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Discussion Paper

The UK's economic future, flying in the face of it all

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Limitations to our flight movements have been – indeed remain – frustrating. This said, unrestricted personal air travel has to resume. When it does, however, **the euro-zone's tourist-hungry Club Med economies will have essentially lost two years of important hard currency-earnings**. On top of such an unhelpful financial legacy, this paper warns that unlocked euroised Club Med nations will potentially face strong recovery headwinds; up against a combination of higher air fares (lifted by increased flight taxes and fuel costs) and competition from near-afar rival destinations for sun and sea (Turkey, Egypt, Tunisia, etc., indeed Dubai and Florida). Against this backdrop, **there can be no doubt that from the perspective of welcoming British holidaymakers –** a traditionally important source of their flying-in tourist income – Club Med € destinations **could only be welcoming of a strengthening in sterling**.

From the more distant perspective of welcoming travellers from Asia, all of Europe, even far from entirely climate-friendly destinations, can also only welcome the rise of its middles classes, particularly across ever more rapidly emergent China, and the elevation too in the value of the Yuan. Passenger air arrivals from Asia will be particularly boosted into those European nations most attractive and welcoming to generous fee-paying students. Those of these that travel back and forth during their studies will consume airport facilities, whilst those who do not will most likely see their families make flying visits. These will create their own demands on Europe's airports and all related inward travel facing sectors. Here, again, the UK stands out, already educating more Chinese across its HEI's (Higher Education Institutions, or more appropriately, I for Industry) than all of the EU27 combined. Indeed, in the years out to 2034, the UK could easy see its annual infact of Chinese students rise by 150%.

Returning to a rising yuan, as well as elevating wealth within China, it will almost certainly be accompanied by a secular $ decline, whose weakness will not least be seen relative to the € and £. Strength in these currencies against the $ would have a number of 'travel consequences'; on balance, highly unfavourable for the euro-zone's tourist sectors and indeed its industries more widely. After all, with the Turkish lira and Egyptian pound ostensibly managed against the $, weakness in the latter would see these fall – further – against their € Club Med rivals for tourism. For the UK, a resurgent £ would offer disinflationary benefits and 'keep the monetary landscape favourable'.

In predicting challenging times ahead for all the euro-zone's Club Med tourism linked sectors – this warning extends to the banks which lend secured on tourist related property.

From the perspective of Britons, the longer they are restrained from tourist travel to the continent, the more favourable to the UK economy, but of course, the greater the expense to Club Med. The UK would after all only further benefit from the retention of entrapped staycationers, spending £s that would otherwise have been converted into €s and jetted-off to create income along Club Med.

Ironically, the longer normality of movement is suspended, the greater the forward return premium of the UK over the EZ; all the greater, the £s upside to the €, and so the greater the urgency for Club Med to get Britons back.

In short, then, were tourist-laden aircraft not to land in the numbers recorded prior to this abrupt grounding, there should be no doubting that an economic blow would land upon Club Med economies. True, there is an argument reduced airflows should be welcomed for the environmental good. An argument, too, that less carbon intensive land-travel could propel us on holiday. As much, however, as road and rail are travel options for holidaymakers all too often these come with a greater expense in money and time than air. The latter ensures road or rail could never take-up what tourism volume was lost by aircraft not taking to the skies in the numbers they did before coronavirus grounded us.

Grounded – Flying in the face of economic reason

This paper deals with some plane (*sic*) truths relating to the number of Europeans travelling overhead across the continent, over the years ahead. The assertion is that **when intra-European air travel resumes in a meaningful way, as it must, it will be less affordable than we have become accustomed to.** And since demand for cross-border tourism is price elastic, this is just one reason to anticipate air passenger movement across Europe will be lower in aggregate going forward, from what had been the experience pre-2020.

Part of why airfares for intra-European travel will become on average more expensive will be the near certain new taxes levied to 'price-in' the environmental harm we cause when we taxi and then take off in aircraft propelled by dirty engines. Taxation will no doubt also be motivated by indebted sovereign treasuries imposing new air fuel and airfare taxes in their efforts to find income to help repair their public finances.

Another potential for more expensive air travel could easily derive from existing 'budget airlines' being unable to return to their old competitive pricing models. Airport operators too could prove a cause of higher airfares if they try to make good what revenues they have lost, and debts incurred, over these last two extremely difficult years. Airport owners could easily use their landlord powers to hike 'rents' and other fees they charge carriers; 'airside' retailers and other concession holders suffering the same fate. We must also not ignore the potential for an ongoing rise in the price of crude oil to make flights more expensive. **Any one of the above reasons would risk adding to costs faced by air travellers; one can only imagine the hike to airfares if all were to conflate.**

Along with higher Europe-wide airfares, we will also almost certainly see further reductions in air travel due to environmental 'flight shaming', albeit with this most likely to impact business travel. There is also of course the potential that the growth in virtual business meetings which this crisis has enforced results in a permanent shift to their use, at the expense of flying business visits.

In addition to putative air fuel duties and increases in existing flight taxes, the volume of travel into euro-zone tourist hot-spots would be harmed by any increase in the relative value of its single currency. Relative value, that is, with regard to currencies which relate to inward travellers – the dollar, the pound, the yuan *et al*. And harmed too in relation to where the euro becomes less competitive relative to currencies linked to rivals for Club Med tourist custom – the Turkish lira, Egyptian pound and again, the US dollar. **The simple truth is that the EZ should be as welcoming of a stronger pound against the euro as it need be concerned at any move downwards in the dollar relative to it.**

It should go without saying that a material reduction in intra-European air travel could not fail to result in negative economic consequences for nations reliant on high volume tourism.

It should also be accepted that there would be adverse economic consequences to nations which dispatch tourists (essentially Europe's seasonally cold north). After all, **as reduced air travel hits average household incomes in EZ tourist-reliant nations, they will in turn become less generous customers of their more mercantilist fellow EZ nations, from whom they have traditionally been net importers of consumer products and capital equipment.** Now, since tourism is a normal good, any impairment to average household incomes across nations traditionally originating tourists will negatively impact their tourism outflows. The latter would in turn compound the hit to nations reliant on inward air travel, and so the negative iterations would go on and on.

In short, if we do not take off in the numbers we once did, then the EZ cannot reasonably be expected to rise to its pre-COVID economic levels.

Let me now air words of part mitigation for the painful blows to future air travel which I have landed.

1. Arrivals by air in Europe from across Asia are certain to rise strongly from 2022, with travellers journeying from China the most noticeable, thanks to the following wind of the unrelenting uplift in the number of middle-class Chinese households and their travel-lust. And, as much as I believe the dollar will continue its fall against the yuan, I no less expect the latter to appreciate against the euro – albeit by less – thus helping to make Chinese travel into the EZ all the more affordable (whilst also easing crude oil costs).

