an alternative to the mandatory contribution presented above, Member States could create the conditions for the setting-up of a voluntary contribution, which would be claimed when passenger flight tickets are bought.

Two main methods can be contemplated for the voluntary contribution:

First, an "opt-in" scheme could be proposed to passengers wishing to act and contribute to the financing of specific projects. The passengers would declare their wish to pay a certain amount when they buy their flight tickets. While this option gives maximum flexibility to the passengers, it would require action from the passengers' side in order to contribute.

Secondly, by using a voluntary "opt-out" scheme, passengers would have to act in order to escape the contribution. This option appears less "voluntary" than the first one. A stringent approach could also be considered, which would make it more costly for the passenger to opt out. Under this approach, the payment of the contribution would be charged automatically to the passenger. Only an *ad hoc* refund request made by the passenger would permit him to avoid final payment of the contribution. This option would maximize the revenues but it would raise issues of passenger/consumer rights.

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4 Source: OECD/EEA database on environmentally related taxes, fees and charges, other economic instruments and voluntary approaches used in environmental policy and natural resources management.

In both cases, impact assessments would have to be conducted on the most cost-effective collection method, focusing notably on the revenues raised and the related administrative costs.

As regards both the opt-in and the non-stringent opt-out, the management of the schemes would most probably have to be conducted by airlines and intermediaries (travel agencies…) selling flight tickets to the final consumer/passenger[5]. This would require adaptation of electronic booking systems. In the case of the stringent opt-out, the existing systems of charging airport fees or flight departure levies could most probably be used; however, administrative costs in connection to refunding may prove high in this case.

Issues relating to the practicalities and costs of the collection of the contribution proceeds are examined in more details in Section 3. However, no additional action should be required from the passengers themselves at the time of check-in at airports because this would lead to significant risks of delay in flight departures due to high congestion in airports.

Detailed evaluation of the practical implementation of these possible structures could require from the Commission the issuing of additional indications on the possible schemes to be adopted.

2.2. The level of the contribution for development

It is assumed that the level of the contribution would remain small, within a range of € 1 to € 5 per passenger on a national or intra-Community flight.

One additional feature of the contribution would be the introduction of dual rates: one level for national and intra-Community flights and another level for international flights. For instance, a person leaving a third country airport to Europe, and returning, would potentially pay the contribution only once while a person departing from a Community airport to another Community airport would pay the contribution twice. Therefore, for the sake of equity, the "international" level of the contribution should be twice as high as the national and intra-Community level.

A differentiation of the level of the contribution according to the class or the type of travel could also be envisaged.

The issue of passengers in transit should be analyzed further.

Finally, an *ad valorem* contribution has not been contemplated in the present paper as its compatibility with Community VAT legislation is uncertain.

3. ASSESSMENT OF THE IMPACTS

The contribution scheme has to be assessed against certain criteria: revenue-raising capacity and additionality; economic and environmental impacts; and practical feasibility and implementation costs. The mandatory or facultative nature of the contribution changes the effects of the measure under most criteria.

[5] Considering the context of ODA financing, the mere placement of donation boxes in airports cannot be regarded as a serious alternative for the collection of the contribution.

3.1. The mandatory contribution for ODA

3.1.1. Revenue-raising capacity and additionality

Assuming participation by all Member States, in order to have an estimate of the maximum theoretical revenues, the results are the following, taking into account the expected reduction in demand (see below):

Contribution level (euro / passenger)		Maximum revenues (Mio euros)
Intra EU and national flights	International flights	
5	10	2 763
1	2	568

3.1.2. Economic and environmental impacts

The impact on flight demand from a mandatory contribution, using medium price elasticity[6], would be the following:

Contribution level (euro / passenger)		Impact on demand	
Intra EU and national flights	International flights	Intra EU and national flights	International flights
5	10	-3%	-4%
1	2	-0,5%	-1%

The contribution levels used here are lower than those of the Member States applying a departure tax.

Strong growth in the number of air transport passengers in the EU25 is expected in the longer term. The mandatory contribution would thus mainly mitigate the rate of growth in air transport passengers rather than lead to a diminution in absolute terms.

However, for an industry with high fixed costs, even a small reduction in demand could have a significant impact on the profitability of air carriers. In order to evaluate the impact, the Commission services would need to investigate in-depth the effects of such a measure, in the context of a full impact assessment..

Regarding distortions of competition, as the mandatory contribution would apply to Community and third country carriers, it would not create direct distortions of competition between airlines. Furthermore, it is unlikely that passengers would change the origin of travel because of a contribution of a very small amount. However, a mixed approach of mandatory

6 Cf. SEC(2005)467 of 05.04.2005.

contributions by some Member States and a voluntary approach by others might have effects of destination-switching.

