Submission for the

2013 Autumn Statement

From the Campaign for Reduced Tourism VAT

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The Campaign for Reduced Tourism VAT is led by:

1. Introduction

The Campaign for Reduced Tourism VAT is led by the British Hospitality Association, Bourne Leisure Group, Merlin Entertainments plc, and the British Association of Leisure Parks, Piers and Attractions (BALPPA). The Campaign was established in 2011, representing over 3,500 individual businesses and over 40 national and regional trade associations.

2. Executive Summary

For over 20 years the UK tourism industry has been concerned at the competitive disadvantage which it faces as VAT is applied to tourism in the UK at the standard rate. The UK is one of only four EU states not to take advantage of a reduced rate of VAT on visitor accommodation, and one of 14 EU countries that apply the full rate of VAT on admissions to amusement parks.[1]

We are the only major tourist destination in the EU not to benefit from a reduced rate of VAT. France, Germany and Ireland have reduced VAT for different parts of their tourism industries in recent years. In October 2013 the Irish Government retained its reduced rate of 9% and recognised its success in increasing overseas visitor numbers, employment and revenue.

Without a reduced rate of VAT the UK sector is struggling to compete internationally. Analysis in Visit Britain's report "*Delivering a Golden Legacy*" reveals that **between 2006 and 2011 the UK lost market share in 28 out of its top 33 markets by visitor volume**. This presents a worrying outlook for a sector which currently ranks at the sixth biggest export earner for the United Kingdom.

"The Impact of Reduced VAT Rates on British Visitor Accommodation, Attractions and the Wider Economy: Report of Discussions with HM Treasury and Results of Dynamic Partial Equilibrium and Computable General Equilibrium Models", published in December last year, **found that a reduction in those sectors would be revenue neutral and contribute £4 billion each year to the UK economy.**[2] This research was carried out between 2011 and 2012 by Professor Adam Blake, a Treasury Adviser using the core of the Computable General Equilibrium (CGE) model in use by HMT.

An earlier report on the same subject was undertaken by Deloitte/Wason/Nevin and published in 2011. This research used a Dynamic Partial Equilibrium model and predicted an annual net fiscal gain to HM Treasury and the creation of 80,000 new jobs in the sector. Summaries of both reports are provided with this submission.

This submission calls on Government to reduce the rate of VAT applied to visitor accommodation and attractions in the United Kingdom as a measure to assist long-term and sustainable growth for the UK economy.

3. The case for a reduced rate of VAT for the sector

Numerous detailed independent analyses have found that reducing VAT on UK tourism to a reduced rate of 5% would stimulate both domestic and overseas demand leading to expansion of the sector, the creation of jobs and a fiscal return to HM Treasury that would reverse the long-term trend of Britain's worsening tourism balance of payments.

This submission provides an overview of the findings of the two most recent studies which used a Computable Equilibrium Model and a Dynamic Equilibrium Model. The Campaign is grateful to HMT officials for having suggested and granted permission for the use of their CGE model.

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[1] European Commission, VAT Rates Applied in the Member States of the EU, 1st July 2013
[2] Campaign for Reduced Tourism VAT (2012) www.cuttourismvat.co.uk/files//Cut%20Tourism%20VAT%20HMT%20discussion%20report%2004dec12.pdf

3.1 Analysis under the Dynamic Partial Equilibrium model

The first independent analysis of the impact of reduced rates of VAT on tourism and the UK economy in 1995 was based on comprehensive research, including case studies of tourism VAT changes in other countries and detailed analysis of the price sensitivity of UK tourism. Based on this research Messrs Nevin and Wason developed a fiscal model to illustrate the potential impact of the VAT reduction. The fiscal model was developed and refined for subsequent studies, resulting in the Nevin/Wason DPE model in the Deloitte/Wason/Nevin report completed in February 2011.

A report for the EU in 2007 on the impact of reduced VAT rates by Copenhagen Economics ApS concluded that *"permanently lowering the VAT rate on a particular good (or service) sooner or later will lead to a reduction in the price of the good more or less corresponding to the monetary equivalent of the lower VAT rate".* **The Nevin/Wason DPE model makes a more cautious assumption that only 60% of the VAT cut will be passed on in lower prices, the remainder being allocated to investment in new or improved facilities, more employment and training and higher wages.** It is assumed that 5% will be retained as increased profits. A further assumption is that most of this effect will take place within two years after the VAT cut and the full effect will occur within four years.

