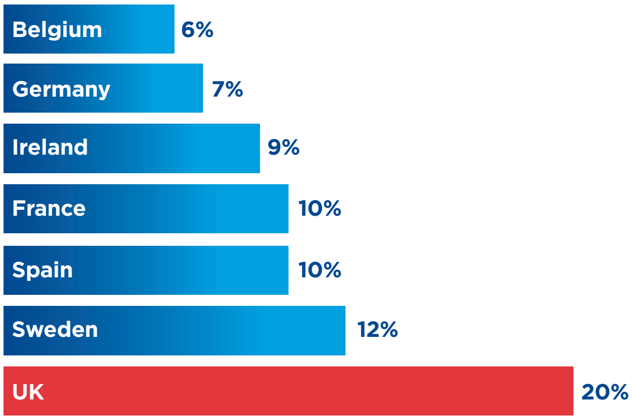
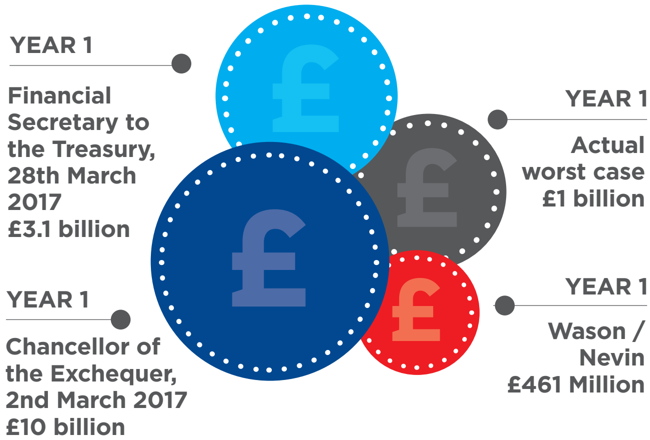
1

Out of 36 European countries only the UK, Slovakia and Denmark do not reduce tourism VAT...



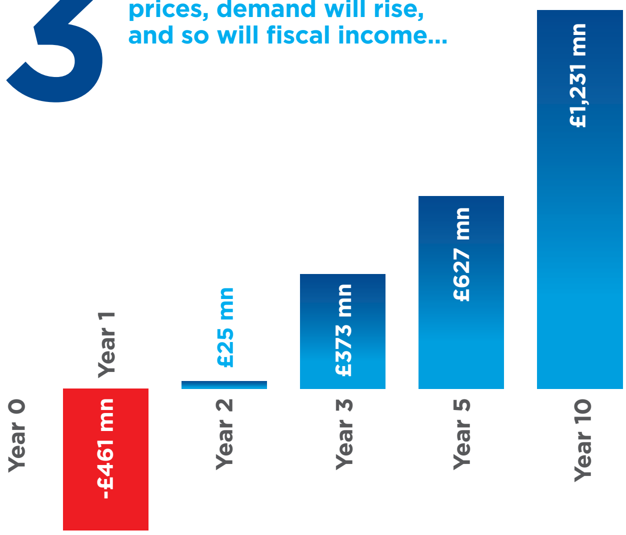
2

... If the UK does too, the direct VAT loss to HMT for one year only, worst case, is around £1 billion, i.e. not £10 billion or £3.1 billion...



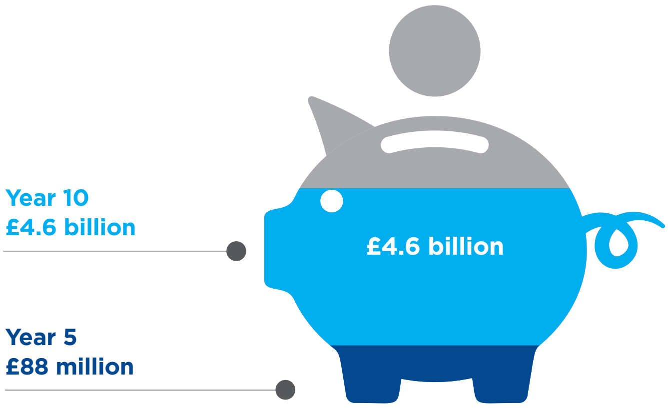
3

... But the VAT cut will lower prices, demand will rise, and so will fiscal income...