Peripheral Countries and regions that are more dependent on aviation for transport could be more affected. This effect would have to be taken into account.

Finally, a mandatory contribution would marginally contribute to reducing greenhouse gas and air pollutant emissions through the impact on (slightly) reduced demand for air travel.

3.1.3. Effects on the tourism industry

As regards the <u>tourism industry</u>, there are two effects stemming from a mandatory contribution: first, a net reduction in air travel demand, and second, destination switching.

In theory, the main impact on tourism of a mandatory contribution applied in all EU Member States would come from reduced air travel demand, also taking into account substitution with land transport. The price elasticities of tourism, for a given destination country, are typically below 1 and often below 0.5. Furthermore, the elasticities for a whole region such as the EU are much lower than those for one country (because of destination switching between EU countries). Destination switching outside the EU would include for example Turkey and North African countries, while other destinations appear less substitutable as they are more geographically distant. As mentioned above, a mixed approach of mandatory contributions by some Member States and a voluntary approach by others might cause some destination-switching between EU countries. However, <u>it should be borne in mind that the maximum price increase of 10 euros for a return ticket has to be compared with the price of a travel package in the order of 300-400 euros, and not simply with the price of the ticket alone</u>.

Finally, the impact on tourism should also be put in perspective against the growth of tourism demand, which is a strong structural trend, both in the EU and worldwide.

The example of Malta shows that a departure tax can be implemented in a member State where tourism plays a significant economic role.

3.1.4. Practical feasibility and implementation costs

The practical feasibility of the mandatory contribution is high. No specific legal constraints would prohibit the implementation of such a scheme. Of course, no discrimination should occur between the measures applicable to national and intra-Community flights.

Experience in the United Kingdom indicates very limited collection costs (around 0.1% of the revenues for the air passenger duty). However, this figure has to be related to the overall revenues of the duty. For operators, administrative costs are expected to remain within reasonable limits.

3.2. The voluntary contribution for financing development

3.2.1. Revenue-raising capacity and additionality

It is very difficult to estimate the percentage of passengers who would voluntarily contribute to the scheme. Public opinion supports overwhelmingly the principle of ODA[7], and even its increase. Therefore, it is theoretically possible that the use of the opt-in would be rather high while the opt-out would be low, when the level of the contribution remains small. However, the "Landau report"[8] refers to some experiences on the collection of charitable donation through routine bills, like water supply bills, where the collection rate (i.e. the percentage rate of contributing consumers) was very low: below 0.1%! The modality of the latter donation was very different from the proposed contribution on airline tickets.

Due to the lack of data and evidence on comparable experiences, notably on probable collection rate, estimates remain very uncertain and illustrative only. The table below indicates the revenue raising capacity of a contribution under various hypotheses[9] and assuming a homogeneous adoption of the measure in all Member States:

Contribution level by flight type	National/Intra-Community :1 € International: 2 €			National/Intra-Community :5 € International: 10 €		
Collection rate	30% (Opt-in)	90% (Opt-out)	*100%*	10% (Opt-in)	50% (Opt-out)	*100%*
Annual revenues (EU-25; million euros)	172	515	*572*	286	1 429	*2 859*
Of which :						
- revenues from national/intra-EU flights	113	339	*377*	189	943	*1886*
- revenues from international flights	58	175	*195*	97	486	*973*

(The case of a 100% collection rate is only provided as a reference case).

The possible fiscal deduction of the contribution would reduce net revenues. Moreover, the administrative costs of managing the deduction of contributions paid by citizens on income tax may be high, both for airlines and tax administrations. However, for legal reasons and in order to avoid a discrimination against other donation schemes, tax deductions might have to be considered in some countries.

7 According to the Landau report, 92% of the people in Germany support the principle of development aid, 78% in the United Kingdom, and 74% in France.

8 "Rapport au Président de la République: les nouvelles contributions financières internationales", working group chaired by Mr. Landau, France, 2004.

9 In addition to the scenarios presented in the table, the main hypotheses are the following: i) the collection rate decreases if the theoretical contribution level increases; ii) the opt-out scenario would rather concern the stringent approach.

Besides, as the means of implementing the contribution scheme on tickets bought in third countries are unknown at this stage, it should be noted that the revenues from contributions on international flights (see table above) might be lower.

The stability and predictability of the resources raised through the scheme are uncertain and would also depend on continued public acceptance of the scheme. This may have a negative impact on the possibility to use the scheme in the context of a special-purpose international financing facility (IFF).

3.2.2. Economic and environmental impacts

The voluntary nature of the scheme means that, despite the modest amount of the contribution, any passenger would be free to choose not to pay it. Consequently, it can reasonably be assumed that the impact of such a contribution on air transport demand would be negligible, if passengers are well-informed and rational. Actually, in contrast to a tax, if the contribution is likely to affect the decision whether to travel or not, the passenger could in those circumstances decide not to pay it. The behavioural response to even a stringent opt-out may lead to the conclusion that, economically speaking, such option should not be considered as equivalent to a mandatory measure.