2. With motivation as much driven by commercial considerations as environmental concern, we should expect significant capital investment into the 'greening' of aviation, directed at helping to ease the "shaming of air travel".

3. If existing budget airlines, or otherwise, give up their airport gates and landing slots, others with competitive pricing models could launch to fill them.

As to which European nation is best placed for all of the above, the question is easy enough to answer.

Ahead of this crisis the UK had been running *c*£30bn deficit in its balance of tourism (chart 4). Naturally, then, any reduction in our travel to Europe and/or arrivals from Asia (notably China), can only be positive for UK GDP. The UK after all has shown itself to be top of European itineraries for the ever increasing number of Chinese keen to travel to the continent. Top choice in particular for those Chinese keen to come to study in *situ*. For the record 2018/19 Chinese freshers in the UK broke above 100,000, and we would expect this to rise to c250,000 by the 2034/5 academic year. With ever more direct flights from China to the UK (chart 1), expect to see an ever widening balance of travel surplus enjoyed by the UK over China.

A third reason why the UK should benefit from the arguments set out above is its corporate tax and public listing attractiveness, both of which should help attract nascent budget airlines.

A fourth consideration for those with an eye on the UK is the fact that those most common in passing through its airport are Britons themselves (contrast this with say Ireland, Spain or Greece). The UK is of course not alone across Europe in regard to the most common customers for its airports being 'locals' -*viz*. Germany. If however, as I am convinced it will, the pound takes off in most exchange rate dimensions from the levels it currently sits, one should expect Britons to exploit this by taking off and of course returning in ever greater numbers from UK airports (chart 2).

Chart 1: Flights to and from China; UK, France and Germany

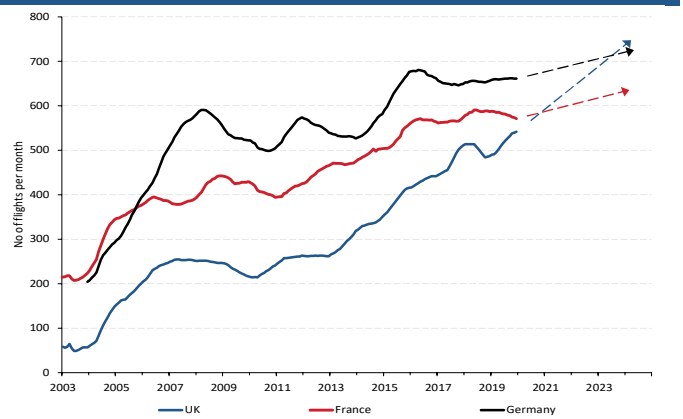
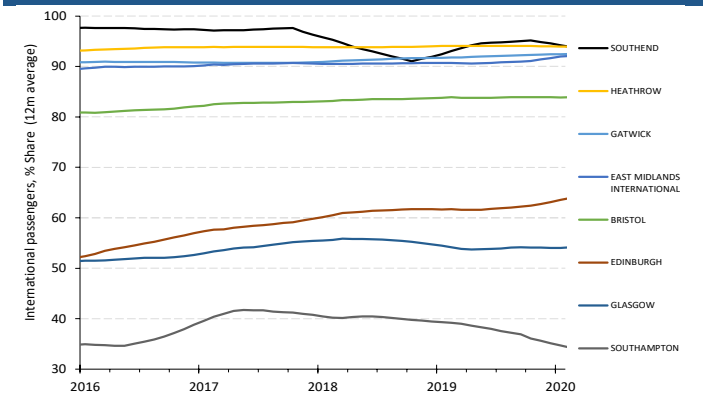


Chart 2: International passengers for selected UK airports, %



Source: Eurostat, Civil Aviation Authority, Toscafund

Let me come to a fifth but far from final and exhaustive reason why the UK is so well positioned if all of the above proves true. There are presently only three – long established – firms which assemble aero engines for wide bodied aircraft. Two of these are centred in the United States, GE and Pratt & Witney. The third, however, is very much a British-owned brand – indeed, The State owns a Golden Share. With this in mind I am in no doubt that Rolls Royce will be amongst the keenest of companies to take-up the Chancellor's 130% super-deduction tax relief. It will do so as it invests in the research and development of aero-engines to help us return to taking off in as large a number as before, but doing so much more cleanly. The UK is also well placed to capitalise were Sustainable Aviation Fuels (SAF) to be developed from food waste, a topic beyond the parameters of this mere tour guide to future travel.

Many tens of millions of households across Europe tend to the holiday needs of a great many tens of millions of others making 'flying visits'; as the latter spend, the former earn, and in turn spend on what their visitors produce. Indeed, for more than a handful of European nations, tourism is the most important source of hard currency earnings. Allow for the fact that primary travel sectors feed a great many secondary and tertiary ones, and it can legitimately be argued that whatever share of a nation's GDP statisticians suggest tourism and travel accounts for – see table 1 – is an understatement of the true financial importance, of inward travel. Furthermore, given how demanding we are of others when away from our home nation, it is reasonable to argue that the share of total employment accounted for by all sectors reliant to some degree on travel and tourism is even higher than statistically suggested.

With the above in mind, let us please contrast for a moment the tourist data for Ireland and Slovenia in table 1. In 2019, each nation welcomed tourists in numbers amounting to 230% of their respective populations. And yet official figures suggest tourism accounted for a modest 4.3% of Ireland's GDP, less than half the 9.9% 'recorded' for Slovenia. This discrepancy can best be explained because parts of the Irish economy, heavily reliant on tourism, are not captured in the figures. After all, just consider the multitude of bars in Dublin, Dundalk, Waterford and Wexford etc. These draw tourists precisely because they are 'locals'. There is also Ireland's use of creative corporate tax accounting. This exaggerates the importance of, say, passing through pharmaceuticals, electronics and aircraft leasing in Ireland's GDP and trade surplus, at the expense of **real** tourists passing through. My point is that, if measured properly, the share of tourism within Ireland's economy would make it sit close to the top of table 1.

As convinced as I am that the reported share of the Irish economy geared to serving tourists under-represents the reality, I believe the equivalent data for the UK also misrepresents matters (see once more table 1). True, the UK has a sizeable hospitality sector which entertains tourists as well as Britons. No less true, the UK is home to a considerable industry geared to facilitating our travels abroad, not least airports and travel agencies. As we have witnessed, Britons being held back from vacationing overseas results in increased 'staycationing', which boosts hiring across sectors benefiting from this. This, in no small part, mitigates the work roles not being performed because we cannot fly away.

Now 2020 has proven, and 2021 is reinforcing all the more, the economic importance of tourism across large coastal and alpine tracts of Europe that we journey to with our money. Of course, 'normal' travel could well resume sometime before the close of this year. My concern is that those reasonably expecting such a return, also assume the coronavirus crisis inflicts only a fleeting blow to travel-dependent economies. To me, this is far too complacent an outlook.

