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VAT, AIR PASSENGER DUTY AND TOURISM IN NORTHERN IRELAND

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northern ireland tourism alliance

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EXECUTIVE SUMMARY

Northern Ireland's tourism sector has been steadily growing over recent decades and the latest forecasts suggest that this trend will continue. Data for 2016 indicates that it was a record-breaking year for tourism. The increasing success of key attractions – including Titanic Belfast and sites associated with Game of Thrones – have contributed strongly to recent growth, while Lonely Planet has identified Belfast and Causeway Coast as its top region to visit globally in 2018.

However, the sector has been growing from a low base, and continues to underperform relative to competing markets. Overall revenues generated by tourism are eight-times higher in the Republic of Ireland, despite having a population just 2.8 times larger than that of Northern Ireland. Despite relatively strong occupancy rates and a growing stock of accommodation, a key difficulty is retaining visitors to Northern Ireland. Many visitors to the key attractions tend to do so through day-trips originating from Dublin, therefore retaining much of the spending within the Republic of Ireland. As a result, the average amount spent per trip to Northern Ireland is under half the equivalent figures for either the Republic of Ireland or UK as a whole.

This is largely due to the unique challenges and competition Northern Ireland faces when compared to the rest of the UK. It shares a land border with the Republic of Ireland which has lower rates of VAT on tourism related goods and services and has no tax on air travel. The higher relative tax burden makes the domestic local tourism sector less competitive. As tourism is a relatively price-sensitive sector, the impact on cost born by a higher tax burden has a greater adverse impact on demand than for other goods and services. Proposed changes to VAT on tourism-related goods and/or APD on short-haul flights may help to overcome these barriers and unlock the sector's growth potential.

Reducing the rate of VAT will help the tourism sector grow. Evidence from modelling exercises, information provided by existing operators and similar policies in the Republic of Ireland all point towards a positive economic impact from a reduction in tourism-related VAT. Firms have pledged a commitment to sign a charter that would ensure a degree of pass-through to consumers following a cut in the VAT rate, reducing costs for consumers and therefore boosting demand. Meanwhile, the additional revenues generated by firms can be reinvested to improve the quality of Northern Ireland's tourism offer, boosting investment and training to further support growth. These factors in turn will encourage an expansion in output, which is associated with employment and wage growth, generating a positive multiplier effect which filters through both tourism and non-tourism related sectors. This policy may also reduce the size of the 'shadow economy', boosting output through reducing the disincentives for businesses below the VAT threshold to expand.

APD has a distortionary effect on short-haul travel to the island of Ireland. The difference in tax reduces the price competitiveness of domestic airports. Following the abolition of the Irish Air Travel Tax in 2014, some visitors who might have otherwise have travelled via Northern Ireland are instead encouraged to do so via airports in the Republic, increasing the tendency of visitors to stay there. Similarly, it is estimated that a million journeys are made via Dublin Airport each year by Northern Ireland residents. This price advantage has allowed Dublin Airport to grow strongly, with passenger numbers increasing by 11 million since 2010, an increase almost seven-times larger than the respective figure for Northern Ireland's three airports over this period (1.6 million). Northern Ireland's tourism sector is also heavily reliant on domestic visitors from elsewhere in the UK, a source of visitors who are effectively 'double-taxed' by short-haul APD.

Reductions to or the abolition of APD can support the growth of Northern Ireland's airports, which in turn will boost the domestic tourism sector. The removal of short-haul APD can 'level the playing-field', encouraging more tourists to both visit and stay overnight in Northern Ireland. It is hoped that encouraging more visitors both domestically and internationally can have a range of positive effects tourism sector, such as boosting the number of visitors, increasing the average duration of stay and therefore increasing total tourism spending. Further, owing to the sea border with Great Britain, amending short-haul APD in Northern Ireland alone may have fewer distortionary impacts on the domestic tourism market than implementing such a policy in other specific parts of the UK. Although reducing APD will have the counter effect of increasing outbound travel by Northern Ireland's residents, this may generate some knock-on benefits for the domestic economy. The leisure air travel sector is shown to have a relatively high economic multiplier, meaning that each pound spent on leisure air travel has a greater impact on the overall economy than for other goods, while approximately half of all spending by outbound tourists is estimated to be retained in the UK economy.

1. INTRODUCTION

1.1 CALL FOR EVIDENCE

In March 2018, HM Treasury put out a call for evidence on VAT, Air Passenger Duty (APD) and tourism in Northern Ireland (NI). The call for evidence is in response to concerns that the tourism sector in NI faces unique challenges and competition when compared to the rest of the UK. For example, it shares a land border with the Republic of Ireland which has lower rates of VAT on tourism related goods and services and has no air travel tax. The higher tax burden in NI relative to the Republic of Ireland, it is argued, makes the local tourism sector less competitive.

Consequently, Government wants to better understand the ways VAT and APD impact the NI tourism sector, and how the sector can be supported to build on recent growth.

1.2 THIS RESPONSE

In this response we draw on available evidence to highlight the importance of the tourism sector and to discuss the impact of VAT and APD. It takes the following structure:

- Section 2 provides an overview of the importance of tourism in NI, how it has achieved impressive growth in recent years, and why it needs to be supported;
- Section 3 provides responses to each of the questions set out by Treasury; and
- Appendix A lists our bibliography.

1.3 THE NORTHERN IRELAND TOURISM ALLIANCE

This response is submitted on behalf of the membership of Northern Ireland Tourism Alliance (NITA) which was founded in January 2018 as a private sector led 'voice' of the tourism industry. NITA currently has members in the following categories:

- Accommodation providers;
- Food and drink industry association;
- Retail tourism partnerships;
- Major tourist attractions;
- Tour guides;
- Passenger transport;
- Airports;
- Ports; and
- Airlines.

NITA also has associate memberships including all local councils in NI, ABTA, Tourism NI, Tourism Ireland, and education and skills providers.

2. IMPORTANCE OF TOURISM TO NORTHERN IRELAND

2.1 INTRODUCTION

Northern Ireland's tourism sector has been steadily growing over recent decades and the latest forecasts suggest this trend will continue. However, there is evidence that the sector has been growing from a low base, and it should and could be larger. It is in this context that we must consider whether cuts to VAT and APD would stimulate further growth.

2.2 TOURISM'S RECORD PERFORMANCE

The Tourism sector has been growing strongly throughout the world in recent years.[1] This has also been the case in Northern Ireland, tourism has grown into a significant part of the private sector and is identified as a pillar of growth in the Department for the Economy's "Economy 2030 vision"[2].

2016 was a year of record highs for the tourism industry in Northern Ireland, with 4,573,000 overnight visits recorded, £851 million spent by visitors and over 2 million hotel rooms sold in Northern Ireland's 137 hotels.[3] It was estimated by Tourism NI that in 2016, the sector accounted for 5.2 percent of GDP and for 1 in 10 jobs[4].

Growth in the sector looks set to continue. Lonely Planet chose Belfast and the Causeway Coast region as the *"best region to visit in 2018"*.[5] Tourism Ireland is using the accolade in a marketing campaign targeting 14 different markets worldwide including mainland Europe and Australia.[6] Tourism NI and Tourism Ireland are also using the success of Game of Thrones to promote tourism to Northern Ireland. The promotions include the creation of an 80-metre long Bayeux-style tapestry telling the story of seasons 1-7, which has seen by 100,000 visitors. The current Game of Thrones campaign is building off the success of the 2016 'Door of Thrones' campaign which was seen by 126 million people.[7]

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[1] http://media.unwto.org/press-release/2018-01-15/2017-international-tourism-results-highest-seven-years

[2] Department for the Economy, Economy 2030: A consultation on an Industrial Strategy for Northern Ireland (Belfast: Department for the Economy, 2017). https://www.economy-ni.gov.uk/sites/default/files/consultations/economy/industrial-strategy-ni-consultation-document.pdf

[3] NISRA, *Northern Ireland Annual Hotel Occupancy Survey 2016* (Belfast: NISRA, 2017). https://www.nisra.gov.uk/sites/nisra.gov.uk/files/publications/Northern-Ireland-Annual-Hotel-Occupancy-Survey-2016.pdf

[4] Tourism Ireland and Tourism NI, *Safeguarding and Growing the Northern Ireland Tourism Economy 2017* (Dublin: Tourism Ireland, 2017).