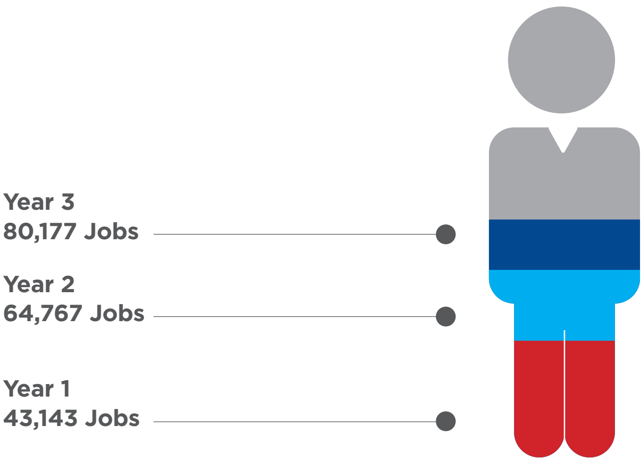
4

... And, with reasonable assumptions, HMT gains £4.6 billion over 10 years



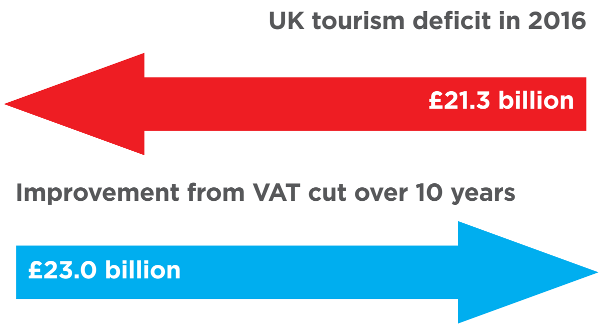
5

... 121,000 jobs created in tourism and the wider economy, particularly in rural and coastal areas...



6

... And the UK's historically bad trade balance improves by 23 billion over 10 years.



The Full Fiscal and Employment Impact of Reduced VAT on Visitor Accommodation and Attractions in the UK

Executive Summary of a report by Tourism Respect & Nevin Associates for the Cut Tourism VAT Campaign

INTRODUCTION

The Cut Tourism VAT Campaign is lobbying for the rate of VAT on visitor accommodation and attractions in the UK to be brought into line with competitor destinations throughout Europe.

Tourism is one of a limited number of goods and services for which the EU permits member states to apply a reduced VAT rate and almost every country takes advantage of this. Non-EU countries do the same. Out of 36 European countries, only the UK, Slovakia and Denmark do not apply a reduced rate for selected tourism services.

The Campaign is calling for VAT on visitor accommodation and attractions to be applied at the UK's single existing reduced VAT rate of 5%, which already applies to limited parts of the UK tourism sector, such as cable cars in theme parks and static caravans.

MEASURING THE IMPACT USING A DPE MODEL

In order to calculate the direct and indirect impacts of VAT reduced from 20% to 5% on visitor accommodation and attractions, a Dynamic Partial Equilibrium (DPE) model has been used. This model was developed initially in the 1990s and has since been refined and expanded frequently and applied to a range of scenarios. The DPE model is dynamic in the sense that it explicitly takes account of lags in the adjustment process, including the time it will take for operators to pass through a VAT cut in lower prices, and the time it will then take for tourists to respond to lower prices. The results contained in this report were published in February 2017 based on the latest Government data.