The reality is that before the onset of this potentially extremely serious *public health crisis,* the economic health of a number of tourist-dependent nations was fragile. Indeed, one could even say that nation after EZ nation, with Atlantic and Mediterranean coastlines, entered this crisis with pre-existing *economic health issues*. For these to have lost even a single year of hard currency tourist income would have been serious enough an economic shock to recover from. This said, it now looks highly likely that nations heavily reliant on inward travel will essentially lose a second year of income. Against this backdrop **one cannot help but be concerned for what economic state EZ Club Med states will be in when this medical crisis has finally ended**. My concern is further heightened as to how they might cope if the volume of intra-European air travel settles at a materially lower level to what was being recorded pre-2020 because of environmental shaming and/or higher costs, tax or otherwise. All the downward pressure on their tourist levels would only be exacerbated were (as I believe will happen) the euro to lose competitiveness against hot-spot rivals.

The European economic model – a moving story

This paper leaves for another instalment the future of Chinese travel into and across Europe. It focuses instead on a single issue overarching the majority of economies across Europe. It is the risk that intra-European tourism is hit long after this and the preceding extremely difficult year. Hit by a combination of the 'friendly-fire' coming from environmental lobbies – shaming and demanding higher taxation on those who would want to fly – as well as direct negative economic factors. After all, whether for business or leisure, travel is pro-cyclical – we fly more often when our fortunes are flying and of course less when they are not. **Tourism and travel also exhibits a crucial and often overlooked feed-back loop across Europe**.

Table 1: The importance of inward travel and tourism across Europe

Country	% contribution of GDP 2019	% share of Employment 2019	Balance on tourism *per capita* 2018	Annual tourist numbers relative to local population 2019	% decline of number of flights between 2019/2020
Croatia	25.0	25.1	22.8	4.2	57.6
Iceland	22.8	21.9	38.3	5.9	62.4
Greece	20.8	21.7	15.7	3.0	50.5
Portugal	16.5	18.6	14.1	1.7	53.9
Malta	15.8	21.1	29.7	6.3	57.1
Spain	14.3	14.6	11.7	1.8	57.1
Italy	13.0	14.9	3.2	1.1	57.5
Austria	11.8	12.5	12.4	3.6	57.7
Estonia	11.7	11.3	2.4	* 2.4	54.4
Turkey	11.3	9.4	2.5	* 0.6	50.8
Slovenia	9.9	10.3	7.5	2.3	65.3
Germany	9.1	12.5	6.3	0.5	56.9
UK	**9.0**	**11.0**	**3.0**	**0.6**	**59.1**
France	8.5	9.4	2.7	* 1.4	54.0
Hungary	8.3	10.0	4.4	1.7	58.4
Sweden	8.2	9.8	3.1	* 0.7	59.3
Norway	8.0	11.4	21.4	1.1	36.5
Latvia	7.6	8.3	1.5	1.0	58.2
Switzerland	7.6	9.5		1.4	56.4
Finland	7.5	8.1	4.4	0.6	57.8
Denmark	6.6	6.9	2.4	2.3	57.7
Slovakia	6.3	6.3	1.0	* 1.0	64.0
Romania	5.9	6.3		* 0.1	54.2
Netherlands	5.7	10.1	2.3	* 1.1	50.4
Lithuania	5.5	5.8	0.4	* 1.0	52.1
Poland	4.7	5.0	1.1	* 0.5	56.0
Ireland	4.3	5.9	2.5	* 2.3	60.4

Source: The World Travel & Tourism Council (WTTC), The World Tourism Organization (UNWTO), EuroControl, Toscafund

An inspection of "flow-data" across Europe's Single Market reveals some nations enjoying surpluses – in manufactured goods and financial services – whilst others earn in excess of what they spend in areas such as tourism, agricultural products and indeed the flows (*sic*) of wines and spirits. Crucially, these surpluses are very much reliant on, and indeed complementary to, one another.

The undeniable reality is that Europeans who earn their living through industrial or office-based pursuits, fund their vacations in no small part because those who would be their hosts, buy their factory wares and financial services. As much as Germany complements say Greece in this regard, so Sweden does with Spain, with many other similar relationships across the latticework of flows in goods and service within Europe. With this in mind the loss of well (*sic*) over one half of their 2020 tourist inflows – see table 1 – has seriously hurt along Europe's 'coasts' and 'slopes'. With these provinces in turn providing export earnings for the regions from which holidaymakers traditionally originate, one must fear for how this has iterated into lockdown 2021 and thereafter 'up and down' unlocked but sticky Europe. Overlay onto this the real and present danger which first Turkey; and then Egypt; and then other regional rivals to euro-zone sunspots see their currencies markedly devalued against the single currency, and what the EU suffered economically and financially a decade or so ago would be nothing to what awaits.

Before continuing with European travel in general, let me consider for a moment a single nation within it. A nation whose outwards travel and tourism has been a source, in many case a very sizeable share, of hard currency income across the EU. A nation for which travel and tourism is in fact a negative line-item in its balance of payments. And a nation where, if its households are for whatever reason forced to stay within their own borders, indeed their own homes, enjoys an increase in domestic wealth. The nation in question is of course the UK.

Strength in UK household spending from 2021 – saved by lock-down

In considering the inability of Britons to spend (chart 3) and travel (chart 4), let me more broadly reflect on the additional c£300bn of savings which I expect to have been 'forced' upon UK households by the time lockdown ends. These savings have been accumulated because we have been grounded from flying out on holiday as well of course as being locked out of music, theatrical, sporting, dining, drinking and other recreational venues. The savings have also amassed because whilst a great many have not being incurring the costs of going to work, their incomes have been largely been supported by The State or indeed continued in their entirety by their employer. If we assume a savings ratio of 10% we would see this £300bn – see chart 3 – generate £1tr of cumulative new spending. This would be split between assets (property, art work, etc. not a component of GDP) as well as goods and services (that do contribute to GDP, albeit any overseas travel counting negatively for the UK but positively for holiday destination such as Spain and Greece etc.).