[5] https://www.lonelyplanet.com/northern-ireland/belfast-the-causeway-coast

[6] https://www.tourismireland.com/Press-Releases/2017/October/Lonely-Planet-declares-Belfast-and-the-Causeway-Co

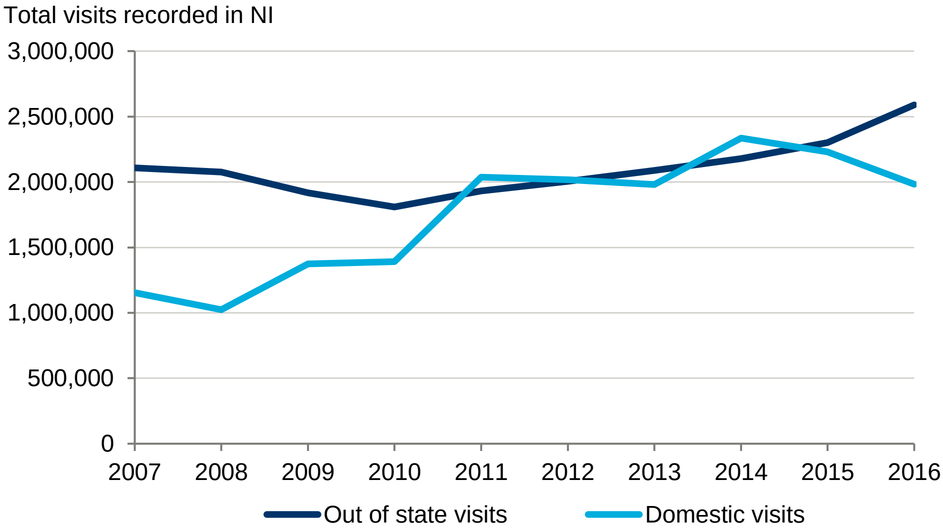
[7] https://tourismni.com/Grow-Your-Business/game-of-thrones/game-of-thrones-campaigns/

Recent record breaking figures have come on the back of significant recent growth. From 2011 to 2016:

- overnight expenditure has grown by almost a third;
- the number of trips grew by 15.3%;
- holiday trips grew by nearly a fifth, while business trips grew by 12.1%;
- the out of state tourism sector, all visitors from outside Northern Ireland, has been driving growth and now account for over half the number of external trips (56.6 percent); and
- trips made by visitors outside GB and the Republic of Ireland grew by just over a third, while their expenditure grew by 32.5%.

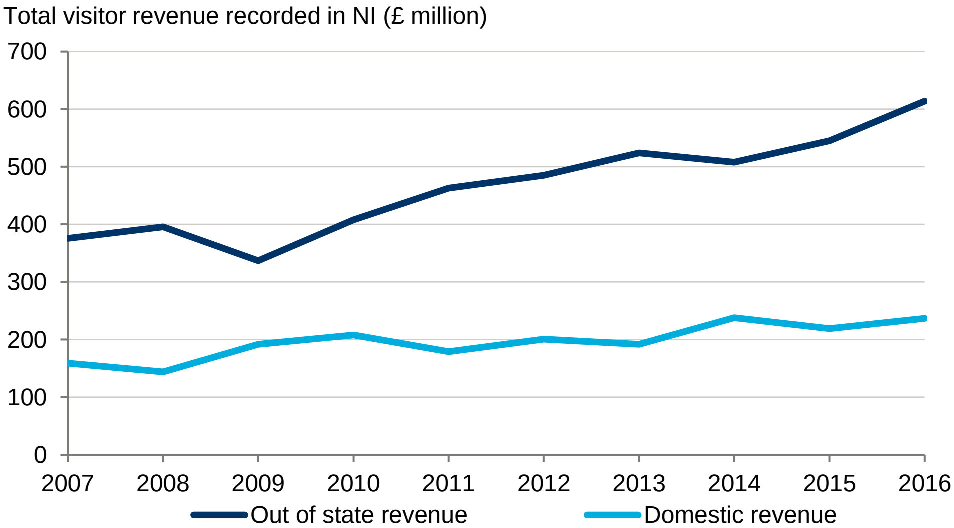
The latest data from NISRA suggested that out of state visitor revenue accounted for 72.2 percent of the £851m total visitor revenue in 2016.

Fig. 1. Total visits to NI, 2007 to 2016



Source: NISRA, Tourism NI, Failte Irleand, CSO

Fig. 2. Total visitor expenditure, 2007 to 2016



Source: NISRA, Tourism NI, Failte Irleand, CSO

Growth has been supported by investment and development of tourist sites and hotels. The Causeway Coast, NI's leading attraction, opened a new centre in 2012 worth £18.5m after the previous centre burnt down in 2000.[8] Titanic Belfast opened in 2012, a £97m development that includes 9 galleries and a museum.[9] Over £16,000 was spent to open a new Carrick-a-Rede rope bridge in 2008.[10] The Ulster Museum reopened in 2009 after a 3-year refurbishment that cost £17m.[11] These four attractions collectively were visited by over 2.5 million people in 2016.[12] Indeed, the top ten visitor attractions have seen growth of 9 percent in visitor numbers between 2012-2016.[13]

Fig. 3. Tourist attractions' visitor numbers 2012-2016, (000s)

	2012	2016
Giant's Causeway	531	944
Titanic Belfast	665	667
Top ten attractions total	3,936	4,291

Source: NISRA

This growth in trips and visitors has been supported by an increase in hotel capacity. The number of hotel rooms in NI has increased by 91 percent since 1998 from 4,903 rooms to 8,577 rooms.[14] In recent years £0.6billion has been spent on building new hotels and improving existing hotels.[15] Investment in the sector is likely to continue. Indeed, planned investment in Belfast alone will result in a 36 percent increase in hotel bedroom stock by 2019.[16]

Such is the growth in tourism in NI, that despite the increase in hotel bed space, there has been an upward trend in room and bed space occupancy. From 2011 to 2016 room occupancy increased from 57 percent to 70 percent and bed-space occupancy increased from 42 percent to 54 percent.[3]

[8] https://www.telegraph.co.uk/travel/destinations/europe/united-kingdom/northern-ireland/articles/Giants-Causeway-visitor-centre-opens/
[9] https://www.ft.com/content/cf145642-ce80-11e2-8e16-00144feab7de
[10] http://causewaycoastaonb.ccght.org/carrick-a-rede-rope-bridge/
[11] http://news.bbc.co.uk/1/hi/northern_ireland/8316550.stm
[12] NISRA, *Northern Ireland Annual Tourism Statistics 2016* (Belfast: NISRA, 2017). https://www.nisra.gov.uk/sites/nisra.gov.uk/files/publications/2016-Annual-Publication_0.pdf
[13] NISRA, *Northern Ireland Tourism Statistics 2012* (Belfast: NISRA, 2013). https://www.nisra.gov.uk/sites/nisra.gov.uk/files/publications/Northern-Ireland-Annual-Tourism-Statistics-2012_1.pdf
[14] https://www.belfasttelegraph.co.uk/business/northern-ireland/hotel-room-stock-up-by-91-since-good-friday-agreement-with-more-openings-this-year-36775474.html
[15] ONS, *The regional value of tourism in the UK: 2013* (Newport: ONS, 2016). https://www.ons.gov.uk/peoplepopulationandcommunity/leisureandtourism/articles/theregionalvalueoftourismintheuk/2013
[16] https://www.savills.co.uk/insight-and-opinion/savills-news/225646-0/over-1-200-hotel-bedrooms-planned-for-belfast-by-2019

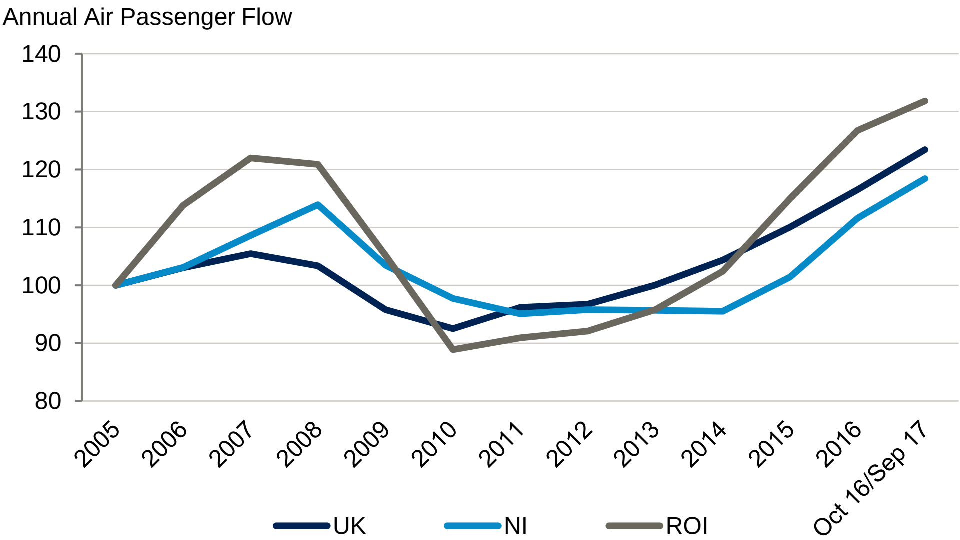
Fig. 4. Hotel occupancy rates, 2016

	Room occupancy	Bed occupancy
Northern Ireland	70%	54%
United Kingdom	61%	46%
Republic of Ireland	72%	55%

Sources: Fáilte Ireland, NISRA, VisitBritain

Growth has also been enabled by better access. According to NISRA, 69 percent of visitors to NI arrive via airplane, and this has been supported by an increase in direct routes which has subsequently enabled passenger numbers to have grown considerably. By 2015 NI airports offered direct flights to a record of 57 destinations worldwide.[17] With the additional routes, air passenger numbers grew by 1.3m from 2005 to 8.6m recorded from October 2016 to November 2017 (an 18.4 percent increase).