THE GOVERNMENT'S OWN CGE MODEL

Professor Adam Blake, an adviser to HM Treasury, carried out a separate analysis of the impact of reduced Tourism VAT using the Treasury's own Computable General Equilibrium (CGE) model, and compared this to alternative measures aimed at boosting the economy, such as reductions in corporation tax, national insurance contributions and the general rate of VAT. He concluded that:

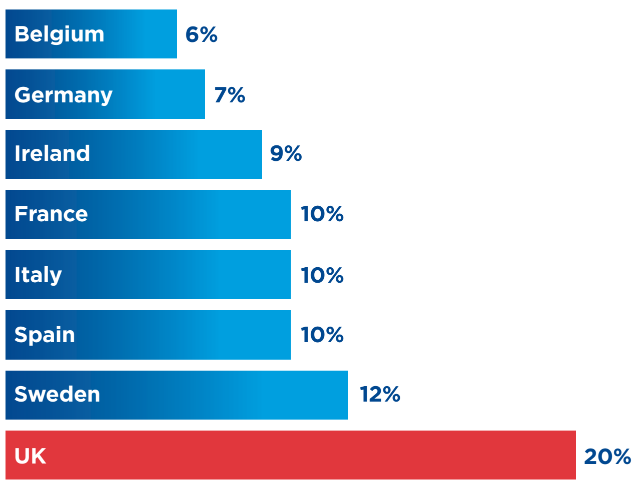
"Cutting Tourism VAT is one of the most efficient, if not the most efficient, means of generating GDP gains at low cost to the exchequer that we have seen with the CGE model".

REVIEW BY DR ANDREW SENTANCE MBE

A thorough independent review of the DPE and CGE modelling was carried out in 2016 by Dr Andrew Sentance CBE, who served for 5 years on the Bank of England Monetary Policy Committee between 2006 and 2011, and Mr Jonathan Gillham, who worked as an economist in HM Treasury and HMRC for more than 7 years. Both now work for PricewaterhouseCoopers. Their report includes the following conclusions:

"The campaign's analysis has been well-researched and has delivered insights to inform policy discussion. The depth of research and the modelling detail has been impressive".

ACCOMMODATION VAT RATES ACROSS EUROPE



CUTTOURISMVAT
BOOST BRITISH JOBS

"Both [the DPE and CGE] modelling approaches support the view that there would be substantial benefits to the UK economy from a cut in the VAT rate on tourism-related activities."

'BEFORE' AND 'AFTER' DPE MODEL RESULTS

The results of the 2017 DPE modelling indicate that, based upon a simple 'before and after' analysis, if the UK applied a reduced rate, there would be a net annual loss to HM Treasury of £33 million. A direct loss of VAT yields of £1.563 billion would be offset by indirect gains from higher yields from income and corporation tax, savings in social security payments, a smaller shadow economy and multiplier effects generating additional tax revenues of £1.53 billion in total.

IMPACT ON FISCAL INCOME OVER TIME

The £33 million loss in fiscal income is based on a simple 'before and after' comparison. In reality, transition to a post-VAT reduction equilibrium will not be instantaneous. There will be lags in the adjustment process:

- firstly, it takes time for some operators to pass through the VAT reduction in lower prices;
- secondly, it takes further time for consumers to respond to lower prices; and
- thirdly, it takes time for operators to employ more staff and expand facilities in response to increased demand.

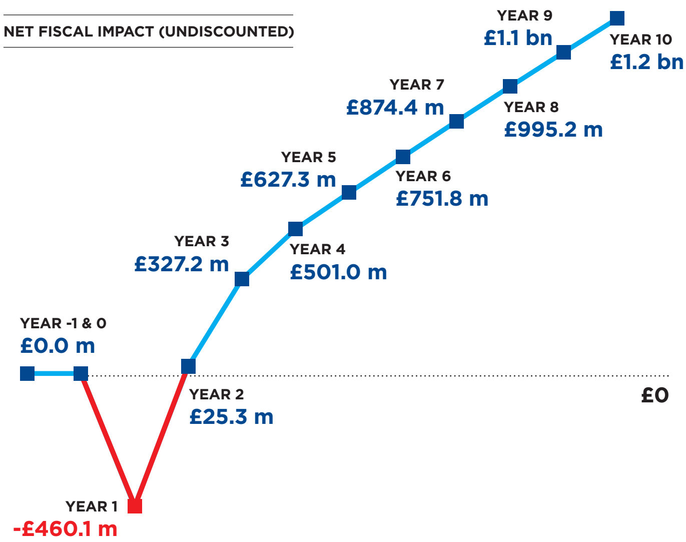
Taking these factors into account, we have estimated that 60% of the total impact of a VAT reduction will be felt in the first year following the reduction, rising to 85% in the second year and 100% by Year 3. These assumptions are believed to be prudent based on the experience of other countries that have changed the rate of VAT on tourism, such as Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, the Republic of Ireland, Italy, Latvia, Lithuania and Spain.

