

Arrivals Duty Free

**Submission to the
Department of Finance**

May 2009



CANADIAN AIRPORTS COUNCIL
CONSEIL DES AÉROPORTS DU CANADA

Table of Contents

Introduction	4
Airport Duty Free Today	6
Experiences Abroad	6
ADF and Security	7
Domestic Competition	8
Positive Economic Impact	8
Ancillary Benefits	9
Conclusion: Arrivals Duty Free is Good for Canada	9

Introduction

Canada's airports welcome the opportunity to provide the Department of Finance with comments as part of its consultations on the proposed introduction of Arrivals Duty Free at Canadian airports. In short, Canada's airports believe that ADF in Canada would repatriate foreign duty free sales back to Canada, increase revenue for duty free operators and airports, create Canadian jobs, and increase federal tax income.

Duty free shops at Canada's airports play an important role in the ability of airports to raise revenue. In particular, the \$174 million industry represents a slice of a particularly important kind of airport revenue – revenue from activities that are not aviation related. This revenue is important as it offsets revenue that must be raised from air carriers in the form of landing fees and other charges. This "aeronautical" revenue is passed on to passengers in their ticket costs, meaning that an airport's ability to maximise "non-aeronautical" revenue can have an impact on the cost to fly to/from a particular community.

Airport duty free in Canada today, however, faces some challenges – most notably in the form of liquid, gel and aerosol (LAG) security restrictions and increasing foreign competition.

Duty free sales in general are dominated by two categories of product that are liquid in nature – luxury fragrances and alcohol. The introduction in August 2007 of security restrictions on the carriage of LAGs aboard commercial aircraft around the world have been particularly burdensome on airport duty free. While some of the restrictions have been eased, there remains confusion about what products purchased in duty free can be brought aboard an aircraft and under what circumstances. International travellers transiting through other airports enroute to their final destination risk having their expensive duty free purchases confiscated.

Meanwhile, foreign countries also are interested in maximising their non-aeronautical revenue through the sale of airport duty free. Some, in particular in markets in which the government still owns and operates the airport, even have a vested financial interest in maximising their airports' ability to sell goods duty free. As a result, an increasing number of countries, including Australia, Brazil, Hong Kong, New Zealand and Mexico, offer ADF today. These countries represent fierce competition for Canadian operators.

Canada's airports believe that ADF represents a unique, no-risk opportunity to alleviate both security and foreign competition challenges for airport duty free operators in Canada today. In addition to rebalancing the competitive landscape, the sale of duty free on arrival in Canada would alleviate many of the LAG security concerns currently thwarting a significant portion of sales.

ADF would help Canadian duty free operators compete more effectively with their foreign counterparts. Many travellers coming to Canada today purchase duty free

goods abroad. In light of security restrictions, increasingly restrictive limits on carry-on items and the general aggravation associated with travelling with additional items, Canada's airports contend that travellers would gladly forgo duty free purchases at foreign airports in favour of purchasing on arrival in Canada. Accordingly, airports contend that the introduction of ADF in Canada would repatriate a significant portion of foreign sales and represent "new business" for Canada – meaning job creation and increased tax revenue.

In particular, as outlined later in this submission, Canada's airports believe that the introduction of ADF at airports in Canada would:

- Repatriate about \$60-70 million in duty free sales a year currently going to foreign airports.
- Create 400 immediate new jobs representing nearly \$13 million in annual wages.
- Generate about \$3-7 million in direct federal taxes.*
- Position Canada at the forefront of the G8 in this area, in line with at least 54 other important trading nations that include Australia, Brazil, Hong Kong, Israel Mexico, and New Zealand

* An estimated \$4 million in additional airport rent payable to the federal government would result from the anticipated increase in total airport revenue generated because of ADF. The CAC supports the elimination of airport rent.

Airport Duty Free Today

Airport duty free is a \$174 million industry in Canada, responsible for contributing about \$15 million in direct contributions to the Government of Canada. However, in the post Sept. 11, 2001 environment, airport duty free operators suffered. In fact sales declined 23% between 2002 and 2005.¹ While a major challenge for Canadian operators has been the growing introduction of Arrivals Duty Free in foreign competitive markets, the introduction of liquid, aerosol and gel restrictions in 2006 hit the duty free sector even further.