Fig. 5. **Annual air passenger flows (2005=100)**



Source: NISRA

In addition, there has also been a surge in cruise ships docking in NI's ports. In 2011 32 cruise ships brought 58,000 passengers to our ports by 2016 this had increased to 93 cruise ships with 152,000 passengers.[12]

2.3 ROOM FOR IMPROVEMENT

Yet growth in the tourism sector has been from a low base. On many measures, the region is underperforming. In 2016 less than 30 percent of external visitors to Northern Ireland came from outside the UK and ROI.[18]

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[17] Tourism Northern Ireland, *Access into Northern Ireland: Summer 2015* (Belfast: Tourism Northern Ireland, 2015). https://tourismni.com/globalassets/facts-and-figures/research-reports/access-into-ni/air--sea-access-ni-summer-2015.pdf

[18] NISRA, *External Overnight Trips to Northern Ireland 2016* (Belfast: NISRA, 2017). https://www.nisra.gov.uk/publications/external-overnight-trips-northern-ireland-publications

Whereas in the Republic of Ireland 51 percent of external visitors in 2016 came from countries outside the UK.[19]

Fig. 6. Origin of external visitors to Northern Ireland, 2016

Origin of external overnight trips	2016
England	39.4%
Republic of Ireland	17.6%
Scotland	12.6%
USA	7.6%
Other Europe	4.9%
Other	2.9%
Germany	2.7%
France	2.4%
Canada	2.1%
Australia	2.0%
Wales	1.7%
Spain	1.6%
Netherlands	1.2%
Italy	1.0%
New Zealand	0.4%

Source: NISRA. Note that figures may not sum due to rounding.

The evidence shows that external visitors from outside the UK and ROI spend more during each trip. The average spend per trip by an external visitor from GB and ROI is £209, compared to £306 per trip for those outside the GB and ROI.[18]

[19] Fáilte Ireland, *Tourism Facts 2017: Preliminary* (Dublin: Fáilte Ireland, 2018). http://www.failteireland.ie/FailteIreland/media/WebsiteStructure/Documents/3_Research_Insights/5_International_Tourism_Trends/Failte-Ireland-s-Tourism-Facts-2017-preliminary.pdf?ext=.pdf

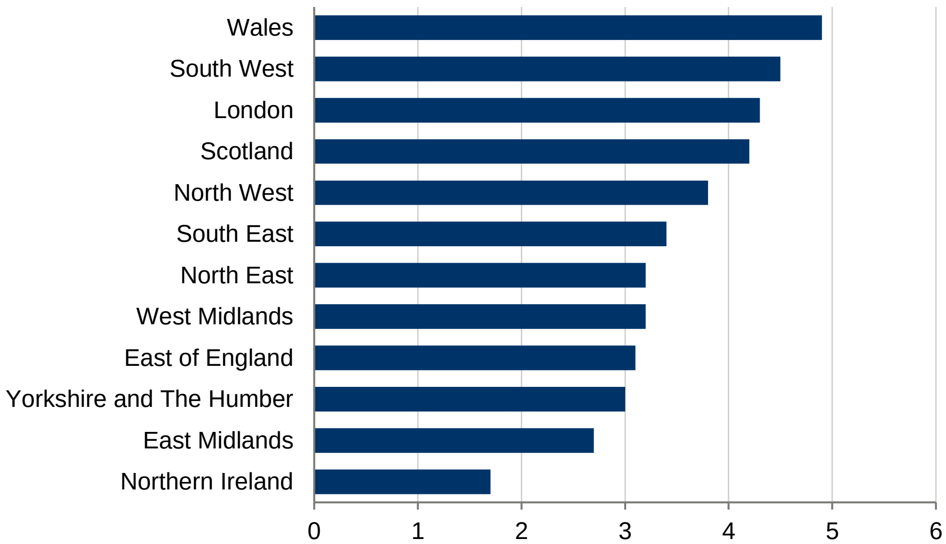
Fig. 7. Average length of stay and spend by origin of visitors to Northern Ireland, 2016

Origin of visitors	Average nights stayed	Average spend per trip (£)
Spain	10.3	231.7
France	7.2	227.8
New Zealand	6.9	239.1
Other	6.8	397.9
Australia	6.8	360.3
Canada	6.7	386.0
Other Europe	6.3	308.9
USA	5.7	322.3
Netherlands	5.6	308.8
Germany	5.5	221.5
Wales	4.3	252.4
Italy	4.2	200.9
England	4.1	228.7
Scotland	3.9	219.2
Republic of Ireland	2.2	154.1

Source: NISRA

ONS publications show that within a UK context, the contribution of the tourism sector in economy is below average in Northern Ireland. Their estimates of the tourism ratio (a good measure of the economic importance of the tourism sector within regions) shows the proportion of the output of all industries in a region that is attributable to tourism expenditure. They found that in 2013 (the most recent estimate contained in their 2016 publication), Northern Ireland's tourism ratio was not only the lowest of all UK regions, it was at least half that experienced in 6 of the other 11 regions.[15]

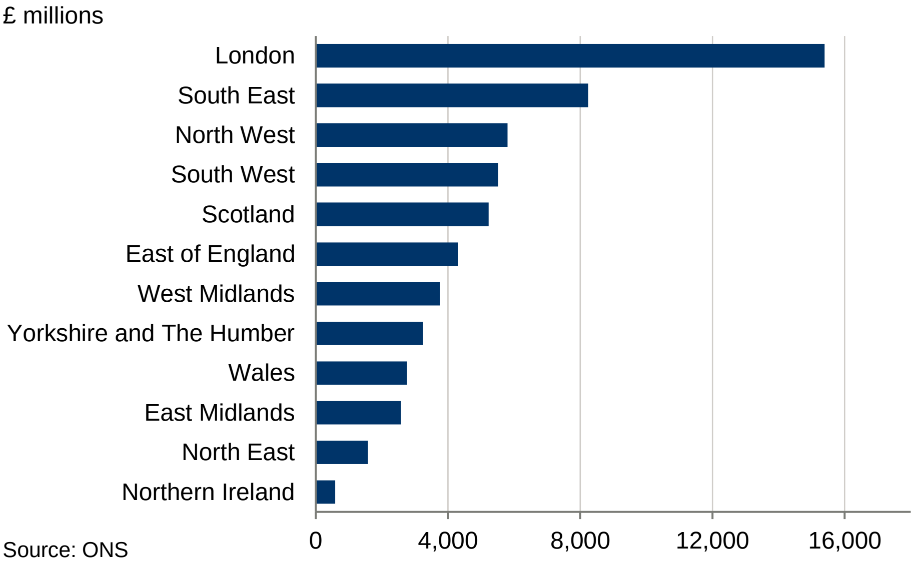
Fig. 8. UK regions tourism ratios, 2013



Source: ONS

In monetary terms, the value of tourism related GVA was also the lowest. In 2013, Northern Ireland had the lowest tourism direct GVA (£595 million), two-and-a-half times lower than the second lowest, the North East (£1.58 billion).[20]

Fig. 9. UK regions tourism direct gross value added, 2013



Source: ONS

In addition, Visit Britain's estimates of the economic contribution of the UK tourism sector were significantly larger than those for NI earlier. They found tourism accounted for 9 percent of GDP and 9.6 percent of UK jobs in 2013. This was forecast to increase to 9.9 percent of GDP and 11 percent of employment by 2025.[21] Furthermore, the World Travel and Tourism Council (WTTC) estimate that for the Republic of Ireland the sector accounted for 5.8 percent of GDP in 2016 and is forecast to rise to 6.6 percent of GDP in 2027.[22]

It is also worth noting that despite strong growth in passenger flows and record high performance in Northern Ireland, both the UK and the Republic of Ireland have grown much faster, 23.4 percent and 31.8 percent respectively over the period 2005 to November 2017. In addition, while Northern Ireland is due to lose its only direct flight to the US, Dublin Airport supported 4.3 million long-haul passenger journeys in 2017, an increase of 19 percent on the previous year[23], while from June 2018, Hainan Airlines will operate 4 flights a week between Dublin and Beijing (two of which will be non-stop and two will have a stopover in Edinburgh).[24] Evidence provided by Hospitality Ulster suggests that total passenger throughput for Dublin Airport has increased by 11 million since

[20] ONS, *Overseas travel and tourism quarterly* (Newport: ONS, 2018). https://www.ons.gov.uk/peoplepopulationandcommunity/leisureandtourism/datasets/overseastravelandtourism

[21] https://www.visitbritain.org/visitor-economy-facts

[22] World Travel & Tourism Council, *Travel & Tourism Economic Impact 2017: Ireland* (London: World Travel & Tourism Council, 2017).