PERMANENT AND RISING GAINS FOR HM TREASURY

As a result of this time-lag, HM Treasury's loss in year 1 will be greater than in the 'before' and 'after' scenario, but the benefits from year 3 will be substantially greater.

The way in which HM Treasury gains from additional fiscal income is shown in the large illustration on the next page.

Although HM Treasury loses £461 million in the first year, it breaks even in year 2 and gains from year 3 onwards. HM Treasury's first year loss and the gains for the next nine years are shown in the chart above.



Over 5 years, HM Treasury's gain amounts to £883 million in discounted terms, an economic rate of return (ERR) of 49.5%, and by year 10, fiscal income will have increased by just over £4.6 billion, an ERR of 70.0%.

These estimates are calculated by discounting future cash flows by 3.5%. This is the discount rate recommended by HM Treasury to reflect the fact that, the more distant in the future that any cash is received, the less valuable it is in today's prices.

CREATION OF JOBS

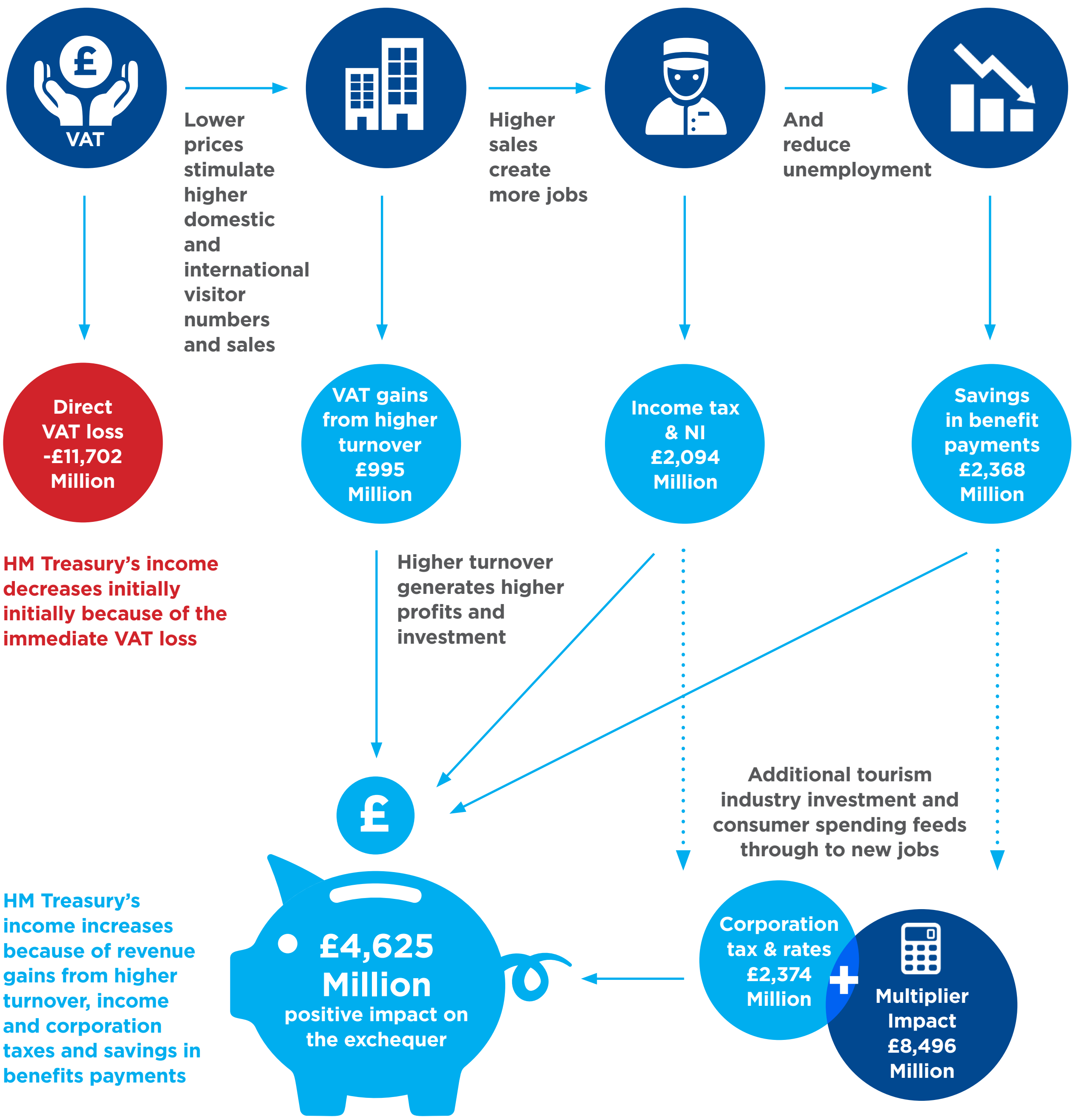
The impact on jobs of reducing Tourism VAT from 20% to 5% will be instantaneous as major operators such as Bourne Leisure, Merlin Entertainments and Premier Inn have pledged to reduce prices by the full amount of the VAT cut on the day that the measure is introduced. These companies will promote this in advance and will employ extra staff before the VAT cut comes into effect to meet the anticipated increase in demand.

