



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 01.09.2005
SEC(2005) 1067

COMMISSION STAFF WORKING PAPER

Annex to

**A possible contribution based on airline tickets as a new source of financing
development:
technical reflections in the run up to the UN High Level Event**

{SEC(2005) 1065}

COMMISSION STAFF WORKING PAPER

A possible contribution based on airline tickets as a new source of financing development: technical reflections in the run up to the UN High Level Event

1. INTRODUCTION

Following a request from the ECOFIN Council in July 2005, the present Staff Working Paper contains an analysis of a possible contribution based on airline tickets as a new source of financing development. The UK Presidency wishes to discuss, at the informal ECOFIN on 9 September, the possible implementation of a common scheme for the financing of specific development projects through a solidarity contribution on plane tickets. Several Member States consider that this would constitute an important political initiative, included in an EU development package, to be presented at the UN High Level Event, which will take place later in September.

This Staff Working Paper does not represent a Commission position on the mechanism to be used; nor does it contain a Commission proposal for a specific mechanism. It simply contains, as requested by the ECOFIN Council, a technical analysis of the two options which Finance Ministers have indicated they wish to further consider, namely mandatory or voluntary payment of a contribution by passengers under an international scheme to which Member States could choose to participate on a voluntary basis. In the limited time available, the Commission services have not been able to carry out additional economic assessment nor any consultation with sectors concerned by this matter (air carriers, travel agents, consumers etc.). Should the Commission be invited to make concrete proposals or should it decide to present specific measures, this would follow the Commission's internal procedure under the better regulation initiative. The paper does not address the issue of the possible uses of the revenues raised through the proposed schemes since this was already addressed in the Staff Working paper presented to the ECOFIN Council in July.

1.1. The development policy background

Detailed information on the development policy background relating to the contribution on airline tickets has already been provided in the Staff Working Papers prepared by the Commission services in April and June 2005¹.

In September 2005, the UN General Assembly will take stock of the progress made by UN Members on the implementation of the global agenda of the Millennium Development Goals (MDG). 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. Official Development Aid (ODA) totalled US\$78 billion in 2004; the financing gap deemed necessary to meet the MDGs has been estimated at some additional US\$50 billion a year.

¹ "New Sources of Financing for Development: a Review of Options" (SEC(2005)467 of 05.04.2005) and "An analysis of a possible contribution based on airline tickets as a new source of financing development" (SEC(2005)733 of 15.06.2005).

Consideration of innovative financing mechanisms is one of the important initiatives, which have been taken. In particular, in the EU, a new collective ODA/GNI target of 0.56 per cent by 2010 has been adopted by the Council, as an intermediate objective towards 0.7 per cent by 2015. Further measures relating to debt relief, notably in favour of heavily indebted poor countries, to aid effectiveness, and to trade, are also being discussed.

At the July meeting in Gleneagles G8 member countries, including four EU Member States stated that they "firmly believe that innovative financing mechanisms can help deliver and bring forward the financing needed to achieve the Millennium Development Goals. They will continue to consider the International Financing Facility (IFF), a pilot IFF for Immunisation and a solidarity contribution on plane tickets to finance development projects, in particular in the health sector, and to finance the IFF. A working group will consider the implementation of these mechanisms."

1.2. The debates in the Council

On the basis of the two above-mentioned Commission Staff Working Papers, the Council has exchanged views on a range of fiscal instruments, aimed at yielding innovative resources for development ODA.

A very broad range of instruments was initially assessed, including:

- Environmental/energy/transport-related taxes, like taxes on maritime transport, aviation, or a CO₂ tax/charge;
- Taxes on currency or financial transactions, like the Tobin tax;
- Health-related food taxes, like a tax on the sugar content of food;
- Taxes on the trade of arms;
- Taxes on the profits of large multinational companies.

After in-depth technical and political evaluation, the Council has progressively focused its attention on aviation-related measures. Finally, the Council has narrowed down its scope of investigation to the possible implementation of a solidarity contribution on airline tickets.

Two initial features of such a contribution scheme would have to be defined. First, would this contribution be voluntary or mandatory for the Member States at EU level? Secondly, would the contribution itself be voluntary for passengers or mandatory (i.e. similar to a flight departure levy)?

Four main scenarios for the possible contribution can be deduced from the above questions²:

Mandatory-Mandatory: mandatory participation of all Member States in an EU-wide tax scheme, introducing a mandatory levy for passengers.

Mandatory-Voluntary: mandatory participation of all Member States in an EU-wide scheme introducing a voluntary contribution for passengers.

² See report from the Chairman of the Sub Committee on IMF and related issues of the Economic and Financial Committee, 28.06.2005.