[23] Dublin Airport Authority, *Annual Report 2017* (Dublin: Dublin Airport Authority, 2018). http://issuu.com/daapublishing/docs/daa_annual_report_2017?e=5056106/60531841

[24] https://www.irishtimes.com/business/transport-and-tourism/hainan-airlines-to-start-first-direct-beijing-to-dublin-flight-1.3427454

2010, an increase almost seven times larger than across the equivalent period for the three airports in NI collectively (1.6 million).

Furthermore, while air passenger flows have grown, there has been a fall in tourist activity at NI's ports and there has been a steady decline in the number of non-freight vehicles. In 1999, 657,755 vehicles passed through NI's ports, by 2016 this had declined by almost a third to 458,664 [25].

2.4 OUTLOOK AND RISKS

Despite the sector underperforming, it has been identified as a key growth sector for Northern Ireland, and for its local economies. It therefore features prominently in development strategies.

In the Department for the economy's draft industrial strategy "Economy 2030 vision"[2], there is an aspiration to reach £1 billion in external visitor revenue spend by 2025. To achieve this ambitious target growth per annum in external visitor revenue will have to increase from 4.9 percent per annum during 2005-2016 to 5.6 percent per annum in 2016-2025.[15]

Another aim of the draft tourism strategy is to reach £1 billion in total (domestic and external) visitor revenue by 2020. This target should be easier to attain as it requires growth in visitor revenue of 4.1 percent per annum during 2016-2020 and growth has been running at 5.0 percent per annum during 2005-2016. [15]

NI's councils have built in national strategies to their local plans. Six of NI's councils have a tourism strategy and the other five have made tourism a major part of their local development plans.

[25] NISRA, *Northern Ireland Ports Traffic 2016* (Belfast: NISRA, 2017). https://www.nisra.gov.uk/sites/nisra.gov.uk/files/publications/ports-2016-publication.pdf

Fig. 10. NI councils' tourism strategies

Council	Aim	Method
ABC	10% annual growth in tourism economy	Targeting mature cosmopolitans and culturally curious
Antrim and Newtownabbey	Tourism is one of the eight points in the council's economic development report	One of the aims of the plan is marketing the council's leisure facilities for tourists in the council and also for tourists in Belfast
Ards and North Down	Increase share of NI tourism economy from 6% to 10% by 2030	Increase awareness of a unique destination and lengthen visits made to the council
Belfast	Double value of tourism by 2020	Achieved through managing reputation, building capacity and developing the city's offer
Causeway Coast and Glens	3% growth per annum in overnight spend, 3% growth per annum in overnight visitor spend and 2% annual growth in visitor numbers	Working on gaps in the market such as lack of luxury accommodation and market failures sure as transport
Derry and Strabane	Tourism will be one of the economy's key drivers	Secure international recognition - European capital of culture and UNESCO creative cities network
Fermanagh and Omagh	5% annual growth in tourism value	Increase marketing and visibility. Develop the tourism product.
LCCC	One of the Council's strategic objectives is promoting sustainable tourism	Promoting and marketing Hillsborough Castle. Promoting the Lagan navigation area.
Mid and East Antrim	Developing tourism to help sustainable growth in NI	Ensure our significant tourism assets are developed, packaged and well marketed to local, national and international visitors.
Mid Ulster	Grow the visitor economy to £50m by 2021	Develop 3 our key tourist attractions Seamus Heaney, archaeological sites and outdoor activities
Newry, Mourne and Down	Assisting NI's goal of achieving 6% annual growth in overnight expenditure	Delivering "EPIC" moments with unique cultural and historical offering

Source: Information taken from each council's tourism strategy or local development plan

Northern Ireland's tourism industry is forecast to grow steadily over the next decade. Tourism Ireland forecasts show that NI visitor nights from all destinations are expected to grow by 2.8 percent per annum from 2018 to 2028, with all key markets experiencing growth rates of between 2 percent for the US up to 7.5 percent for Australia. Revenue to NI from external visitors is forecast to grow by 5.3 percent over the period. Growth in revenue is forecast in all key markets with the US experiencing the slowest growth of 3.4 percent and Australia the fastest at an estimated 9.4 percent.

Fig. 11. Visitors to NI nights length of stay and revenue forecast

Source: Touism Ireland

The composition of visitor origin is forecast to change with growth in mainland Europe and other areas, reducing primarily the share of GB visitors.

Fig. 12. Origin of visitors to NI

Origin of visitors to NI	2018 Share	2030 Share	Change in share
Great Britain	62.5%	57.1%	-5.5%
Mainland Europe	17.7%	20.3%	2.6%
North America	12.5%	12.2%	-0.2%
Other Areas	7.3%	10.4%	3.1%

Source: Tourism Ireland

There is a real opportunity here. In 2016, external visitors spent on average 60 percent less in Northern Ireland[18] than they did in Great Britain[20]. This can be partially attributed to a lower average duration of stay in NI. In 2016 the average length of overnight stays in the UK and Republic of Ireland were 6.1[26] and 6.9[27] days respectively, compared to just 4.4 days[28] in NI.[18]

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[26] ONS, *Travel trends estimates: overseas residents in the UK* (Newport: ONS, 2017). https://www.ons.gov.uk/peoplepopulationandcommunity/leisureandtourism/datasets/overseasresidentsvisitstothe uk

[27] CSO, Tourism and Travel Quarter 1 2017 (Dublin: CSO, 2017). https://www.cso.ie/en/releasesandpublications/er/tt/tourismandtravelquarter12017/

[28] This figure is derived by dividing the number of nights by external visitors (Table 4) by the number of external overnight trips (Table 3).

Fig. 13. Average spend per trip by overseas visitors (£)

Average external visitor spend	2013	2014	2015	2016
UK	650.2	635.6	611.2	599.4
ROI	385.8	392.5	425.0	503.6
NI	250.6	232.9	236.7	237.0

Sources: ONS, Fáilte Ireland, NISRA

There are risks to the outlook. The UK's decision to leave the EU will have implications for the tourism sector. Tourism Ireland states that *"any impediment that affects the seamlessness, or perceived seamlessness of being able to access both jurisdictions on the island of Ireland has the potential to seriously impact the achievement of the Executive's objective of creating a £1bn export tourism industry by 2025."*[4] Michael Barnier stated this year a UK exit from the single market and customs union would make a hard border "unavoidable"[29].

In addition, there is a correlation between tourism performance and exchange rates (see Fig. 14 later). Any appreciation of the pound (which we expect over the short term) will make Northern Ireland more expensive relative to the Republic of Ireland and other locations.

[29] http://www.bbc.co.uk/news/uk-northern-ireland-43001845

3. RESPONDING TO THE CALL FOR EVIDENCE

In this section we draw on existing evidence to provide a response to each question in the call for evidence. We also draw on consultee evidence that was gathered by Oxford Economics during sectoral workshops and individual calls.

3.1 QUESTION 1: WHAT EVIDENCE IS THERE THAT DEMONSTRATES THE IMPACT OF VAT AND APD ON THE TOURISM SECTOR?

There are a number of studies on the impact of VAT and APD on tourism. We distil this evidence below, starting with the impacts of VAT and ending with APD.

3.1.1 VAT

In general, the evidence suggests that VAT cuts are typically passed on to consumers through reduced prices. As prices fall, demand for goods and services increases. The resulting expansion of output and turnover in the sector then boosts wages and creates or sustains employment. The 'multiplier effect' of additional economic activity is felt throughout the economy through supply chain spending (known as 'indirect effects') and increased spending by those employed in tourism and those in the supply chain ('induced effects'). Of course, tourism is also unique in that the additional spending or demand that is leveraged from lower prices, is new to the region (i.e. it is similar to export sales).

A study by the Campaign for Reduced Tourism VAT (2018a) argued that higher rates of VAT mean that NI loses out to tourism activity from the Republic of Ireland.[30] This was echoed by a study by Oxford Economics (2013) which argued that higher VAT rates in NI relative to the Republic of Ireland meant hotels had higher operating costs, which in turn were inevitably passed on to consumers.[31]

The Oxford Economics (2013) report however suggests that the price elasticity of demand for hotels is relatively elastic, with a 10 percent reduction in price generating a 20 to 25 percent increase in demand. So, a VAT cut could improve the affordability of hotels in NI (we show later that there is evidence that VAT cuts tend to get passed through to consumers), resulting in a range of possible benefits including additional visits, longer average visits, or some combination of the two. It may also encourage visitors to upgrade their accommodation and/or increase spending elsewhere in the economy.

The Oxford Economics (2013) report estimated a VAT cut on hotel accommodation to 5 percent in NI would generate an additional 2,000 full-time equivalent jobs in the domestic hotel industry by 2020, with a cumulative GVA

[30] Cut Tourism VAT, *The economic impact of reduced VAT on visitor accommodation and visitor attractions in Northern Ireland* (London: Tourism Respect & Nevin Associates Ltd, 2018).
[31] Oxford Economics, *Economic Contribution of the Hotel Industry in Northern Ireland* (London: Oxford Economics, 2013).

impact of £75m between 2013 to 2020. By contrast, the impact of not cutting VAT over this period is estimated to cost the NI economy £128m, of which £75m is realised in the hotel sector alone.

A study undertaken by Indecon (2017) on behalf of Fáilte Ireland measured the impact of VAT reductions in the tourism sector and noted that from 2011 Ireland enjoyed growth in overseas trips to Ireland by non-residents, employment growth in tourism-related sectors and improved visitors' perceptions of value for money.[32] They also identified a positive employment effect, with 4,800 (or 13 percent) of the 38,400 additional jobs in tourism-related sectors since VAT reductions were due to the policy.

3.1.2 APD

There is differing evidence on the net economic impact of changes to APD. A 2013 study by PricewaterhouseCoopers (PwC) looked at the impact of abolishing APD in the UK.[33] While not concerning the tourism sector alone, it provides an overview of the economic impact of such a policy across the economy. The report identified several positive economic outcomes. It estimates that abolishing APD would provide an initial short-term boost in UK GDP of 0.45 percent in the first year, while averaging 0.3 percent per annum over the first three years. This increase in output is associated with an overall increase in investment and exports of 6 percent and 5 percent respectively over this period. It would further provide the potential for almost 60,000 additional jobs across the UK over the period from 2013 to 2020.

However, this evidence is contradicted by a subsequent 2014 study by the Northern Ireland Centre for Economic Policy (NICEP).[34] This study estimates an overall negative net impact on the economic value of tourism following a reduction in APD. The overall long-term impact is estimated to equate to £2.7 million and £5.4 million for a 50 percent reduction and total abolition in 2026 respectively (in 2014 prices).

3.2 QUESTION 2: WHAT EVIDENCE IS THERE THAT COST IS A SIGNIFICANT FACTOR TO TOURISTS CONSIDERING VISITING NORTHERN IRELAND? WHAT PROPORTION OF THE COST OF A HOLIDAY IN NORTHERN IRELAND IS MADE UP OF VAT AND APD? HOW MUCH DOES THE COST OF A HOLIDAY IN NORTHERN IRELAND DIFFER FROM OTHER PARTS OF THE UK, AND FROM OTHER PARTS OF THE ISLAND OF IRELAND?

There is a wealth of evidence that cost plays a significant role in tourists decision making. In the response to Question 1 we showed how the evidence

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32 Indecon, *Impact of the VAT Reduction on Irish Tourism and Tourism Employment* (Dublin: Fáilte Ireland, 2017).

33 PricewaterhouseCoopers, *The economic impact of Air Passenger Duty: A study by PwC* (London: PricewaterhouseCoopers, 2013).

34 Northern Ireland Centre for Economic Policy, *Air Connectivity in Northern Ireland: The economic impact of changes to air fares and short-haul Air Passenger Duty* (Belfast: University of Ulster, 2014).

suggests that the price elasticity of demand for hotels is relatively elastic. In other words, tourists are sensitive to the price of hotels.

This reinforced by the findings of Masiero & Nicolau (2012a)[35] who conclude that *"the results of the empirical application show that the demand for tourist activities is that of ordinary goods insofar as price increases diminish consumption."* They have found the same result in other studies.[36]

The most recent Tourism Industry Barometer from Tourism NI (December 2017) presents the results of a tourism business survey in NI.[37] The result of the survey show that costs are perceived to be a key factor in recent success and a cause for concern for NI tourism businesses. For example, more than one in five tourism related businesses in NI (22 percent) cited favourable exchange rates as having a positive effect on their business in 2017 as it made NI a less expensive destination for tourists from the Republic of Ireland, the rest of Europe and further afield than it has been in recent years.

When asked for their concerns for the rest of the year costs and competition were key concerns. Over one quarter of tourism businesses surveyed quoted rising prices for goods and services, a fifth (19 percent) reported competition from other destinations, 17 percent stated unfavourable exchange rates, whilst 15 percent cited insurance costs as issues of concern for their business in 2017. Looking further ahead, around one in seven cited the rising price of goods and services (17 percent), whilst the same number (17 percent) mentioned unfavourable exchange rates as concerns for the future.

Tourism Economics[38] forecast international tourism flows based on demand (the origin of trips) and supply (destination visits) for almost 190 global markets. To demonstrate the importance of price in generating tourism demand, their modelling process features exchange rates as a key driver of spending power. As presented in Fig. 14 below, exchange rates are closely related to tourism spending. As the value of domestic currency appreciates, this increases the relative spending power of domestic consumers elsewhere, thus boosting demand for visits abroad. An example of this is demonstrated by the increase in tourists visiting the UK following the recent depreciation of the pound.[39] Similarly, according to a VisitBritain survey, a favourable exchange rate is more likely to have a positive impact on both business (55 percent) and leisure (40 percent) visitors.[40]

[35] Masiero, L. and Nicolau, J., *Price sensitivity to tourism activities: looking for determinant factors* (Lugano: Tourism Economics, 2012).

[36] Masiero, L. and Nicolau, J., *Tourism Market Segmentation Based on Price* (Lugano: Journal of Travel Research, 2012).

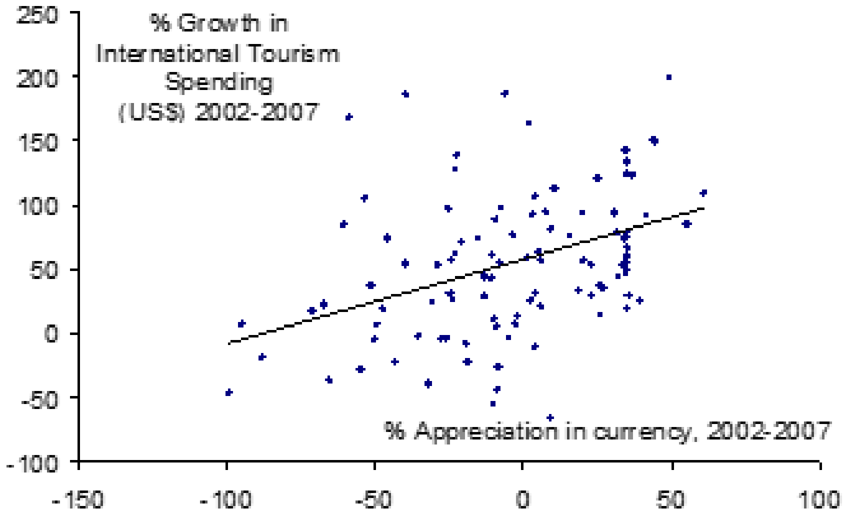
[37] Tourism Northern Ireland, *NI Tourism Industry Barometer December 2017 – At a Glance* (Belfast: Tourism Northern Ireland, 2018). https://tourismni.com/globalassets/facts-and-figures/research-reports/tourism-performance-statistics/tourism-industry-barometer/tourism-industry-barometer-at-a-glance-dec-2017.pdf

[38] A sister company of Oxford Economics.

[39] http://www.bbc.co.uk/news/business-40972840

[40] VisitBritain Research, *Impact of exchange rate on tourism to Britain: Foresight – issue 147* (London: VisitBritain, 2017). https://www.visitbritain.org/sites/default/files/vb-corporate/Documents-Library/documents/foresight_147_-_impact_of_exchange_rates_nbi_v2.pdf

Fig. 14. An example of the relationship between exchange rates and tourism spending



Source : Tourism Economics, IMF

3.3 QUESTION 3: ARE THERE ADDITIONAL CHALLENGES, UNIQUE TO THE TOURISM INDUSTRY IN NORTHERN IRELAND, WHICH MIGHT BE ADDRESSED THROUGH VAT OR APD CHANGES?

The land border with the Republic of Ireland, close proximity to Dublin Airport and substitutability between holidaying in Southern Ireland and holidaying in NI results in a number of challenges that are unique to NI.

3.3.1 APD and connecting travel

A common theme regarding the impact of APD is that it enables Dublin Airport to capture a disproportionately large share of traffic. This is the case for both outbound and inbound journeys; approximately one million journeys are made via Dublin by NI residents each year, while conversely a million visitors to NI land in the island of Ireland via Dublin. There are generally felt to be two related reasons for this: Dublin has a greater range of destinations, while APD acts as a disincentive to travel directly to and from NI (or via other locations in the UK). We consider each of these causes below.

While APD on long-haul travel is exempt from NI airports, in practice very few journeys are available. Further, consultees indicate that short haul travel from NI's airports have a heavy focus on the domestic market, with 75 percent of journeys serving the domestic market. Analysis by the Irish Central Statistics Office shows that the top ten most popular air routes to NI in 2014 were all domestic flights.[41] By contrast, a broader range of destinations are available from Dublin Airport; according to the Dublin Airport Authority, 41 airlines operated flights across 176 destinations in 2017.[23] The abolition of the Air Travel Tax in 2014 may have enabled airports in the Republic of Ireland a first-mover advantage in this regard. Residents of NI are therefore attracted to

[41] CSO and NISRA, *Visitors to Ireland and Northern Ireland 2014: A Statistical Profile of Tourism* (Dublin: CSO, 2016). http://cso.ie/en/media/csoie/releasespublications/documents/tourismtravel/2014/Northsouth2014.pdf

Dublin Airport in part by the ability to travel directly to certain destinations; conversely, the most feasible way for tourists visiting the island of Ireland (or NI more specifically) from these locations may be via a direct connection from Dublin.

Coupled with the broader range of connections available, the propensity to use Dublin Airport may be due in part to APD. Flights to and from Dublin, which do not bear this tax, may be more price competitive than their equivalent directly to NI, or indirectly via other UK airports. The relative demand for flights from Dublin may explain in part why relatively few direct connections are available from NI airports.[42]

The cost incurred by travelling via a UK airport is exacerbated by APD being levied twice (essentially a 'double tax'). It is noted that 75 percent of air traffic to NI airports is domestic. While APD is only levied on flights leaving UK airports, this is applied to both inbound and outbound flights as part of domestic travel.

APD may also be applied twice on a single journey for flights that connect via hub airports elsewhere in the UK. It is noted that there are some exceptions for connecting flights.[43] For example, a domestic connection (e.g. from abroad to Heathrow, then on to a NI airport), subject to the time of arrival in the UK[44], is exempt from APD as the first flight has departed from outside the UK. Similarly, where a connecting flight is international (e.g. from a NI airport to Heathrow, then abroad), and onward travel is within 24 hours of the arrival of the first flight, APD is applied only to the latter flight. However, if the next leg of a journey falls outside of these timescales, or travel is not undertaken on the same or a conjunction ticket, a traveller will incur APD twice.

In summary, APD reduces the price competitiveness of NI airports relative to Dublin. Alongside other factors, this enables Dublin Airport to offer a wider range of destinations for both short and long-haul travel. APD also acts as a 'double-tax' on domestic travel and provides disincentive to travel directly to a NI airport via a UK hub airport from abroad. This further attracts customers to Dublin Airport who would otherwise travel via NI airports. Consultees indicate that cuts to APD may alleviate both problems; it increases the relative affordability of travel via NI airports – either directly or from hubs elsewhere in the UK – while boosting demand may encourage airlines serving these airports to increase capacity and open up new routes.

3.3.2 Changes to APD

The effectiveness of reductions to/abolition of APD on short-haul flights will be largely determined by the reactions of airlines. A commitment by operators in NI to opening up new routes/passing on the benefit to passengers is likely to be beneficial in garnering political support for such a measure.

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[42] Although it is acknowledged that other factors, such as airport size and capacity, are also relevant factors.

[43] https://www.gov.uk/guidance/air-passenger-duty-and-connected-flights

[44] Required departure times are conditional on the arrival time of the first flight: if midnight to 4am, at or before 10am the same day; if from 4am to 5pm, within 6 hours of the scheduled arrival; and from 5pm to midnight, at or before 10am the following day.

In measuring the impact of reducing APD, the government should pay regard to the cyclical nature of airline planning decisions. According to our consultation exercise, airlines typically plan on a 9 to 12-month basis. The response to such a policy is therefore likely to be delayed, which should be taken into consideration in monitoring its effectiveness.

Consultees point to the example of the Republic of Ireland, where the abolition of the Air Travel Tax has led to considerable growth in capacity, with airlines responding by opening new routes. However, other factors have also contributed to supporting this growth. An incentive scheme that removes charges for using airports above a certain number of passengers is cited as key in this regard. Further, there may have been a political onus for the main carriers (Ryanair, Aer Lingus) to pass on the benefits of such a tax cut to consumers; NI does not have an equivalent 'native' airline, and so airlines currently operating at its airports may not be as invested in the success of such a policy.

3.3.3 VAT and competition with the Republic of Ireland

Tourism is promoted on an all-island basis in Ireland which means there could be a degree of substitutability between tourism activity across the two jurisdictions. Given a large number of visitors to the Island land via Dublin, there is intense competition for NI based firms to attract visitors north of the border. There is also the challenge of encouraging them to stay in NI, rather than to visit as part of an organised day trip. Intuitively, to maximise the benefits from visitors, NI needs to be able to encourage visitors to stay overnight, stay longer and therefore spend more in the region.

However, a common view held by consultees is that the lower VAT rate in the Republic of Ireland enables firms to gain a competitive advantage. Owing to the relative affordability of their services, Irish firms have the ability to generate greater profits, while remaining relatively price competitive with NI firms. Operators in the sector have indicates that this in turn would enable them to invest in improving the quality of their offer. With less of a tax burden it is therefore easier for Irish firms to retain external visitors and their spending to the detriment of NI.

We have already shown that tourism is a relatively price sensitive sector. The general view held by consultees reflects that, holding Dublin aside (where accommodation is particularly expensive, owing in part to a limited supply of hotel rooms), the prices elsewhere in the Republic of Ireland tend to be broadly comparable with Belfast. Hotels elsewhere in NI tend to be cheaper again in order to attract customers. This is particularly of concern in areas close to the border; for examples, hotels in Londonderry/Derry struggle to attract visitors to the city, as hotels within a few miles in the Republic of Ireland offer cheaper rooms, largely due to the VAT differential.

Anecdotally, the lower tax burden also helps firms in the Republic to offer more training to its workforce. By contrast, tourism-related firms in NI tend to operate at a lower margin, and do not benefit from the 'cushion' that firms in the Republic have in this regard.

3.3.4 Changes to VAT

Through our discussions with leading NI hoteliers and the NI Hotels Federation we understand that a reduction in VAT would be passed to the customer through lower prices. We have been informed that given the competition to secure bookings through international tour operators, the sector would have to pass the reduction on. However, this would be acceptable as it is widely thought that lower prices would lead to an increase in visitor numbers. Consequently, leading companies in the sector are willing to sign up to a charter where they would promise to pass a minimum share of a reduction in VAT through to customers, set aside the rest for refurbishment, and to create additional job opportunities.

3.3.5 Alternative approaches to implementing tax changes

Alongside a simple change to the rate at which VAT and/or APD are levied, a number of alternative approaches to changing these taxes have been suggested.

There may also be opportunities to trial both VAT and/or APD changes on a temporary basis, by building in a ‘sunset clause’ to this policy. This may reduce the risk of such a policy for the Treasury should the material benefits be lower than expected. Further, it in turn may offer an effective mechanism for ensuring the positive impacts of reductions to APD in particular are realised. With the knowledge that the benefits may be withdrawn, airlines may have a greater incentive to demonstrate that these benefits have been passed on to consumers, through reduced prices and the opening up of new routes.

It has been suggested that NI may be a suitable area to trial such a policy. Given its relatively small size, any changes to VAT would have limited impact on overall tax revenues, limiting the risk for the Exchequer. Further, as it is non-contiguous to the rest of the UK, the impact of the displacement of domestic firms from elsewhere may be relatively limited – especially if the tax amendment is only temporary. However, such a policy is unlikely to gain political support from relevant ministers in government should it require primary legislation. It is noted that, owing to existing pressures on Parliamentary time associated with Brexit-related Bills, ministers may not be willing to allocate time to such a policy, particularly if only temporary in nature.

3.4 QUESTION 4: WHAT IMPACT DO CURRENT VAT RELIEFS, EXEMPTIONS AND REFUNDS HAVE ON THE TOURISM INDUSTRY IN NORTHERN IRELAND? ARE THEY A SIGNIFICANT BENEFIT?