There are currently at least 54 countries around the world that now offer ADF, with others exploring its introduction. For travellers from Canada to these countries, passengers are only able to purchase duty free upon departure from Canada. At the country on the other end of their trip these travellers may purchase duty free at airports on arrival or on departure (as well as at airports and on aircraft en route). The opportunities for Canadian airport duty free operators to have access to these duty free sales are disproportionately limited – the competitive playing field is uneven.

COUNTRIES WITH ADF TODAY²

Argentina	Hong Kong S.A.R.	Peru
Australia	Iceland	Qatar
Bahrain	India	Singapore
Bahamas	Indonesia	South Africa
Barbados	Israel	Sri Lanka
Brazil	Italy	St. Maarten
Brazil	Jamaica	Taiwan
Chile	Jordan	Thailand
Costa Rica	Lebanon	The Gambia
Cyprus	Malaysia	Trinidad and Tobago
Denmark	Mauritius	Turkey
Dominican Republic	Mexico	Uganda
Egypt	Morocco	United Arab Emirates
Ethiopia	Netherlands	Uruguay
Fiji	New Zealand	Vanuatu
Finland	Norway	Venezuela
Greece	Oman	

Experiences Abroad

Arrivals Duty Free has been so successful abroad that in many places the programs have been expanded. As neighbouring countries have witnessed ADF successes and suffered a decline in duty free sales accordingly, they too have adopted the program.

In Australia ADF was introduced in limited measure for quantities of alcohol and

tobacco products in 1984. In 1995, quantities were increased and in 1999 an expanded array of products was allowed. Again in 2005 the country increased personal allowances.

The result was that in Australia duty free sales over the period climbed by more than 30%. Perhaps more importantly, this growth appeared to have no impact on domestic retail sales, in which continued growth was experienced.³

"Arrivals duty free has become an accepted and valued aspect of Australia's welcome to tourists....the availability of arrivals duty free has transformed the first experiences of Australia's airports from a less sterile to a more vibrant and welcoming experience."

- Hon. John Brown, Former Australian Tourism and Customs Minister

Similarly, when ADF was introduced in Norway in 2005, Copenhagen Airport reported a 3.2% fall in revenue due to sales repatriated by Norway.⁴

ADF and Security

Duty free sales in general are dominated by two categories of product that are liquid in nature – luxury fragrances and alcohol.

While some of the restrictions have been eased, there remains confusion about what purchased in duty free can be brought aboard an aircraft and under what circumstances. International travellers transiting through other airports enroute to their final destination risk having their expensive duty free purchases confiscated.



In 2008, according to statistics from the Frontier Duty Free Association and the Canada Border Services Agency, some 23% of duty free products sold at airports were alcoholic beverages, primarily wine and spirits. Another 31% represent perfume, cosmetics and skin care. Together, both LAG-dominated categories represent a whopping 54% of airport duty free sales, and millions of dollars have been lost in LAG duty free sales since the 2007 LAG restrictions were put in place.

Arrivals Duty Free represents a way for Canadian duty free operators and airports to capitalize on both the LAG restrictions and confusion about them among travellers.

For passengers for whom their initial point of landing in Canada is their final destination, there would be no security risk from LAG sales as the passenger would not board another aircraft. For passengers connecting on to a third destination, duty free operators would be able to assure the security of LAG purchases in accordance with federal security requirements in much the same way that the security of bottled water is assured in sterile areas today.

Domestic Competition

The primary opposition to the introduction of ADF in Canada has come from domestic retail operators who claim that its introduction would cannibalize their sales. However, evidence would seem to suggest that this opposition is unfounded.

In Australia we note that an initial 23% increase in duty free sales after the introduction of ADF was not accompanied by a decrease in domestic retail sales.⁵ Quite to the contrary, the domestic retail sector continued to grow as the growth in duty free revenues primarily came at the expense of duty free operators at foreign airports.

Officials in Hong Kong support this theory. Studying ADF in advance of its introduction, Hong Kong's Legislative Council Panel on Financial Affairs concluded that about 20-30% of arriving travellers carried duty free goods with them estimated to be worth about HKD \$1.2 billion a year – all of it purchased outside of Hong Kong since the region did not yet offer ADF:

"We believe that the sale of duty-free goods on arrival would largely replace the purchase of such equivalent goods outside Hong Kong...Hence, there should not be any overall revenue implications arising from the sale of duty free goods on arrival."⁶

Hong Kong has since gone on to expand its ADF offering at Hong Kong International Airport.