Voluntary–Mandatory: voluntary participation of Member States in an international scheme introducing a mandatory levy for passengers at national level.

Voluntary-Voluntary: voluntary participation of Member States in an international scheme foreseeing a voluntary contribution by passengers at national level.

At its meeting on 12 July 2005, the Council concluded that there appear to be only two politically feasible options, namely the "voluntary-mandatory", and the "voluntary-voluntary" approaches. It therefore invited the Commission to provide further analyses on these two options.

2. THE VOLUNTARY-MANDATORY OPTION

Under the voluntary-mandatory option, it would be up to Member States to decide whether or not to apply a compulsory levy on airline tickets.

2.1. The possible structures and rates of the levy

Along the lines used for existing flight departure duties³, the main features of the levy on airline tickets could be:

- The event generating the obligation to pay could consist in the carriage from a participating Member State airport of chargeable passengers on chargeable aircraft.

A chargeable passenger would be anyone carried for reward on the aircraft, subject to possible exemptions, for instance in favour of young children who do not have their own seat. Crew members would not be regarded as passengers.

A chargeable aircraft would be any aircraft carrying passengers, subject to possible exemptions linked for example to the weight of the aircraft or the number of passenger seats.

- The levy could be collected by the operators of chargeable aircraft (mainly air transport undertakings) or intermediaries. It should be noted that such undertakings are already accustomed to collecting various additional charges, taxes and levies.

Operators of chargeable aircraft, used for the carriage of chargeable passengers from an airport in a participating Member State, would be identified in that Member State and would be required to keep records and accounts, submit tax returns, and make corresponding payments.

The issue of passengers in transit and of connecting flights requires specific attention. When an aircraft makes a stop "en route" and passengers do not change aircraft, then no additional levy should become due for the leg of the journey immediately after the stop. One levy only would then be due, according to the final destination⁴. On the other hand, a passenger using connecting flights may in theory be subject to the levy on the first, or the second, or both

³ In the EU, Denmark, Malta and the United Kingdom apply such duties.

⁴ And the travel class or other relevant elements.

flights. However, for neutrality reasons⁵, such a passenger should ideally be treated in the same way as one making a stopover. This issue may have an impact on which Member State (of departure or of connection) collects the revenue.

To ensure consistency in an international scheme, and to avoid double charging or non-charging, it is important that Member States participating in the scheme act in a coordinated manner. For instance, if only one leg of connecting flights is chargeable, common criteria to determine whether the subsequent flight on a journey may be treated as connected, would have to be established. The Commission could assist participating Member States in order to ensure consistent implementation and compatibility with Treaty and other obligations of such measures.

The rate of the levy would ideally be the same in all participating Member States. Dual rates could be introduced: one level for national and intra-Community flights and another level for international flights. The "international" level of the levy could be twice as high as the national and intra-Community level (although this could vary if a comparable levy is introduced in certain third countries). A differentiation of the level of the contribution, for instance according to travel class, could also be envisaged.

2.2. Practical feasibility and implementation costs

The practical feasibility of the levy is high. The levy could be added to the price and paid when the ticket is purchased, as is the case with airport duties, fees and charges, such as the UK "Air Passenger Duty" which is charged on commercial flights, from a UK airport, of each passenger by the operator in the price of the ticket⁶. Under this scheme, the UK collected some £791 (€1,150) million in duty in 2003-04 from a relatively small number of registered airlines (279)⁷, which would indicate that collection costs are small for the Government. Also, given that only some £0.6 (€0.9) million was written-off in that period would suggest that compliance by operators is very high. But, perhaps more importantly, are the views of the registered airlines to this tax which were provided in response to a survey conducted by the UK authorities in 2002⁸. It is reported that nearly all operators undertake their own internal record keeping processes using their own computer systems, some 96% felt that completing returns was easy, and only one-third felt that meeting their statutory responsibilities was unnecessarily costly. However, there is no assessment of the costs for operators.

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.

⁵ An exemption would be neutral as to the choice of the route between departure and final destination. It would also be neutral for companies, whether they operate direct routes or not.

⁶ There are currently four rates of duty: standard rates of £10 (€15) for specified European destinations, and £40 (€60) for all other destinations, and reduced rates of £5 (€7.50) for specified European destinations, and £20 (€30) for all other destinations. There are some exemptions, for example flights departing from certain remote regions (the Scottish Highland and Islands), and conditions concerning connected flights and connections. The airline operator responsible for the flight is required to register and, in addition to normal record keeping type requirements, make returns and pay the duty on a monthly basis.