The immediate impact of cutting VAT on visitor accommodation and attractions from 20% to a reduced rate of 5% would be a loss of VAT yields. However, the base on which VAT is levied will not remain constant. Lower tax rates will feed through to lower prices, which will stimulate higher demand and so increase the total revenue base on which VAT is levied, benefiting the whole economy and not just the tourism sector. Using reasonable and plausible assumptions, the loss of fiscal income from the cut in VAT will more than be made good by additional income tax receipts, savings in social security payments, and an increase in profits, corporation tax payments and tax on dividends. **The DPE Model indicates that in total, the net fiscal gain as a result of the VAT reduction is estimated to grow to £835 million per annum by Year 10 following a VAT cut, and the Net Present Value (NPV) of the fiscal gains generated for the Exchequer over 10 years, compared to a 'no change' policy scenario, is £2.6 billion, at 2011 prices.**

Additional jobs will be created as a result of the higher spending induced by lower VAT rates and lower prices. Based on an average gross turnover per job (full- and part-time) of approximately £35,000 in the attractions sector and £45,000 in the accommodation services sector, **the total number of jobs created by higher sector turnover will be 64,000 jobs in accommodation and 14,000 jobs in visitor attractions,** representing approximately 52,000 full-time equivalent jobs. It is further assumed that 65% of these jobs will be new jobs that would not exist without the VAT reduction, while 35% will represent displaced jobs.

3.2 Analysis under the Computable General Equilibrium model

The CGE model, before adjustment to reflect some of the assumptions in the DPE model and particular characteristics of tourism, shows a net fiscal cost to the Exchequer of a reduction in VAT on visitor accommodation and attractions. However this cost is far lower than the direct VAT loss. There is actually a small fiscal gain of £77 million in the year prior to the reduced rate becoming effective, followed by a loss of £232 million in 2013 (compared to the direct VAT loss of £1.7 billion in 2013) and slowly increasing year-on-year deficits thereafter.

Professor Blake considered a number of alternative assumptions in the CGE model reflecting those that underlie the Dynamic Partial Equilibrium (DPE) model.[3] Not all of these could readily be reflected due to the structure of the CGE model. Of the assumptions discussed, Professor Blake chose to consider four, two assumptions relating to elasticities within the model and two alternate assumptions relating to employment.

One of these relates to a proposed commitment by which the tourism industry, as part of a collaborative agreement, agrees to take on an additional 10,000 workers who have previously been long-term unemployed. **These results show substantially higher GDP gains, peaking at £4 billion per year (rather than £3 billion without these additional assumptions), a positive fiscal impact for the first 4 years and a cumulative fiscal impact over the 2012-2020 period that is only slightly negative at -£151 million.**

The results of the impact of a reduction in tourism VAT in the CGE model were compared with the results of other hypothetical tax changes as follows:

- Scenario 1 - a reduction In VAT on accommodation and visitor attractions to 5%; and
- Scenario 2 – Scenario 1, plus a reduction in VAT on food and beverage services to 5%
- A 2p reduction in the standard rate of corporation tax (simulation CT)
- A 20% reduction in rates for employers' national insurance contributions (NIC)
- A 1p reduction in the standard VAT rate (VAT).

To make the comparison between these five scenarios more precise, GDP and fiscal impact effects over the nine year period 2012-2020 are discounted and added up. This gives a resulting ratio between fiscal impact to GDP, which can be interpreted as the fiscal cost (when, as is always the case in these results, it is negative) of each pound of GDP gained. The results are:

Comparisons between discounted GSP and fiscal impacts from tax comparison scenarios
(£m, discounted at a rate of 3% p.a.)

	Scenario 1	Scenario 2	CT	NIC	VAT
Discounted GDP over 9 years	19,271	79,430	29,615	103,354	28,337
Discounted fiscal impact over 9 years	-3,493	-18,150	-17,973	-24,603	17,830
Fiscal impact to GDP ratio	-0.18	-0.23	-0.61	0.24	-0.63

With a ratio of -0.18, reducing VAT on visitor accommodation and attractions represents *"one of the most efficient, if not the most efficient, means of generating GDP gains at low cost to the exchequer that I have seen with the CGE model"*, according to Professor Blake.