In the first year, over 43,000 jobs will be created, rising to 92,000 in the fifth year and over 121,000 by year 10. The year-by-year impact of lower VAT on jobs is shown in the chart on page 5.

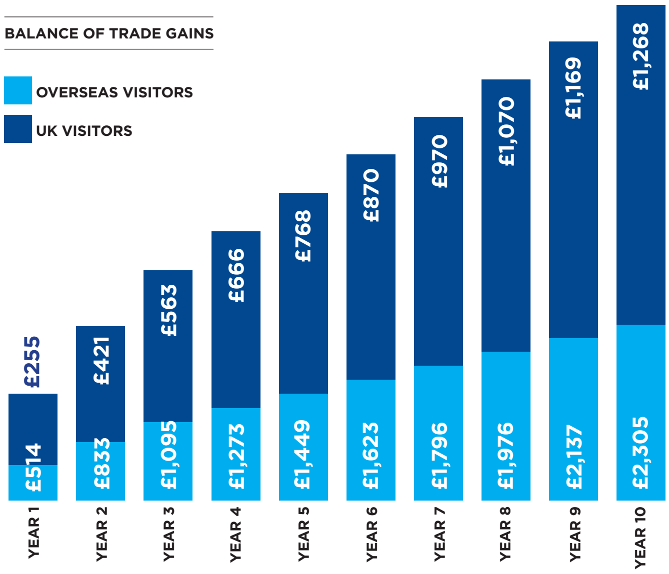
IMPACT ON THE BALANCE OF TRADE

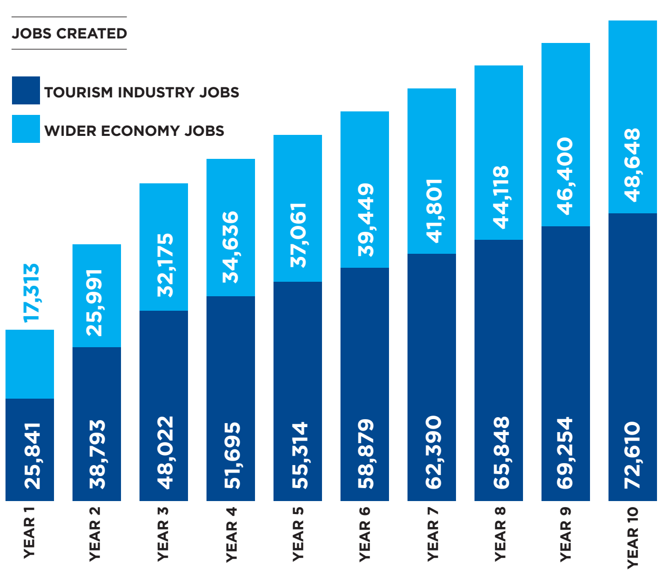
There are two ways in which lower Tourism VAT would