Chart 3: UK households' saving ratio and the coronavirus spike

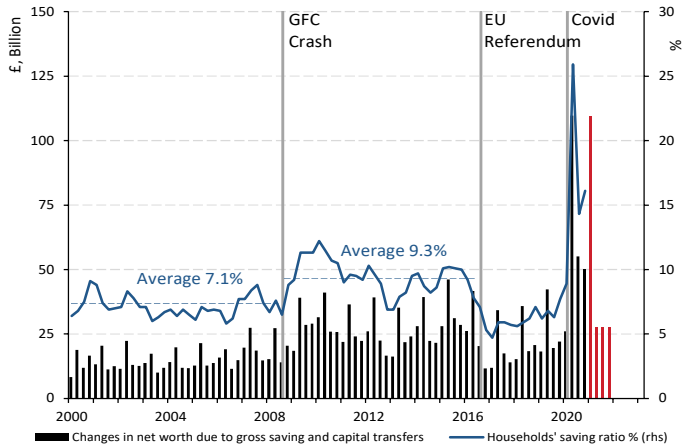
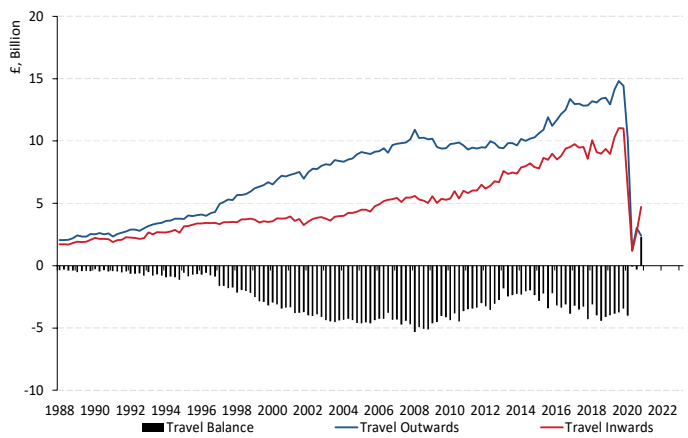


Chart 4:UK inward and outward travel spend:Staycation boom



Source: ONS (data for both charts to Q4 2020), Toscafund

When this pent up 'unwanted' saving is released, as it must, then yes it will spur on a degree of inflation. It will also almost certainly stimulate wage growth, the latter even despite the – short lived – spike in unemployment (see chart 5).

At the last viewing the breakeven RPI implied by Index-Linked Gilts was just over *c.*3%. Since the RPI has tended over the last 10 years to be *c.*0.8% higher than the CPI, this would suggest 'the market' believes the latter will move up to only just above the BoE's 2% target. This leaves room then for an upwards inflation 'surprise' in 2021, something which actually to my mind at least would not be a bad thing (yes to repeat, I do see positive nominal and indeed real wage growth, see chart 6).

The point I would make concerning inflation is that when/not if, but when, the pound begins to move towards its rightful values of c1.3 and c1.7 against the euro and dollar respectively, it will prove disinflationary within the CPI. I also confidently – and not unrelatedly – predict a great deal of capital arriving to the UK as income-hungry European pension and insurance funds, which have long stood back awaiting a resolution to Brexit, release their brakes and target UK property assets (as for a Brexit deal on financial services, my positive UK outlook towards the sectors involved, neither assumes or dismisses one, or indeed relies on one). And yes, rents will rise across large swathes of CRE [ex. of course, high streets and shopping centres, which themselves will inflate again once they have re-set with entirely new occupiers many doing entirely new things].

Returning to the UK's enforced household savings/pent-up spending, the story is similar in the US, but very different across Europe, because of at least these three reasons:

1. Teutonic thrift has long meant savings ratios across 'Northern Europe' tends to be twice the rate of the UK/US – and continues to be the case despite zero rates. For its part Germany has a *c.*11% saving rate, with this most recently spiked up to 28% (the Q2 UK figure being 29%).

2. Large parts of 'Southern Europe' and indeed more widely – where inward tourism accounts for between 10% and 25% of GDP's, see table 1 – rely on the likes of 'cold water' Britons, Germans et al spending their vacation money in warm water and cold slope resorts. This travel and its considerable spending multipliers have been for the vast part been suspended this year and almost all of last, a loss representing the flip-side of the spike in household savings ratios in the UK, Germany et al (see chart 3 for the UK). In fact UK GDP in 2020/1 has been made 'less bad' because of the lack of our travel – the UK long recording a net deficit in travel services, a balance which this year turned positive (see chart 4, capturing the Staycation boom).

3. Across the European nations denied cross-border net inward spending, even with households **denied the chance to spend**, their savings ratios will not have spiked anything like they have in the UK and Germany. Moreover, there is a strong possibility of deflation, something which will act to actually lower the propensity to spend, and so threaten to induce the Paradox of Thrift.

Chart 5: UK jobless rate and forecasts Toscafund vs OBR

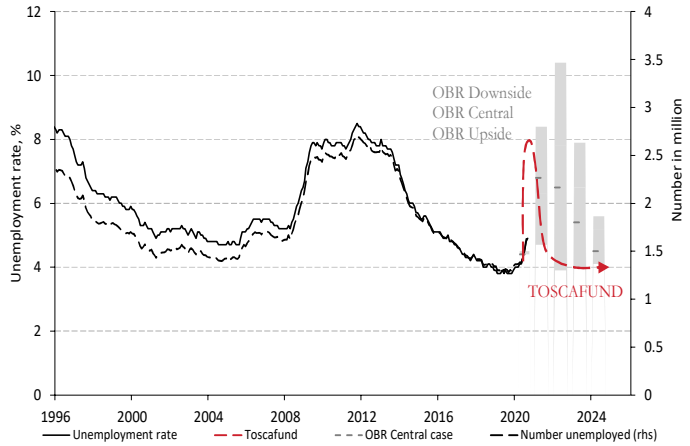
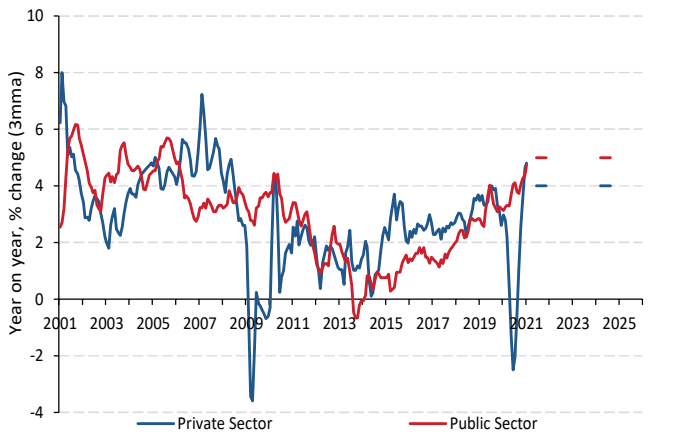


Chart 6: UK wage growth over-time – lifted by over-time



Source: ONS, OBR (Forecasts from November update), Toscafund

Can we please then move on for all our sakes?

To recap, seldom has the answer to one 'moving' question been so crucial in answering a second of considerable economic importance. The first question is "Will Europeans take off again and fly across our continent in the numbers we once did?" If the answer to this is a firm "No", then so too is the answer to the second question; "Will those economies spread widely across the Continent reliant on other Europeans flying to them, take off again?".

The reality is that as much as extensive road and rail infrastructure exists across the continent to transport us Europeans from place to place, air travel has made itself a time-efficient and convenient practical preference. Indeed, thanks to intense competition and a comparatively low aviation fuel tax 'payload' (to which I will return), flying is also an extremely cost-effective travel option.

So, to repeat, whilst road and rail links between mainland Europe's cold and warm water states are generally well-invested and reliable, a great many overnight journeys across Europe – for vacations and work, and sometimes both – involve taking the cheap and easy option of taking to the air. Moreover, although ferries, bridges and tunnels connect across, over and under European coastal waters, tourist and business air travel numbers have long looked down on the volumes of these alternatives. Indeed nowhere has air been the preferred travel option than journeys from and to the UK, Europe's largest sovereign island nation. Now, I have to make clear that throughout this piece I am have been writing not of cargo moving across borders, but people, whether their motivations are commercial travel or recreational.

Let me turn to the money multipliers generated when one of us travels to holiday across Europe. Now it is true that it is home to a great many enthusiasts for caravans, cycling, hiking and sleeping under canvass. But it is equally true that the vast majority of Europeans prefer to enjoy their vacations in hotels with fully plumbed *en-suite* conveniences, to which I must repeat they prefer to travel to and return from, with the convenience of air. Moreover, when it comes to our annual leave, this concept has become plural. For many Europeans there is not merely a journey in search of reliable summer sun or winter snow. We must also consider those for whom an annual diary entry is the traditional long golf weekend with old friends; or the trip to follow a home sports team playing away. Throw in a celebratory weekend city break and Europeans are peripatetic in enjoying their down-time. The reality is that whilst Europe has long offered a large amount of travel options – all the more so with the tearing down of the Iron Curtain – ever more airline and airport options has made the continent ever smaller.

Environmental economic 'air heads'

Let me return to a question I raised earlier and reframe it, as "Why might Europeans not travel in the numbers they once did across their Continent?".

The question is very easy to answer in the short term. For the time being, we face the risk of being caught by sudden changes to quarantine rules, as well as restrictions as to what we can do whilst away, and that ensures second thoughts will be given to discretionary travel. Even when concerns over risks and restrictions are finally allayed, as they must, there will be what airline business model flies again, more specifically if budget airlines continue to be ubiquitous. Not unrelated to this, we need to consider what new forms of tax fall on air travel – and there will be – both to pay for the state funding demanded of this crisis, and to meet environment demands. Let me first consider the former.

We have seen and will continue to witness huge debt-funded fiscal expansions in response to this crisis. There can be no doubting that taxation on our spending, most notably when we fly, will be one of the means to try to help fill the even-deeper debt holes which have resulted. Now, few can doubt that recreational and business travel is pro-cyclical and a normal good; ceteris paribus it is reduced as its price rises and/or disposable incomes fall. Consequently we should expect to see weak air departures from nations whose economies emerge much weakened by coronavirus and more heavily taxed. Indeed, there is a serious risk of a negative feedback loop.

Suppose that the interruption to air travel and tourism wrought by coronavirus were ostensibly to be a one-off event. Well, even if Covid-19 related travel disruption were to be confined to 2020 and early 2021, the negative impact across Europe of losing a valuable one year's plus earnings could not fail to undermine the appetite to import consumer and capital goods of those nations most badly affected. Now not only are imports to Europe's tourism and travel reliant nations the exports of northern Europe's – cold – river, lake and sea – water mercantilist economies, the latter provide the former with considerable tourist inflows. This raises the risk Europe falls into iterative decline.

With Greece, Spain, Portugal, Croatia, Cyprus, Malta, Italy *et al.* suffering weaker tourism, so they would not be expected to say replace with the same regularity their taxi fleets with new cars made elsewhere across Europe. And as important automotive supply chains in Germany, France, Slovenia, Hungary, Romania, Slovakia, Czechia *et al.* are weakened, so their ability to dispatch workers to leisure across Europe will be undermined and so forth, back and forth. This of course raises the idea that a European-wide car scrappage scheme is introduced to incentivise replacing dirty engine cars with good, a fiscal programme offering both economic and environmental merit. Here also we come to a catch 22. A huge scrappage scheme would not come cheap. Indeed to be effective it would need to be very, very generous. Generous yes, but paid for how?

As much as debt printing can and will be used for a scrappage scheme and other economic supports, there will be powerful elements across Europe demanding some semblance of fiscal probity, for which read 'quickly raising entirely new tax revenues'. To my mind at least targeting air travel – tearing up for instance the 1944 Chicago accord, so as to finally start taxing aviation fuel – is an easy target satisfying both those with an eye on halting the growth of fiscal deficits and those, not of course mutually exclusively, with an eye on closing the carbon deficit.

More punitive taxing of air travel is widely lauded as essential for our environment because it will reduce our use of air travel. The issue is that,

Duty of Air passengers

One cannot pen a piece on the UK's 'future of flying' without consideration of what is in store for Air Passenger Duty (APD). This 'uniquely' British tax was first introduced in 1994 with motivations more economic than environmental. The backdrop for the introduction of APD was an effort to raise exchequer income from sales-based taxation within the confines of what was permitted by the UK's membership of the EU. With the latter precluding the unilateral introduction of a new Ad Valorem tax, so APD was born. Whilst this 'flat rate' seat tax varied in a number of dimensions – domestic versus international and economy versus business and private jets – it was not directly linked to ticket prices. Rather than chronicle changes undergone by APD since its introduction, I will cut to its future. The UK out of the EU means it no longer has to conform to its Directives on such things as sales tax. This accepted, I have no doubt the new freedom will manifest itself in an entirely different spending-based tax system, not merely for the UK, but varying across it. A freedom moreover which will see changes to how passenger air travel is taxed. Rather than a slab/blunt fixed fee, I expect aviation to be taxed according to distance travelled and efficiency of aircraft being used. And to repeat I have no doubt changes will come too for air travel for those leaving and indeed very possibly arriving into the EU.

because of all the reasons I have touched upon above and still others that I could add, even with no additional taxation intra-European air travel will not merely fail to grow as strongly in the decades ahead as it did in the decades before, but cannot fail to fall. The question is what awaits those regions and indeed nations across Europe – see again table 1 – whose individual *eco-systems* – at the expense of our single eco-system – have geared themselves so much to receiving tourists, they risk succumbing to a strain of Dutch Disease?

Before coronavirus cast its ugly shadow there was a chance that Europeans could continue to travel across their continent in as large numbers as before, with all the economic good that arose from this, but with much-reduced environmental harm. This chance required a careful strategy of economic reorientation and development of environmentally friendly forms of air propulsion. Then Covid-19 struck, and drastically reduced air travel into European nations whose economies were heavily reliant on heavily laden aircraft landing in large numbers. These were economies which it must be stressed began 2020 with pre-existing underlying weakness. The frailty of the likes of Spain, Italy, Greece *etc.*, will not merely see those EU nations who sold to them lose exports, but have to financially nurse them all the more. In short, there will decreasingly be a greater need to tax air travel across Europe in order to temper it for environmental good, because in all likelihood the economic clouds darkening over the continent will of themselves reduce air travel across it.

Breaking news

In considering Europe's future tourist flows it seems that we can now assume that the **2021 'seasons' are lost almost entirely**. Lost because the vaccine roll-out across Europe is proving so nationally piecemeal and indeed nationally divisive; the Oxford-Astra Zeneca vaccine proving a fierce battleground. So piecemeal and divisive in fact that where it has been largely complete, there is a practical injunction to leaving to visit nations where it remains very partial. Another element of the breaking news is the beginnings on March 19th of what will ultimately prove a disorderly devaluation in the Turkish lira (see chart 7).

Chart 7: € ever less competitive to Turkish ₺ and Egyptian £

Source: Bloomberg, Toscafund

Chart 8: € per £ - In euro-zone's best interest the Gap Closes

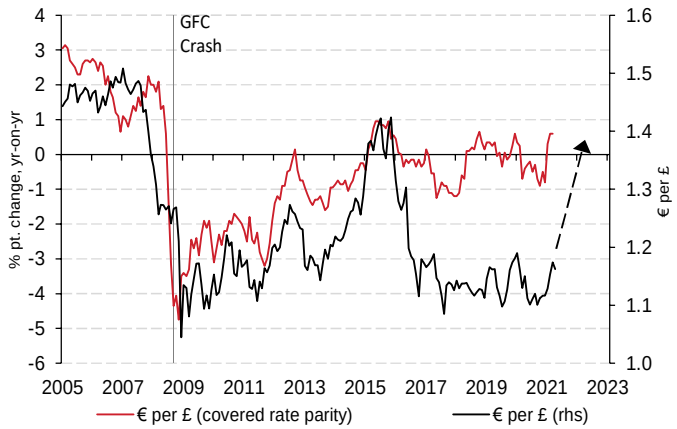
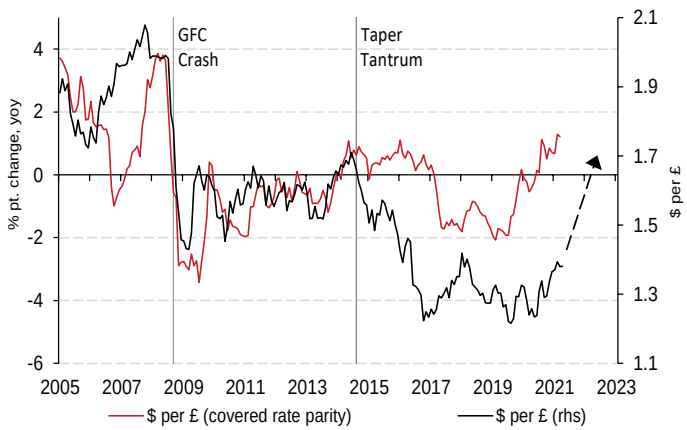


Chart 9: Rising Sino purchasing power vs. weakening American

Source: Bloomberg, Toscafund

Chart 10: $/£ – Another Gap set to Close



A New Chinese tour guide for Europe

On December 11th 2001, China was finally allowed to accede to the World Trade Organisation, thus heralding its arrival onto the modern global macroeconomic stage, but still making it a 'growth teenager'. Since then, China's impact has been nothing short of remarkable; remarkable not least in the number of its nationals arriving into Europe 'to tour'. As to where they have landed in their ever larger numbers – until of course this crisis interrupted matters – the evidence is clear enough – Germany. Now, whilst the prima facie data may be clear, the reasoning as to where exactly in Europe the Chinese have hitherto chosen to most land is more nuanced.

Yes, Paris is a world class draw for any tourist, and not least those travelling from China. So too is London. Whilst Frankfurt too has its tourist and more general attractions these do not spring as immediately to mind. Why then has Frankfurt been a seemingly more popular first port of call in Europe for the Chinese, not merely compared to London, but Paris too? The explanation I am heavily inclined towards is airport accessibility from China.

One merely has to consider how Frankfurt operates four runways against the two at Heathrow. True, Heathrow matches Frankfurt for the number of daily flights. The issue here is how much more closely guarded landing slots at Heathrow are compared to Frankfurt, and how contested these happen to be when made available. The reality is that when landing slots for Heathrow do trade, they do so as the most expensive across Europe, indeed proving amongst the most prized anywhere around the world.

From the perspective of this research, there is therefore no contest as to where the Chinese would most like to fly direct to – the UK. On one accepting this not unreasonable assertion, so too we must also recognise the next. If in the wake of this crisis a number of 'western' airlines cut back on their schedules and so make landing slots available at Heathrow/Gatwick/Manchester, there should be no doubt that buyers for these slots will originate most from China.

Regardless of whether or not we see more direct flights between China and the UK (see chart 1), and I have no doubt we will, the number of Chinese coming to the UK as tourists is certain to rise sharply over the coming years, regardless of where those heading westwards land first.

Chart 11: Chinese Student Visa's issued

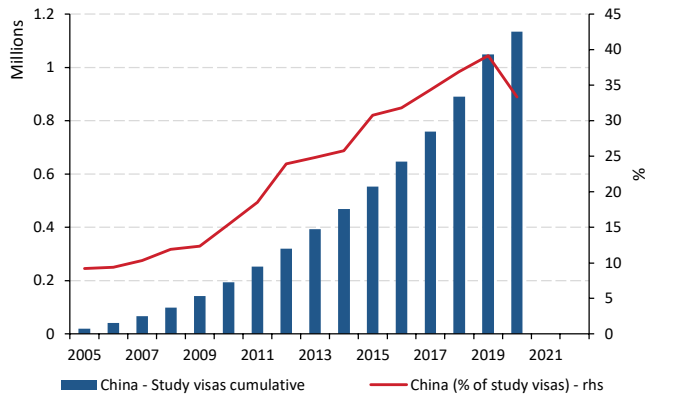
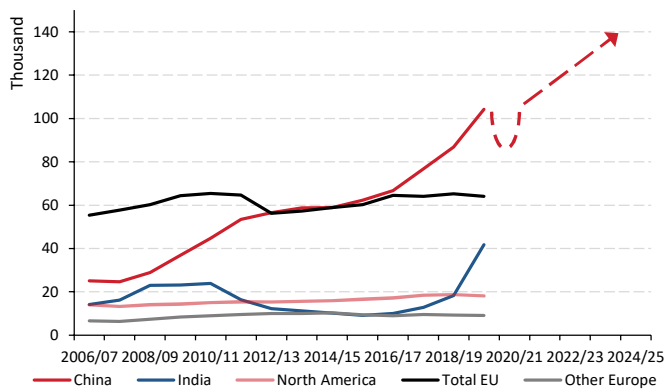


Chart 12: First-year foreign students across the UK HEI's



Source: Home Office, HESA (First year students from China studying Undergraduate and Postgraduate degrees), Toscafund

Now, one cannot consider the number of Chinese travelling to the UK with no ostensible business reason, merely leisure, without reference to those doing so for family reasons. With this in mind we can be confident that in addition to ever more Chinese travelling to it as tourists, the UK will receive an increasing number of young Chinese drawn for study (chart 11). These will enrol in its fee-paying schools and its considerable number of Higher Education Institutions, all spread widely across Britain and Northern Ireland. There will also be those arriving to attend 'Summer-School'. Indeed, a figure of *c.*250,000 coming to the UK from China as university freshers within a dozen years – the figure is presently 104,240 (for the 2019/2020 academic year see chart 12) – is not merely reasonable, but conservative (for the record Chinese enrolment in fee paying schools was most recently *c.*23,000).