As set out in the call for evidence document, the UK VAT system includes several features which may benefit the tourism industry, including:

- *"several wide-ranging zero-rates of VAT, including for certain foodstuffs, public transport, books and magazines;*
- *an exemption on admission to cultural attractions managed by public bodies or not-for-profit organisations, this includes museums, galleries, art exhibitions and zoos;*
- *a VAT refund scheme for museums and galleries, allowing national and university museums and galleries to claim back VAT incurred on most goods and services purchased in order to grant free rights of admission to their collections;* and
- *the Tour Operators Margin Scheme (TOMS), which simplifies VAT accounting on travel supplies so businesses do not have to register and account for tax in each Member State where the services and goods are enjoyed."*

As most of these tax exemptions have been in place for a sustained period of time, the impact that they have on the NI tourism sector is difficult to isolate. However, when considering the overall composition of tourist spending, it is unlikely that these exemptions are likely to be of material consideration. While savings on some attractions and foodstuffs may provide some advantages, this typically constitutes a relatively low proportion of overall spending. These sources of spending are also unlikely to be the first thing potential visitors compare. Instead they are more likely to start by comparing the prices of flights and accommodation (given their relative share of the cost of a trip).

Although data on the profile of spending on goods and services by inbound tourists is not available, anecdotally we understand that goods where the full rate of VAT is applied – such as accommodation and restaurant meals – form the majority of a typical visitor's total spend. Thus, the increased cost resulting from the higher rate of VAT on these goods compared to the Republic of Ireland, effectively an additional 11 percent tax, is likely to exceed any positive impact of existing reliefs, exemptions and refunds.

3.5 QUESTION 5: WHAT IMPACT DO VAT AND APD HAVE ON PEOPLE CONSIDERING VISITING NORTHERN IRELAND FOR BUSINESS PURPOSES?

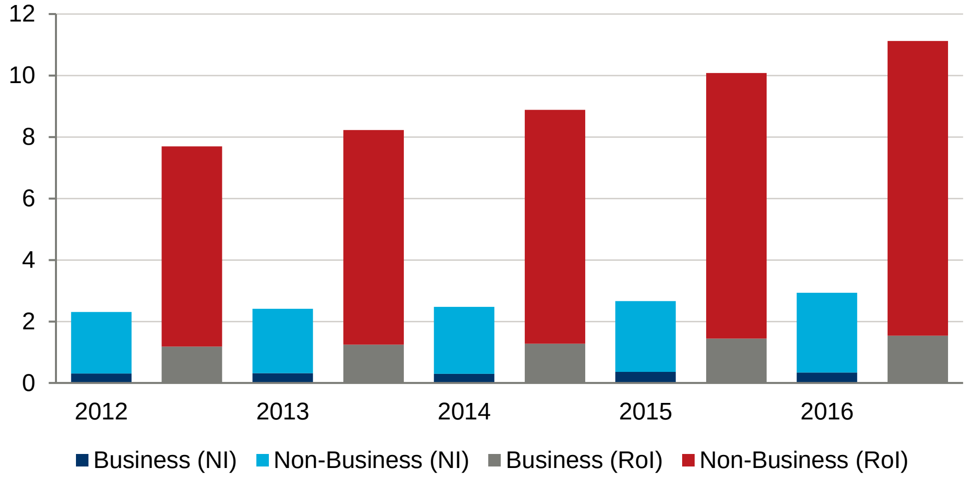
Tax reductions could increase the number of visits for business purposes. While VAT can be claimed back for business travel within the UK, many people booking business travel will do so through comparison websites which show gross prices (i.e. with tax). In other words, business travellers are not shown the cost exclusive of the tax they can claim back. Therefore, the higher rates of VAT may therefore deter some business journeys, although the overall impact of VAT is likely to be minimal.

APD however is not refundable, and therefore may adversely impact levels of business travel both to and from NI. This is particularly the case for intra-UK travel, where APD is charged twice on a return journey. Data from the NISRA shows that the 342,000 overnight business trips to NI in 2016 represented just 13 percent of all overnight visits. Although the number of business visits to NI have grown over this period, equivalent to 12 percent (or 38,000 additional visits), business travel contributed just 6 percent of all additional journeys to NI over this period (619,000 additional visits). By contrast, business visits in the

Republic of Ireland grew by 30 percent (357,000 additional visits), a rate over twice that of the NI equivalent.

Overnight trips to by reason of visit to Northern Ireland and the Republic of Ireland, 2012 to 2016

Overnight trips by reason for visit (millions)



Source: NISRA, CSO

However, it is noted that business travellers tend to be less price sensitive than tourists. As shown by the NICEP (2014), business travellers tend to be less price elastic than leisure travellers (discussed in more detail in the response to Question 13). The impact of reductions in APD, holding other factors constant, is less likely to encourage additional business journeys than for leisure visitors.

3.6 QUESTION 6: WHAT EVIDENCE IS THERE THAT CHANGES TO THE VAT RATE APPLIED TO TOURISM IN OTHER COUNTRIES HAS HAD A SIGNIFICANT IMPACT ON THE DEMAND FOR TOURISM IN THOSE COUNTRIES? WHAT EVIDENCE IS THERE TO SUGGEST THE REDUCED RATE OF VAT IN IRELAND HAS POSITIVELY OR NEGATIVELY AFFECTED TOURISM IN NORTHERN IRELAND? WHAT WAS THE IMPACT OF THE NORTHERN IRELAND ASSEMBLY'S 2012 DECISION TO SET A £0 APD RATE ON DIRECT LONG-HAUL FLIGHTS DEPARTING NORTHERN IRELAND?

3.6.1 Impact of reduced VAT in the Republic of Ireland

As part of the 2011 'Jobs Initiative', the Irish government set out a targeted reduction in the rate of VAT from 13.5 percent to 9 percent for a series of labour-intensive tourism sectors. According to research by the Department of Finance at the time of the policy, this measure was expected to reduce tax receipts by €350 million per year.[45] The reduced rate came into effect on the 1st July 2011 and was originally intended to expire on 31st December 2013,

[45] Brendan O'Connor, *Measuring the Impact of the Jobs Initiate: Was the VAT Reduction Passed On and Were Jobs Created?* (Dublin: Department of Finance, 2013).

although it is noted that tourism VAT remains at 9 percent at the time of writing.[46]

The Indecon (2017) study on behalf of Fáilte Ireland sought to measure the impact of this policy. The report notes a series of positive trends in this sector from 2011 onwards, including the number of overseas trips to Ireland by non-residents, employment growth in tourism-related sectors and visitors' perceptions of value for money. However, these may be driven by a variety of different factors, such as better economic conditions (both domestically and abroad), improvements in tourism provision and due to exchange rate fluctuations. These outcomes can therefore not be 100 percent attributed to the VAT cut alone.

This report also identifies a positive employment effect. It calculates that each 1 percent reduction in price is associated with a 1.2 percent increase in employment, holding other factors constant. This implies that 4,800 (or 13 percent) of the 38,400 additional direct jobs in tourism-related sectors since the introduction of this policy can be attributed to this policy. In testing the higher ranges of the pass-through rates detailed above, the estimated employment impact extends to 8,900 additional jobs (or 23 percent). While the 'additional' jobs growth forms a minority of overall increases in this sector, it is important to note that the reduction in VAT measured (by 4.5 percentage points) is under a third of that both proposed and modelled by both the Campaign to Cut Tourism VAT (2017, 2018) and Nevin Associates (2014)[47] studies (15 percentage points). If implemented, these greater VAT reductions may generate larger additional benefits.

The Indecon (2017) report also demonstrates that this policy had a negative overall impact on tax revenues. It calculates that the true gross costs are equivalent to €187 million per annum, well below the original €350 million estimate. It estimates that the impact on the Exchequer through revenues from additional tourist activity and the reduced costs of social welfare payments equate to approximately €53 million per year. However, this is offset once the shadow price of public funds is accounted for, which estimates the distortionary effects of the policy on the allocation of resources (equivalent to €55 million). Lower VAT rates may alter the incentives facing consumers[48], while similarly drawing in firms to these sectors who might operate more productively elsewhere in the economy. Neither Campaign to Cut Tourism VAT (2018a) nor Nevin Associates (2014) estimates appear to account for this social cost. Further, even excluding distortionary effects, the additional tax revenues generated account for under 30 percent of the cost of the policy, demonstrating a negative impact on revenues (equivalent to €132 million annually).

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[46] https://www.irishtimes.com/business/transport-and-tourism/budget-2018-relief-in-tourism-industry-as-9-vat-rate-maintained-1.3250739

[47] Nevin Associates, The fiscal impact of lower VAT rates on visitor accommodation and attractions in the United Kingdom (Edinburgh: Nevin Associates, 2014).

