Delivering growth – the impact of a reduced rate of VAT for the hospitality sector

The hospitality sector in the UK has long called for a reduced rate of VAT for the sector. This reflects the disparity with other, rival overseas hospitality and tourism destinations and a strong belief in the economic, employment and social benefits of a reduced rate of VAT for hospitality.

It is clear that a reduced rate would deliver higher growth, boost employment, lead to lower consumer prices and ultimately be cash-generative for the Treasury, contributing to Government debt reduction. Based on a reduced rate of 12.5% it would deliver:

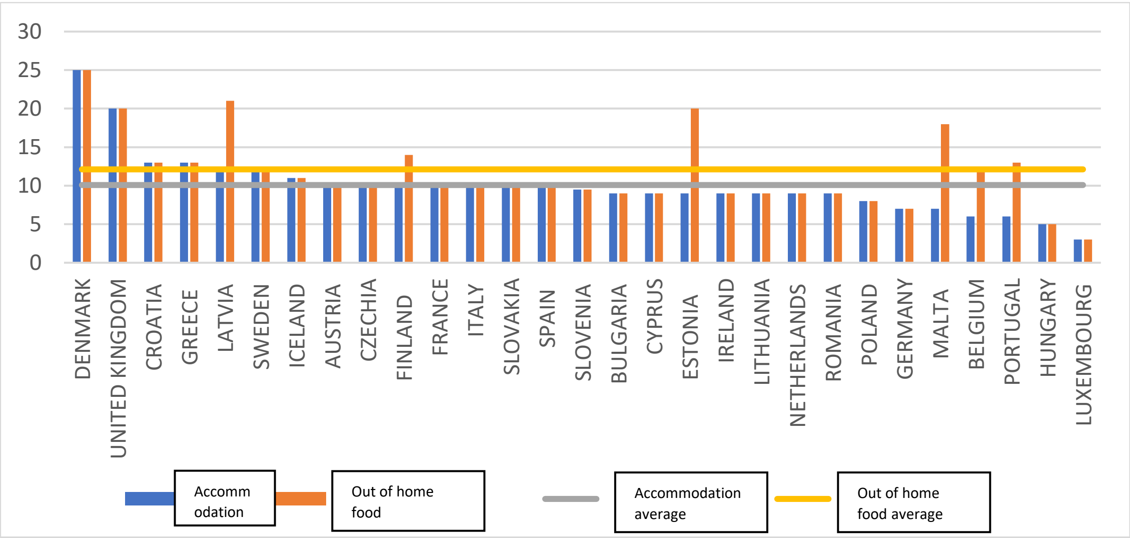
Growth: Additional sales of £7.7 billion in 10 years – c.5%
Inflation: 3% reduction in prices based on 50% pass-through
Reducing Government debt: Net fiscal gain for HM Treasury over 10 years of £4.6 billion

The tourism context

The UK currently faces a significant, and unnecessary negative balance of payments on tourism. In 2022, overseas residents spent £26.5bn in the UK, while our residents spent £58.5bn overseas – a deficit of £32bn[1]. Generating additional spend from overseas and having more Britons switching from overseas to the UK (currently £14bn) is crucial to closing this gap – and pricing (and taxation) plays a part in this.

The tourism and hospitality sectors are a major part of the UK's economy. Hospitality employs 3.5 million people across every part of the nation, adding £96bn to the economy. The sector invests around £7bn each year. And generates over £20bn in exports through tourism spend – the nation's third biggest export. It is estimated that **hospitality could grow by up to 6% per year** with the right conditions, including a supportive tax regime. This would be spread right throughout the UK.

Price and tax rates clearly have an impact on customer choice of where to visit. The UK is pricing itself out of being competitive, hitting business growth and the nation's soft power. A reduced rate will incentivise Britons to holiday in the UK more frequently – at holiday parks, caravan sites, family-run B&Bs and hotels - while also attracting more overseas visitors.



---

[1] ONS

As well as the economic benefits, there are huge social benefits. Growing our sector promotes social mobility through higher pay, training and career progression; making holidaying in the UK more affordable offers health benefits to those currently priced out; there are environmental benefits as fewer people fly abroad; and it will regenerate coastal communities with new investment.

The reduced rate during the pandemic was a significant boost for the sector, though was underused due to ongoing closures and restrictions. Yet it also gave real-world evidence of how businesses react to a reduced rate.

The relatively recent experience for both industry and Government of implementing a reduced rate means that the administrative difficulties of such a change are much reduced, legislation and guidance can easily be drafted and systems adapted.

The UK's exit from the EU also simplifies the process and allows Government to tailor the reduced rate more to their own economic and social objectives.

Impact on inflation

The increase in the rate of VAT for the sector has added an estimated 1.4 percentage points to the national CPI rate, from October 2021 through to September 2022, that has had a knock-on impact on Bank of England decisions and people's disposable income. Pricing responds to changes in the VAT rate – when the VAT rate was reduced by Labour during the economic crisis, the majority of the cut was passed on in line with Government intentions. During Covid, it was a more mixed picture as businesses attempted to rebuild their balance sheets – but, again, in line with Government advice.

The spare capacity in the sector, and the incentive for more investment will ensure that prices will be passed onto customers. Government direction is heeded on pricing but could also be directed towards workforce as a means to increase wages, training expenditure and investment.

Evidence from the reduced rate (source: YouGov, Deloitte survey of hospitality businesses)

While it is difficult to precisely define the impact of the reduced rate of VAT in the midst of a pandemic, we can identify how businesses and consumers behaved.

- 54% of businesses passed on the reduced rate in lower prices
- Over a third of businesses saw a boost in trade
- And conversely, saw a drop in trade once VAT was increased
- A majority of adults opposed the return of VAT to 20% in April 2022
- Lower prices in hospitality had a positive impact on the lives of six in ten survey respondents, with 69% claiming it was better for society

Estimated impact of a future reduced rate

In early 2022, a study[2] was commissioned to look at the future impact of a 12.5% reduced rate of VAT for the sector. The study demonstrated a boost in employment, economic activity and Government revenues over 10 years.

- 182,400 jobs created over 5 years
- 286,850 jobs created over 10 years

[2] Economists commissioned by the Cut Tourism & Hospitality VAT campaign

UKHOSPITALITY

- Additional sector turnover over 5 years of £4.9 billion
- Additional sector turnover over 10 years of £7.7 billion
- A positive return on investment for Government in under 5 years
- £4.6 billion of Net present value fiscal gains for HM Treasury over 10 years – accounting for higher taxes through growth

Annex:

Regional impact after 10 years – additional turnover and jobs

	Turnover £m	Jobs
North East	£200	8,088
North West	£683	27,421
Yorkshire & The Humber	£432	17,395
East Midlands	£332	13,373
West Midlands	£544	21,971
East of England	£565	22,713
London	£1,795	71,983
South East	£995	40,009
South West	£638	25,471
England	**£6,184**	**248,425**
Wales	£270	10,806
Scotland	£549	21,985
Great Britain	**£7,003**	**281,216**
Northern Ireland	£140	5,633
United Kingdom	**£7,143m**	**286,849**