How Treasury Gains from Reduced Tourism VAT over 10 Years



Sign up as a supporter of
Cut Tourism VAT by emailing us at
support@cuttourismvat.co.uk
and join one of the largest
industry campaigns in the country





assist the balance of trade:

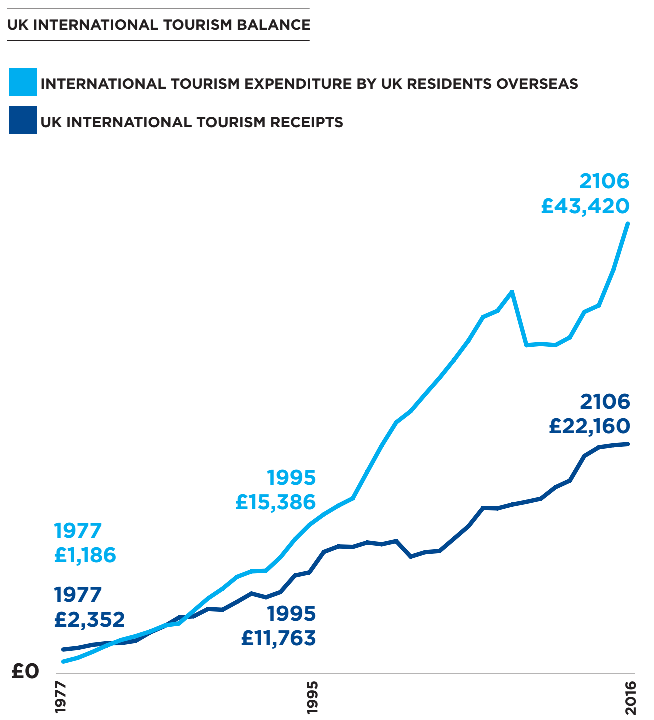
- By increasing the UK's foreign exchange earnings from overseas visitors. It is estimated that overseas tourists account for approximately 40% of all expenditure on visitor accommodation and attractions in the UK.

- By reducing foreign exchange expenditure by UK residents on holidays abroad and increasing expenditure on domestic holidays, short breaks and days out to visitor attractions.

This combined impact produces a 'positive double whammy' for HM Treasury, compared to other measures where positive and negative benefits to an extent cancel each other out. For example, reducing Air Passenger Duty makes it cheaper for foreign residents to visit the UK but also makes it cheaper for British residents to travel abroad. Reducing Tourism VAT makes it cheaper for foreign residents to visit the UK and for British residents to take holidays and short breaks within the UK.

Our computations indicate that the improvement in the UK's balance of trade as a result of this 'positive double whammy' would be £2.2 billion by Year 5 if VAT were cut from 20% to 5%. Over 10 years, the cumulative improvement in the UK's balance of trade in response to a VAT reduction from 20% to 5% would be £23 billion, making a very significant contribution to the overall balance of trade position.

The year-by-year improvement in the UK's foreign exchange earnings following a VAT cut is shown in the chart above.



UK INTERNATIONAL TOURISM BALANCE

The figure above shows the UK's international tourism receipts and expenditure over the past 30 years (1977 - 2016 inclusive).

Sign up as a supporter of Cut Tourism VAT by emailing us at **support@cuttourismvat.co.uk** and join one of the largest industry campaigns in the country

In the late 1970s, the UK's international tourism receipts actually exceeded its international tourism expenditure, generating a modest surplus on the tourism balance. Since then, the growth of tourism expenditure by UK residents overseas has outstripped receipts from international visitors to the UK, resulting in a widening tourism deficit.