⁷ HM Customs and Excise Annual Report and Accounts 2003-04

⁸ Excise and Other Taxes Business Needs Survey 2002 (Air Passenger Duty) Market Research Report prepared for HM Customs and Excise March 2003.

2.3. The impacts of the levy

The impacts of the levy are examined in detail in the Commission Staff Working Paper of 15 June 2005. For this exercise it was assumed that the level of contribution would remain small and would differentiate between intra-Community flights and international flights (i.e. a person leaving a third country airport for Europe and returning would pay the contribution once only whereas someone taking a return flight within the Community would pay the contribution twice).

Assuming, therefore, the introduction of a levy in all 25 Member States at a rate⁹ between €1 and €5 (on domestic and intra-EU flights) and between €2 and €10 (on international flights), maximum revenues raised would range between €568 million and €2763 million¹⁰, taking into account the impact on demand. Five Member States (France, Germany, Italy, Spain, and United Kingdom) would represent roughly three quarters of the total proceeds.

The impact on demand would be the following, using a medium elasticity of -0.8¹¹:

Levy rate (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 impact on tourism is difficult to quantify because of a lack of relevant data and because of the tight timeframe available for the preparation of the present document. Peripheral and island Countries and regions that are more dependent on aviation for transport would be more affected. The price elasticities of tourism for the EU region are much lower than for one country because of destination switching between EU countries. Destination switching outside the EU would include Turkey or North African countries rather than other more geographically distant (and less substitutable) destinations. 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 precise impact of these reductions in demand on the airline industry is difficult to predict, but it is certain that for an industry with high fixed costs, even a small reduction in demand could have a significant impact on the profitability of air carriers. Moreover, airlines will not welcome the imposition of an additional levy on their passengers at the time when oil prices are at an all time high.

The decision by one Member State to implement a levy would have an impact also on those Member States which would not impose a similar measure. In the case of a return flight between one Member State applying a levy and another Member State having opted out, one leg of the return flight would be subject to the levy. However, as only one leg of the journey

⁹ An *ad-valorem* contribution was not considered due to uncertainty as regards its compatibility with EU VAT legislation as well as its potential impact on prices particularly in peripheral regions.

¹⁰ Specific treatment for passengers in transit/connected flights is not taken into account in these estimates.

¹¹ Cf. SEC(2005)467 of 05.04.2005.

would be affected, the impact on tourism for the Member States not applying the levy would be halved in comparison with the uniform application of the levy by the 25 Member States.

Finally, passengers would be unlikely to switch the origin of travel when the levy rate remains small.

3. THE VOLUNTARY-VOLUNTARY OPTION

Under the voluntary-voluntary option, Member States would have to decide whether or not to apply a national measure setting up a voluntary contribution scheme by passengers.

3.1. The possible structures and rates of the voluntary contribution

Theoretically, several approaches could be considered. An airline company could for instance decide to initiate a donation scheme by its passengers. However, such an individual and isolated action does not address the overall objective of raising significant resources for ODA. Nor can the mere placement of donation boxes in airports be regarded as a serious alternative in that context. The request for a voluntary contribution at the time of registration by the passengers is excluded because it would lead to more congestion in the airports. The most feasible solution is that Member States would set-up a scheme according to which the voluntary contribution would be collected (along with other additional charges, taxes etc) when passenger flight tickets are bought. Two main methods can be contemplated for this 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.
- Secondly, by using a voluntary "opt-out" scheme, passengers would have to act in order to escape the contribution. A stringent approach could also be in theory considered. 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 gross revenues but administrative costs would most likely be high and it would raise issues of passenger/consumer rights.

As with the levy option, the voluntary payment would be linked to the carriage by aircraft from a participating Member State airport of paying passengers. The obligations for operators would also be similar to those applicable for the levy.

Issues relating to passengers in transit and connected flights, mentioned in section 2.1 of the present paper, are also relevant for the voluntary contribution, but to a lesser extent.

Finally, the level of the contribution is assumed to be in the same range as the levy. Differentiated rates could also be introduced, according to the destination (national and intra-Community flights / international flights) or travel class...

3.2. Practical feasibility and implementation costs

3.2.1. The opt-in and the non-stringent opt-out

The management of the opt-in and the non-stringent opt-out would ideally be conducted by airlines and intermediaries (travel agencies...) selling flight tickets to the final consumer/passenger. However in the case of a voluntary levy, the support of such intermediaries would have to be secured and a slightly more sophisticated adaptation of electronic booking systems would be required than would be the case for a mandatory levy, but is something to which such undertakings are already accustomed when offering other travel options to passengers..