As more young Chinese study in the UK, we should anticipate they will attract family members to visit them, as well of course, students travelling back and forth. The upshot of all this is certain to be a volume of air passenger traffic involving Chinese nationals of a quantum the UK has never record before and, with time, overshadowing flows from Europe.

Asia flying in to Europe's rescue?

Let me now pull away from prospects for intra-European travel and move to the outlook for the number of those beyond it as it were flying in to the rescue. I will begin by dismissing the chance a long-serving source of tourism to Europe enjoys strong growth. I write here of leisure and general regular business travellers originating from the United States. Amongst the many reasons I make this prediction is the conviction the dollar falls into a disorderly exchange rate decline in most currency dimensions not least relative to the bulk of European currencies. For tourist hungry euro-zone nations this loss of affordability will compound the decline in competitiveness suffered as the Turkish lira falls into its own dramatic slide relative to the dollar and euro (the Egyptian pound tumbling soon thereafter).

With no prospect of US arrivals flooding in, and indeed the real risk their numbers lessen as the dollar falls – as it soon must, chart 10, there can be only one other credible source of sizeable tourist flows into and across Europe, and that is China. A China whose huge, and expanding, middle class cannot fail to grow its travel lust, their currency certain to strengthen ever more; and so buy them more travel options (chart 9). The considerable opportunity set to arise across Europe in welcoming Chinese tourists will not come without its challenges.

The challenge for all of Europe's tourist-hungry regions will be meeting the needs of travellers from China with interests, diets and habits so much different from what hotels, bars, clubs and restaurants have hitherto been accustomed to, and have as a result accommodated, entertained and catered around. Such a reorientation (sic) will not come quickly or easily but will not be insurmountable. This brings me to the Spain, Portugal, Greece, Cyprus *etc.*, which are so much geared to British tourists.

Widely across Club Med much of the volume tourist offering has long played to Brits. Because of this it can hardly auger badly that the pound is soon set to reclaim a great deal of the ground lost against the euro since 2016, and indeed move further up from there (chart 8). It will hardly be unwelcome too that the UK economy is set to be robust in the coming years, returning to growth much sooner than consensual thinking suggests. It is in no way contradictory to add that a large part of this positive prognosis for the UK relies upon a strong Chinese economy dispatching an ever greater number keen to invest and work, study and simply sightsee, at the same time as Europeans relocate/evacuate to the UK for economic reasons.

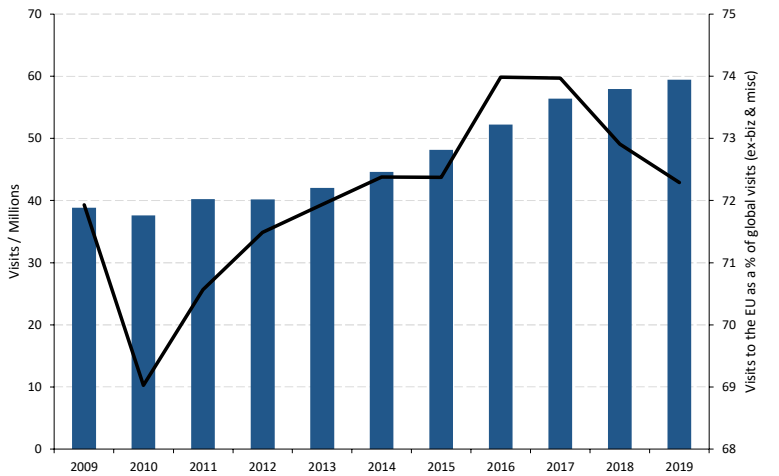
Tourism – a valuable economic take-away

When away from home on our hard-earned vacations, we can be extremely demanding. What I mean here is that in paying to relax and recover from our working lives, we expect others to work in turn for us. Moreover, whilst some of those serving our needs possess creditworthy skills and crafts – chefs, hotel managers, air traffic controllers, and alike – we have to accept that for the most part the roles of those whose services we draw upon require elemental training, albeit we welcome a welcoming disposition.

Table 2: UK share of tourism, %

Cyprus	35.9	Hungary	6.1
Malta	25.7	Latvia	5.7
France	17.7	Sweden	5.6
Spain	17.1	Denmark	5.1
Portugal	14.6	Italy	5.0
Greece	13.2	Czech Republic	4.1
Netherlands	13.0	Lithuania	4.1
Iceland	9.7	Croatia	3.8
Bulgaria	8.5	Austria	3.0
Belgium	7.8	Liechtenstein	2.9
Poland	7.3	Slovakia	2.8
Finland	6.5	Estonia	2.5
Germany	6.3	Slovenia	2.4
Romania	6.2	North Macedonia	1.6

Chart 13: UK leisure visits to the EU



Source: Eurostat, ONS (Visits to the EU by UK residents, excl. business travellers and other non-leisure), Toscafund

In reflecting on how travel and tourist-related sectors dominate the economies of a great many parts of Europe, one recognises how the incomes of a great many families rely upon our visits (table 2 and chart 13). For instance one partner might be employed in a hotel, the other a taxi driver mostly ferrying to and from that hotel as well as back and forth from the regional airport. If they have sons or daughters still-at-home, these too could well be employed in some tourist-related capacity, say in an administrative or technical role within a hotel or airport. It could in fact be they all work in their family-owned restaurant or bar. All told, whilst tourism industries can be very rewarding when working well, they also incubate economic concentration-risk when for whatever reason we are grounded.

Even the fortunes of those seemingly employed outside tourist sectors, say in a local bank, insurance or realty office, cannot fail to be linked to loans and other such under-writings made on hotels, holiday apartments, car rental firms etc. These are not merely contrived illustrations but very much a reality. Realities from Portugal's Atlantic wall all the way along its Mediterranean coast and eastwards across Spain's Costa del Sol, the French Côte d'Azur, down and up Italy's long coastlines, over to Croatia then Greece – and its myriad islands – to Bulgaria's Black Sea, and not to ignore the islands of Malta and Cyprus. I could go on to list many other parts of Europe which are summer seasonal favourites of those elsewhere across Europe who demand each year a week or two, indeed sometimes more, of reliable rays of sunshine to enjoy their work down-time.