The deterioration increase in the UK's international tourism expenditure was reversed over the 4 years after 2008, driven by a decline in UK real incomes following the international financial crisis. However, as real incomes recovered and the pound strengthened against other international currencies after 2011, UK expenditure overseas started to rise sharply again. This in turn led to a widening of the UK's tourism deficit to a record of £21.3 billion in 2016.

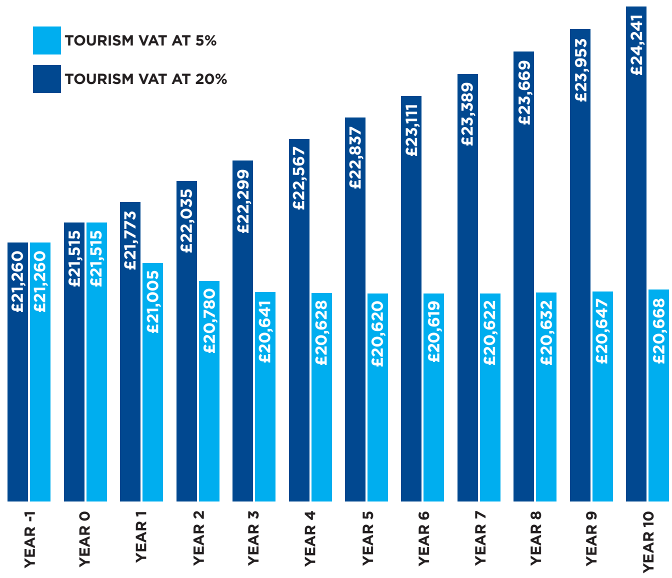
In 2017, our tourism forecasting model would predict a reduction in the tourism deficit. This reduction will be driven by the fall in the value of the pound since the Brexit vote in June 2016, which stimulated inbound tourism while having a dampening effect on outbound tourism.

However, any improvement in 2017 should not be taken as a signal that the long-term deterioration in the UK's tourism balance is about to reverse. On the contrary, our forecast would remain – as it has over the last 20 years – that, under a 'business as usual' VAT scenario, the UK's tourism balance is likely to remain in deficit and progressively deteriorate over time, as a result of the competitive disadvantage suffered by the UK tourism industry because of the onerous VAT burden.

By contrast, a reduction in the rate of Tourism VAT will provide a dynamic stimulus to the sector, increasing earnings from both UK residents and overseas visitors, and thus improving the UK's balance of trade, creating new jobs in the sector and generating higher taxes for HM Treasury. It will also reduce the size of the significant 'shadow economy' falling outside the tax regime altogether.

The chart opposite shows the difference in the UK's projected tourism balance over the next 10 years if VAT is reduced to 5% compared to VAT continuing at 20%, assuming that all other factors remain unchanged.

PROSPECTS FOR THE TOURISM BALANCE WITH AND WITHOUT VAT CUT



Prospects for the balance of tourism payments over the next 10 years with and without the reduction in Tourism VAT to 5%, assuming all other factors are unchanged.

CONCLUSIONS

The extensive analysis undertaken on the direct and indirect impact of lower tourism VAT, both through our model and through HM Treasury's own CGE model, and checked independently by a former member of the Bank of England Monetary Policy Committee, demonstrates that it would also be a highly cost-effective method of promoting UK exports, improving the balance of trade and creating new jobs. Over time, it would also generate higher revenues for HM Treasury from an increased taxation base. The dynamic gains from lower Tourism VAT suggest that it merits serious consideration by HM Treasury as a mechanism to promote economic growth and employment in the UK and enhance the well-being and enjoyment of UK residents.

Reducing the price of holidays, short breaks and days out at visitor attractions by up to 15p in the pound would be highly popular and advantageous to virtually all UK residents, as well as an incentive to overseas visitors.

The Campaign for Reduced Tourism VAT is led by: