International Chamber of Commerce
The world business organization

Policy Statement

The airline ticket tax – a business viewpoint

Prepared by the Corporate Economists Advisory Group

Introduction

Following the development of a report commissioned by French President Jacques Chirac, a handful of countries have proposed the idea of taxing airline tickets to raise funds for development aid. On 1 July 2006, France will take the lead in implementing this proposal by imposing a new levy on all commercial airline tickets, ranging from one to 40 euros depending on the distance traveled and type of ticket, in the hope that other countries will follow suit.

While ICC fully acknowledges the importance of combating world poverty, it has serious concerns about creating a special purpose tax that targets airline tickets. As a matter of principle, ICC is deeply opposed to the creation of earmarked taxes targeting a specific business sector for the intention of funding an unrelated public objective.

Harmful effects

A tax to finance development aid that exclusively targets the aviation industry and airline travellers would be arbitrary, detrimental to that particular industry, and would create serious economic distortions. On several occasions in the past, ICC has deplored the proliferation of taxes imposed on airlines and users, which increase travel costs and reduce demand. The tax would impose new competitive distortions on a sector already suffering from heavy losses as a result of cyclical and external difficulties despite recovering growth rates.

An airline ticket tax would lead to economic inefficiencies by distorting the choice between alternative modes of transportation and inducing travelers not to use certain destinations or connections. In many cases, while air transport would be the most efficient transport mode in an inter-modal comparison, the tax could lead travellers to opt for a second-best, surface based-option. Another effect of the tax would be to harm economic activity outside major urban regions. In countries with large land masses, air travel is the only means to travel the country in a time-effective manner and the only way to access communities in remote regions.

The rationale for taxing airline tickets is likely based on the premise that air transport is a good enjoyed by the well-off. However, in practice such a tax would be particularly painful for low-income households who represent a growing segment of air transport users and are already very sensitive to ticket prices.

The proposed scheme is likely to function at cross purposes with the objectives it is supposed to achieve. To the extent that an airline ticket tax impacts airline companies based in developing countries, their ability to survive in a competitive industry may be impaired, thus depriving the country of much needed earnings. Through its depressing effect on air traffic movement, the tax will perversely hit a large number of developing countries that have invested heavily in the promotion of tourism and greatly rely on tourism earnings to support their economic growth. As a general matter, the tax would increase the cost of doing business overseas, hardly a way of encouraging productive investment in the developing world.

Highly uncertain returns

Most developed countries provide significant funds for Official Development Assistance (ODA), measured either in absolute terms or as a percentage of gross national product. Typically countries provide for ODA out of their general tax revenue and not from earmarked taxes. This includes all five countries that have reached or exceeded the ODA target of 0.7 percent of GDP: Norway, Luxembourg, Denmark, Sweden and the Netherlands.

It is highly questionable whether the introduction of a special foreign aid tax would provide significant additional funds for development. Countries that adopt such a tax under international pressure would be tempted to offset its effect by devoting to foreign aid fewer funds financed from general-purpose taxes. Countries that already apply airline ticket taxes to finance general government expenditures might opt to reduce these taxes in order to avoid adding an excessive burden on airlines' competitiveness.

New economic opportunities are needed, not a new tax

ICC believes that removing barriers to trade, investment and entrepreneurship in an open market should remain the preferred means of achieving long-term development. For example, there is no doubt that the protection of agriculture in many developed countries increases the need for aid in the developing world and directly counteracts the effects of official and other development aid. In particular, reducing export support to agriculture in developed countries and improving market access for agricultural imports from the developing world will both diminish the need for development aid and free funds that might be used for ODA. The proposed tax is an unfortunate cosmetic device that may divert attention from such real and pressing needs for action that would truly assist developing economies.

The World Bank's World Development Reports have consistently demonstrated that open markets and economic liberalization provide the fastest, most reliable path to increased growth and development. These studies show that the economic, legal and political institutions of a country explain more than 80 percent of the international variation in real income per capita between 1995 and 1999 in more than 130 countries. Civil liberties, responsible government expenditures, political rights, freedom of the press, and strong property rights had the most consistent, positive influence on a country's per capita income. The variables having a negative effect on per capita income included black market activity, excessive regulation, poor monetary policy, and trade barriers, policies that continue to be associated with many of the countries that receive the most ODA.

Conclusion

ICC remains fundamentally opposed to the creation of a supranational tax for development aid– even in the form of an internationally coordinated national tax – since it fails to meet basic standards of democratic accountability and economic rationality. An air ticket tax would introduce new competitive distortions between businesses, countries and regions, and would have highly uncertain results for development. ICC urges national governments to reject proposals for a dedicated tax scheme and to work towards poverty reduction efforts based on the proven strategies of democratic accountability, open markets, transparency, rule of law and sound economic policies.

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About ICC

ICC is the world business organization, the only representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. ICC promotes an open international trade and investment system and the market economy. Business leaders and experts drawn from ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. ICC was founded in 1919 and today it groups thousands of member companies and associations from over 130 countries.