3.2.2. The stringent opt-out

As regards the stringent opt-out, the direct management of the scheme would be the same as a mandatory scheme. However, the most sensitive issue here would be the additional cost of managing the refund requests by some passengers. The administrators or the intermediaries (most likely, 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 burdens for the refund are too high, acceptability by the public may then be reduced, which would have a negative impact on citizens' voluntary financing for development.

3.3. The impacts of the voluntary contribution

It is very difficult to estimate the percentage of passengers who would voluntarily contribute to the scheme. As public opinion supports overwhelmingly the principle of ODA, it is theoretically possible that the use of the opt-in would be rather high, as long as the level of the contribution remains small. Due to the lack of data and evidence on comparable experiences, notably on probable collection rates, estimates remain very uncertain and illustrative only. As it is the case for the voluntary-mandatory option, the impact on tourism for the Member States not applying the levy would be halved in comparison with the uniform application of the contribution by the 25 Member States, notably in terms of possible destination switching.

The table below indicates the revenue raising capacity of a contribution under various hypotheses¹² 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 €		
	30% (Opt-in)	90% (Opt-out)	100%	10% (Opt-in)	50% (Opt-out)	100%
Annual revenues (EU-25; million)	172	515	572	286	1 429	2 859

¹² 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.

euros)						
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 provided for reference purpose only).

If a Member State decides to grant a fiscal deduction relating to the contribution, this deduction would reduce net revenues. The administrative costs of managing the deduction of contributions paid by citizens on income tax may be high both for airlines and tax administrations.

Unless the opt-out was made extremely inconvenient, the voluntary nature of the scheme means that any passenger would be free to choose not to pay it. Consequently, the impact of such a contribution on air transport demand and on tourism would be negligible.

Finally, the stability and predictability of the resources raised through the voluntary contribution are uncertain.

3.4. CLASSIFICATION OF THE MEASURE AS ODA

One consequence of the decision on the mandatory or voluntary nature of the contribution is a possible different treatment with a view to the classification as ODA.

Since the proposed scheme has no precedent, there is no ready-made answer on whether the funds involved would be regarded as official or private in OECD Development Aid Committee (DAC) statistics. The decision on this would be up to the DAC Working Party on Statistics (WP-STAT). In due time therefore, a paper should be submitted to the WP-STAT setting out the options under consideration and asking for advice on ODA eligibility.¹³

Since no ODA recording currently occurs when funds are raised from the public, such a paper would have to include specific options regarding the use of the funds. Depending upon the latter and the mechanism for raising the funds, the WP-STAT would then indicate whether the spending in question would be regarded as official or private development assistance as well as the point at which flows would be measured (at the time of spending in a partner country, at the time of pooling into a fund etc.).

4. CONCLUSION

The EU has consistently supported efforts to increase ODA. In the run up to the UN High Level Event, several Member States consider that an important political initiative, to be included in an EU development package, would consist in getting all Member States to implement a common mechanism for the financing of specific development projects through a solidarity contribution on plane tickets. However, given that a consensus does not seem to

¹³ The meeting planned for October 2005 may be the first occasion for such an approach.

exist among EU Member States, only a voluntary approach at national level appears feasible since this would leave each Member State the freedom to refuse to participate in the scheme without precluding those Member States who so wish from applying a mandatory levy. Applying both a voluntary contribution and a levy may not prove more difficult than applying only a voluntary scheme. The EDP system of the airline companies would have to take into account that some Member States apply a levy.

It has to be recalled that Community law does not prevent a Member State from unilaterally introducing a levy on airline tickets. However, there are advantages to implementing a levy and/or a voluntary contribution in a coordinated manner:

- Coordination at EU level would enhance the visibility of the initiative, which would appear as a concrete EU initiative for the September UN High-Level Event. The political message of European solidarity towards developing countries would of course be more forceful.
- It would reduce potential negative effects. For instance, a common structure would facilitate the implementation of the measure by the operators.
- It would ensure against any incompatibilities with Treaty obligations.

If Member States, or a group of like-minded Member States, intend to make progress on a contribution on airline tickets, the Commission would consider participating in any working group that they would constitute for this purpose. Such a working group could be tasked with the objectives of working out the details of the various options (including the use of funds raised), call for any in-depth study of the various costs and impact of the options (including issues such as the feasibility of alternative options, the impact on peripheral regions/countries, the international dimension and the issues of additionality), as well as seeking clarification on their accounting implications. Finally during the implementing phase, the Commission could help Member States to co-ordinate the treatment of passengers in transit and of connected flights. Formal enhanced cooperation is excluded, notably in the absence of a proposal for a Community legal act from the Commission. Coordination could however be done informally, for instance through meetings with the appropriate experts of the participating Member States and the Commission.