Positive Economic Impact

The experience with ADF abroad indicates that, rather than shifting sales from domestic retailers to duty free retailers, the introduction of ADF in Canada would repatriate foreign sales and serve as a net gain for Canada.

Were the experience in Australia to be replicated in Canada, under ADF an estimated \$60-70 million in additional sales currently going to overseas airports would be repatriated to Canada. This would result in an immediate economic impact of 400 new jobs, nearly \$13 million in wages and \$3-7 million in federal taxes. Over five

years, this increases to 500 new jobs, \$16 million in wages and \$4-9 million in federal taxes.^{7*}

Indeed, on expanding ADF in 2007, Australian Minister for Small Business and Tourism Fran Bailey noted:

*"International tourists are now spending \$2,836 per visitor, that's an extra \$262 on average from the previous year. Through initiatives such as this, we are encouraging tourists to spend more money in Australia, helping to create even more jobs for Australians."*⁸

Ancillary Benefits

The changing competitive landscape of airport duty free around the world, the ability to mitigate the negative impact of LAG security restrictions, and domestic job creation are three compelling reasons why Canada should allow for Arrivals Duty Free at Canadian airports.

However, there are additional ancillary benefits that include a decrease in the quantity and weight of carry-on baggage and improved management of passenger flow through airport customs facilities.

As passengers would select ADF purchases over duty free purchases at foreign airports, ADF represents a potentially significant decrease in the quantity and weight of carry on baggage. Decreased weight eases the fuel burn of an aircraft, which already has led many air carriers around the world move to limit both the quantity and weight of both checked and carry-on baggage items in recent years. Removing duty free items from aircraft through the introduction of ADF, thus, would reduce the fuel cost for air carriers and accordingly have a positive environmental impact.

Meanwhile, the pattern of international flight arrivals at airports is such that passengers tend to present themselves at customs halls in waves. ADF would help mediate the pressure from these waves by removing a portion of these arriving passengers from the initial rush on border services.

Conclusion: Arrivals Duty Free is Good for Canada

Canada's airports are encouraged that the federal government has chosen to study the potential impact of Arrivals Duty Free in Canada. Canada's airports have long faced a wide range of financial challenges that place them at a competitive

* An estimated \$5 million in additional airport rent payable to the federal government over five years would result from the anticipated increase in total airport revenue generated because of ADF. The CAC supports the elimination of airport rent.

disadvantage to airports in the United States and around the world. ADF represents one important way to improve Canada's competitive position.

With ADF in place in at least 54 foreign countries around the world, including countries like Australia and New Zealand with which Canada compares itself often, Canada would hardly be an early adopter by introducing ADF. It would, however, be ahead of many of its important trading partners/competitors as the first member of the G8 to do so. The introduction of ADF would be an excellent, low risk initiative that would allow Canada to very quickly give Canadian duty free operators and airports a competitive advantage with the immediate impact of increased sales, job creation and tax revenue improvements for Canada.

At a time when the government seeks to stimulate the Canadian economy, including its struggling tourism sector, Canada needs to be creative and flexible in its approach. Canada's airports support the creation of ADF as just such an initiative and are ready to do their part to ensure that ADF implementation would be a success in Canada.

¹ Arrivals Duty Free Business Case, InterVISTAS, July 20, 2006

² Arrivals Duty Free Business Case, InterVISTAS, July 20, 2006

³ Arrivals Duty Free – Airport Shopping for Success in Canada, August 2007

⁴ Arrivals Duty Free – Airport Shopping for Success in Canada, August 2007

⁵ Arrivals Duty Free Business Case, InterVISTAS, July 20, 2006

⁶ LegCo Panel on Financial Affairs - Sale of Duty-Free Goods on Arrival, May 1999

⁷ Arrivals Duty Free – Airport Shopping for Success in Canada, August 2007

⁸ New Rules to Boost Shopping for Airports, joint press release from the Minister for Justice and Customs and the Minister for Small Business and Tourism, Oct. 6, 2007