4. Industry commitment to job creation and growth

Professor Blake's CGE analysis with additional assumptions included an adjustment for the effects that the expansion of employment in tourism would have on benefit payments, particularly at a time of high unemployment, and notably youth unemployment. **This takes account of the high level of part-time employment and the relatively high proportion of low-skilled employment in tourism.** Thus it is believed that expansion of the tourism sector at the present time will create jobs, a significant proportion of which will be taken up by the unemployed, the young and part-time workers, many of whom may be new to the workforce and with limited alternative employment opportunities. **The opportunities will arise in all parts of the UK, including seaside resorts and rural communities.**

A further assumption, to underpin the plausibility of tourism jobs being taken by the unemployed, is that the tourism industry would enter a collaborative agreement including the VAT reduction, along the lines of the French 'contrat d'avenir', which might include taking on more workers who have previously been long-term unemployed. In the CGE model with additional assumptions, it is assumed that an additional 10,000 long-term unemployed would be taken into employment in visitor accommodation and attractions.

As part of a government decision to reduce VAT on visitor accommodation and attractions the industry would be willing to explore a series of further commitments that would seek to ensure that the benefits of the VAT reduction would reach consumers, employees, suppliers and the economy as a whole. Such commitments might encompass:

- passing on at least 50% of the VAT reduction in the form of lower prices;
- creating an agreed number of new jobs, including those for young people;
- increasing spend on staff training, working with the Department of Business Innovation & Skills; and
- investing in improvements to the tourism product, thereby generating demand in building services.

These assumptions were to an extent tested by a survey of Campaign supporters undertaken in January 2012. Over 95% of over 200 respondents said that if a 5% VAT rate were achieved some or all of it would be passed on. Eighty-two per cent said they would invest more in their product/facilities, 67% would employ more people, 57% would invest more in training and just under half (48%) would increase staff wages.

5. Compliance with the Chancellor's taxation principles

Consideration has been given by the Campaign to how well the tourism VAT reduction proposal adheres to the key principles that should underpin formulations of tax policy as enumerated by the Chancellor in the 2011 Budget statement.

- **Growth and Economic Efficiency:** Our modelling shows that a VAT cut in the tourism sector could do more to boost growth than the Government's current strategy of reducing the rate of corporation tax. VAT on the tourism sector represents a highly economically distortive tax that adversely affects UK business investment and the balance of payments. The tourism sector has the potential to provide the right kind of jobs that are needed to support the wider government policy agenda of reducing benefit dependency and helping young people, part-time workers and the long-term unemployed to find valuable and structured employment opportunities.
- **Fairness:** Not only is the current VAT regime highly distortive, it is uncompetitive too. Key European tourism destinations have cut their tourism sector VAT rate in order to obtain a greater share of European tourist spend. Analysis shows that the UK is an attractive destination to visit, but it is not price competitive.
- **Certainty and Simplicity:** A lower VAT rate will increase demand in the tourism sector and help businesses generate the cash internally to drive investment.
- **Practicability and Coherence:** While VAT can be claimed back on some foreign tourist purchases, the system is only partial and can be confusing. Lower VAT payments for items such as accommodation could stimulate tourism spending in other areas of the economy.
- **Sustainability:** The tax system faces a range of long-term challenges. A VAT rate cut in the tourism sector can help rebalance the tax system to become more growth supporting, thus sustaining tax revenues in the long-term.

6. Conclusions

Having examined the impact of reduced VAT on tourism using both CGE and DPE models, the Campaign is strongly of the view that reducing VAT on visitor accommodation and attractions will create jobs and stimulate growth throughout the economy at very low risk to Exchequer income.

It is believed by the Campaign that cutting VAT on tourism will lead to fiscal surpluses over time that will - combined with a basket of complementary policy measures such as increased marketing spend and improved visa regulations and procedures – reverse the long-term trend in the decline of the UK's tourism balance of payments and go some way towards achieving the Prime Minister's goal of increasing the proportion of UK residents' spend on domestic tourism from 36% to 50%.

This is not a request for stimulus or support for the tourism sector. This policy is commended as a measure to assist long-term and sustainable growth for the UK economy. The tourism sector is willing to workwith the Government to support 10,000 long-term unemployed back into work to make this policy measure fiscally viable.