As the impact on demand can be assumed as negligible, there would be in consequence no expected impact on the financial situation of air carriers - apart from that of administrative costs-, of their suppliers, and on tourism activities. For the same reason, there would be no expected distortion of competition. Voluntary contribution by the passengers would not place the EU, the Member States, or the economic operators, at any competitive disadvantage. Moreover, in terms of equity, voluntariness is also appealing as it cannot be regarded as being regressive.

Finally, in the absence of any effects on demand and on air carriers, the measure would have no environmental effect.

3.2.3. Practical feasibility and implementation costs

No specific legal constraints would prohibit the implementation of such a scheme. Again, no discrimination should occur between the measures applicable to national and intra-Community flights.

Further work has to be completed to ensure the practical feasibility of the voluntary contribution, especially in the cases of the opt-in and of the non-stringent opt-out. For the latter cases, administrative costs supported by operators are unknown at this stage. However, the experience from providing Passenger Name Records to the US Department of Homeland Security, where booking systems also had to be modified and passengers have to provide personal details, shows that it can run into tens of millions of euros, for flights to and from the US alone. Administrative costs would have to be further assessed, taking into account the levels of the expected proceeds, to ensure that the relation between these costs and revenues remains reasonable. In addition, these scenarios would leave open the question of the flight tickets bought in third countries.

As regards the stringent opt-out, the direct management of the scheme would be linked to existing systems of charging airport fees or flight departure levies. However, the most sensitive issue here would be the cost of managing the refund request introduced by some passengers. The airlines would have to establish a system to administer potentially large numbers of refund, with the risk for mistakes, complaints, and fraud. Moreover, banking costs may well exceed the level of contribution. It should also be borne in mind that if administrative hurdles for the refund are too high (with a view to limiting the number of refund requests), the scheme could be regarded by some citizens as similar to a tax. Acceptability by the public may then be reduced and may have a general negative impact on citizens' voluntary financing for development.

It would be open to question, in the case of a voluntary contribution, whether Member States should allow airlines to recover the costs of administration from the money raised.

4. USE OF REVENUES RAISED THROUGH THE CONTRIBUTION BASED ON AIR TICKETS

Resources raised through the contribution should be earmarked for development. The governance of these monies is one of the crucial outstanding issues. The mechanism that is chosen should combine a high degree of transparency, low transaction costs, flexibility, and accountability to the citizens whose contributions it deploys.

The resources could for instance be coordinated/pooled, with a light governance structure mandated to contribute to highly visible development initiatives. They could for instance be attributed to the Millennium Development Goals (MDGs) as a whole, or to a selected MDG, (*e.g.* immunisation in support of the child mortality MDG, HIV/AIDS, or safe drinking water) or to a specific pilot project. Results from the projects financed should be regularly presented to citizens in the context of a communication strategy.

This approach should meet the criteria identified, and also provides a highly politically visible European initiative for the September UN High-Level Event.

The advantages of selecting a single MDG could include easier public presentation, and might also include a lighter governance structure if contributions could be made directly to an existing agency. The disadvantages might include a damaging imbalance of resources across the MDGs, which are mutually supportive and need to move forward together.

Many details remain to be worked out. These include whether decision on the use of resources should be taken by representatives of the Member States, or by an independent Board of Trustees. They also include issues such as the voting structure (which could for example be based on the previous year’s actual contributions if decisions are taken by Member States), the mandate (for example, geographical scope, type of activity, and aid modalities), and accountability mechanisms.

Several other options could be envisaged:

– Member States could appropriate the contributions to their own budgets. This might risk reducing the incentive to voluntary contribution. It could also forego a clear European identity to the initiative, and reduce the visibility of the activities funded. It could also lower the profile of the initiative for the UN September event.

– The ECOFIN referred to this voluntary levy in the context of a pilot IFF for immunisation. The presently proposed IFFIm is designed to “front-load” ODA from participating Member States: a link to the proceeds from a voluntary levy would entail substantial rethinking of the basic approach. However, the risk for bondholders could be too high when the repayments are only based on the unpredictable revenues of voluntary contributions.

5. CONCLUSION

While Member States could apply a development contribution unilaterally, coordination at EU level/pooling of funds could enhance the visibility of the initiative, whether voluntary or mandatory. A common approach could not only avoid negative economic effects between Member States, but would also help ensure a powerful message and raise public awareness of development issues, thus encouraging the social acceptability of the contribution. Moreover, the political message of European solidarity towards developing countries would be more forceful. In addition, this would allow envisaging an opening of the initiative to other willing partners in the context of the September UN High-Level Event.