Just as Europe has its seasonal tourist hot-spots so it has cold-option winter versions. From skiing on the mountains of Austria, France, Italy, *etc*. to lapping up festive grotto visits all the way up to Lapland, still more European families flood from one part of it to another, performing as they do priceless monetary pollination. And whilst many overnight stays are road trips, just as many are made by air. The reality is that any impairment to air travel as we have seen last year and this with coronavirus – something which environmentalists would prefer to see made permanent – cannot fail to have serious negative economic consequences. The reality is that not being able to welcome travellers from abroad has worsened economic matters across nations such as Italy, Spain, Greece *et al*, each already impaired economically because their own nationals have been forced into lockdown. These are nations it has to be remembered where internet retailer and general e-commerce is far less developed than in say the UK or indeed Germany (see charts 14 and 15). Far less developed and so far less able to compensate for the loss of go-to-it consumption with the take-up of come-to-me delivery.

Chart 14: UK retail internet penetration

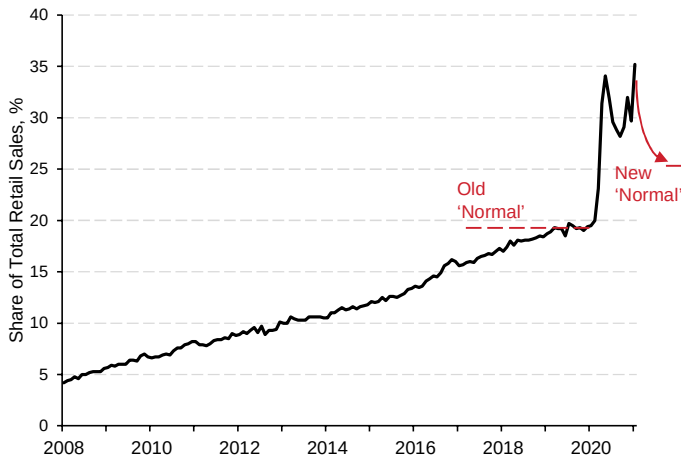
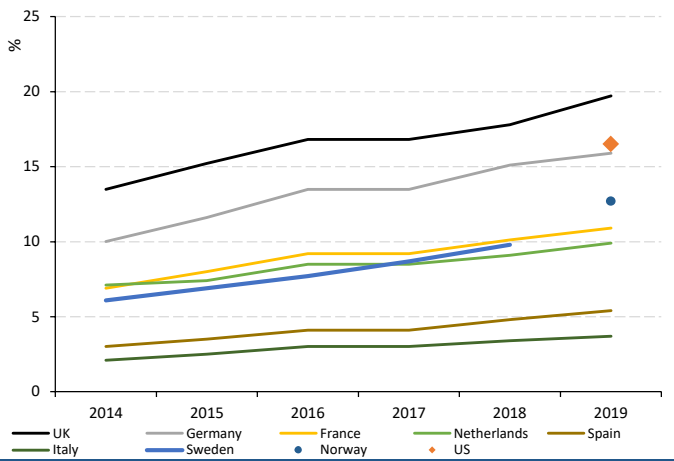


Chart 15: Online penetration compared across economies



Source: ONS, Eurostat, Toscafund

Conclusion – why being grounded flies in the face of economic reason

This piece has dealt with the prospect that if intra-European air travel is much reduced – for reasons of environmental good and/or higher (*sic*) air fares – in the years ahead, then a great many nations across the euro-zone will face serious economic hardships; very possibly worse than those they suffered a decade or so ago. In short, if tourist travellers do not fly in and out in the numbers which we have become accustomed to, then prime-age locals across the euro-zone's Club Med will respond to the resulting deteriorating economic conditions by flying elsewhere for good, in search of work, making a bad situation all the worse.

There will no doubt be those who consider, as purely imagined, the economic concerns expressed in this piece, and the hyperbolic negative consequences it claims will accumulate. Concerns, which whilst levelled squarely at the euro-zone's Club Med nations, I argue will quickly become a sizeable financial problem for the whole of the single currency, and indeed the EU in its entirety.

Those dismissive of my alarm may well claim that even a two year loss in tourist income is not insurmountable with, moreover, no reason to doubt Club Med tourist levels returning next year to their pre-Covid 'normal', if not, indeed higher. They will no doubt point to the rising arrivals from economically-emerging nations, which I actually predict to more than compensate for any reduction in visitors originating from old sources of tourism. They may furthermore argue that even were the euro-zone's Club Med nations not to see tourists arriving in the numbers they once did, these nations have alternative economic facets going for them to amply and quickly compensate. They may even claim that a reorientation away from their heavy reliance on 'sun and sea' sectors should be a welcome move for Europe's Club Med economies. Welcomed because it would help broaden their growth base and so immunise them from a variant of the Dutch Disease.

As for the threat that a devaluation in the currencies of 'regional' tourist rivals, such as the Turkish lira, Egyptian pound and Tunisian dinar, will introduce acute competitiveness pressures, no doubt there will be some who will say *plus ça change*, claiming there is nothing really new or unduly threatening in what is, after all, hardly uncommon.

I can only make clear I have desperately tried to bring myself to believe it will continue to shine economically along the euro-zone's Club Med coastline. Yet, as hard as I have tried, I cannot. After all, ahead of the months they will be flooded with the traditional levels of sun, they will yet again be bereft of the tourists that normally seek it, arrivals who traditionally provide employment and income to many, many millions and create a positive external balance on otherwise strained national accounts. Against this, I simply cannot avoid seeing dark financial clouds forming ominously overhead, from Portugal, Spain, Italy, Greece, Croatia, Malta, and all the way across to Cyprus.

Devaluation contagion?

I have claimed, as near certain, that devaluations in currencies of nations neighbouring and closely rivalling, for tourism, the euro-zone's Club Med economies. Cited in particular have been the Turkish lira and Egyptian pound. In making this assertion, I have stopped short of suggesting warm-water coastline nations within the EU, but outside the euro-zone, will follow suit.

Consider for instance Croatia, whose Adriatic coastline faces Italy, or Black Sea-facing Bulgaria. These are rivals not merely for Europe's sun-seekers, but skiers. As much as I would not predict devaluations in the kuna or leu against the euro, I would not dismiss the prospect entirely. We are after all in extremely testing times. Times through which economies are being denied their traditional sources of foreign income in almost their entirety, and doing so entering a second year.

The reality is that for 'coastline and alpine' economies, tourist income is by nature (*sic*) highly seasonal; revenues over a handful of months proves pivotal for their annual national accounts. Now, assume Turkey gets through this summer without devaluing. Accept too the vaccine roll out across the EU ensures normal seasonal tourist service resumes before 2022. Against such a backdrop, this paper would be wrong on so many accounts.

If, however, Turkey does devalue and/or this accursed virus continues to largely restrict our behaviours into 2022, I will be proven correct in many ways, but quite possibly very wrong in claiming devaluations will not come within the EU. For against the backdrop of a third year of some degree of tourist disruption, national self-interest will trump collectivism. And, if it does, then so much else will come to prove wrong across Continental Europe.

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