[48] A VAT cut effectively reduces the price of tourism goods and services. This may encourage consumers to purchase a greater proportion of these goods, relative to their existing preference, and by extension reduce consumption of goods they value more in other sectors.

3.6.2 Impact of the abolition of APD on long-haul flights from NI

APD on long-haul journeys (to qualifying countries over 2,000 miles) were abolished from Northern Ireland in January 2013.[49] There is limited information on the extent to which this has impacted the airline industry, in part due to the difficulty in isolating the impact of this policy from broader changes to the NI tourism sector.

The reduction of APD on long-haul flights was a policy response partly due to threats of removing Belfast International's single long-haul flight to New York Newark.[50] Analysis by the NICEP (2014) provides evidence that airlines responded to this change by adding additional long-haul routes, although the other contributing factors are not considered. It notes that in Summer 2013 there were seven weekly scheduled services to long-haul destinations (all in the United States). However, NI is due to lose its direct flights to the US. This suggests that, beyond an initial expansion, the abolition of long-haul APD has had little effect, although this may largely be explained by the growth in traffic from Dublin Airport.

Similarly, although APD continues to be levied on short-haul journeys, a majority of flights from NI airports tend to serve these destinations. Brian Ambrose, Chief Executive of Belfast City Airport[51], said in 2017 that *"while it [APD] is devolved for long-haul, 99 percent of our business is not long-haul, so it's not really making any great impact"*. The magnitude of impacts on airlines following the removal of APD on short-haul flights may not therefore be comparable to the impact of its abolition on long-haul equivalents.

3.7 QUESTION 7: WHAT IS THE COMPOSITION OF THE TOURISM INDUSTRY IN NORTHERN IRELAND? HOW HAVE THE INDIVIDUAL TOURISM RELATED SECTORS LISTED IN 4.1 PERFORMED IN RECENT YEARS?

It is not possible to isolate tourism related employment in NI given the difficulty of unpicking which parts of NI sectors service domestic demand, and by extension the share that services visitors. We can however look at the general performance of the sectors identified in the call for evidence. Fig. 15 below shows the change in full-time equivalent employee jobs from 2000 Q4 to 2017 Q4. Overall the tourism related sectors have grown at twice the pace of FTE employee jobs in the wider economy (32 percent vs 15.4 percent). Over half the growth (51.3 percent) was attributable to the 'food & beverage sector' with a further 6.2 percent of tourism related growth coming from 'accommodation'.

In addition, land transport accounted for nearly one quarter of the growth (24.7 percent). The sector includes passenger rail & other passenger land transport as well as non-tourism activity such as 'freight transport & transport via pipelines'.

[49] https://www.gov.uk/guidance/rates-and-allowances-for-air-passenger-duty
[50] http://www.travelweekly.co.uk/articles/38344/chancellor-slashes-apd-on-belfast-flights
[51] A member of Northern Ireland Tourism Alliance.

Fig. 15. FTE employee job growth, NI (2000 Q4 to 2017 Q4)

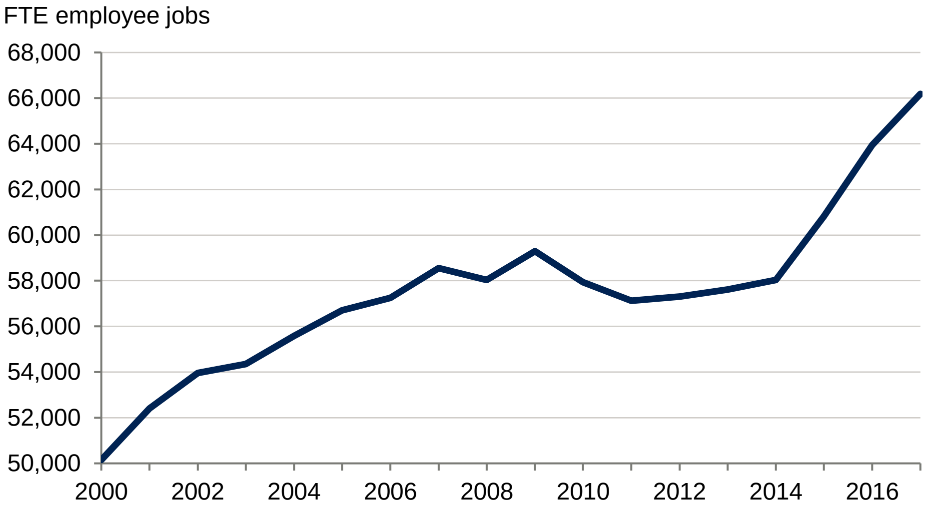
Sector	Number	%
Land transport & transport via pipelines	3,955	38.4%
Water transport	45	9.4%
Air transport	-155	-22.1%
Warehousing & support activities for transportation	1,385	44.5%
Accommodation	990	15.8%
Food & beverage service activities	8,220	40.0%
Travel agency, tour operator & other reservation service & related activities	-475	-32.8%
Creative, arts & entertainment activities	370	77.9%
Libraries, archives, museums & other cultural activities	-15	-0.8%
Sports activities & amusement and recreation activities	1,715	35.5%
Total tourism	**16,035**	**32.0%**
Total NI	**83,785**	**15.4%**

Source: NISRA

Despite the general growth in the sector, 'travel agency, tour operator & other reservation service & related activities', 'air transport' and 'libraries, archives, museums & other cultural activities' all declined over the period, losing 645 jobs.

The above masks three distinct phases of underlying growth in the tourism sector. From 2000 to 2007, the sector enjoyed year on growth in FTE employee jobs. However, the global financial crisis in 2008 brought a small contraction of 0.9 percent in FTE employee jobs. With the exception of 2009, this was the start of a seven-year period of contraction or limited growth in the sector. By 2014, FTE employee jobs in the tourism sector was still below that experienced in 2007. However, from 2014 to 2017 the sector has grown on average by 4.5 percent per annum, adding over 8,100 jobs (half the growth from 2000 to 2017).

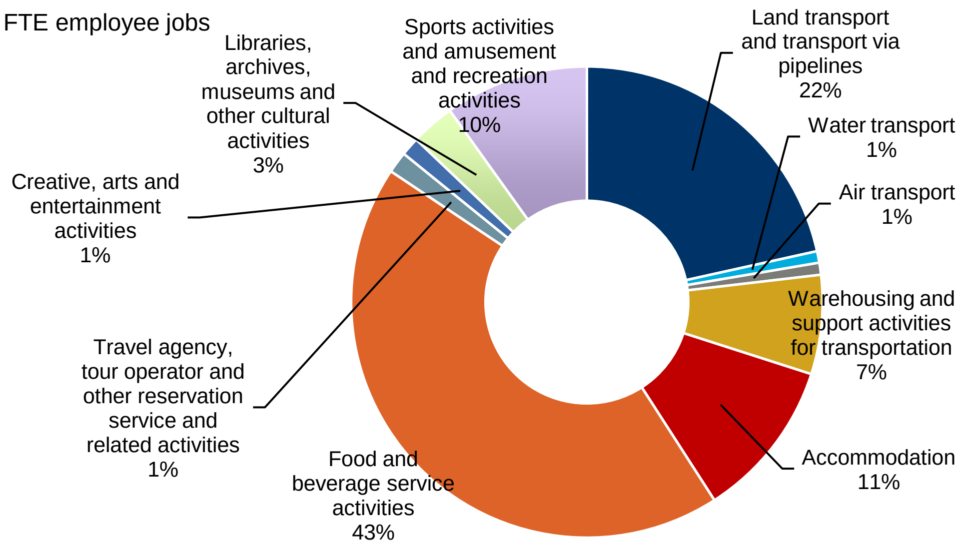
Fig. 16. FTE employee job growth in tourism related sectors, NI (2000 Q4 to 2017 Q4)



Source: NISRA

As of Q4 2017, the food and beverages sector and accommodation sector accounted for 54 percent of FTE employee jobs in these tourism related sectors. The NI Tourism Satellite Accounts (TSAs) provide an estimate of the share of the sectors that are tourism related. Unfortunately, the TSAs, are only available for 2004 and therefore are out of date. For example, we have already shown how the sector has grown in employment terms (and in visitor numbers, investment, choice etc), so the estimated tourism share of sectors in the TSAs may underestimate the true value. Nevertheless, they suggest that 38 percent of employment in both the food and beverage and accommodation sectors are tourism related. This compares to only 14 percent of passenger transport services and 2 percent of recreational, cultural and sporting services.

Fig. 17. Composition of the employee jobs in tourism related sectors, NI (2017 Q4)



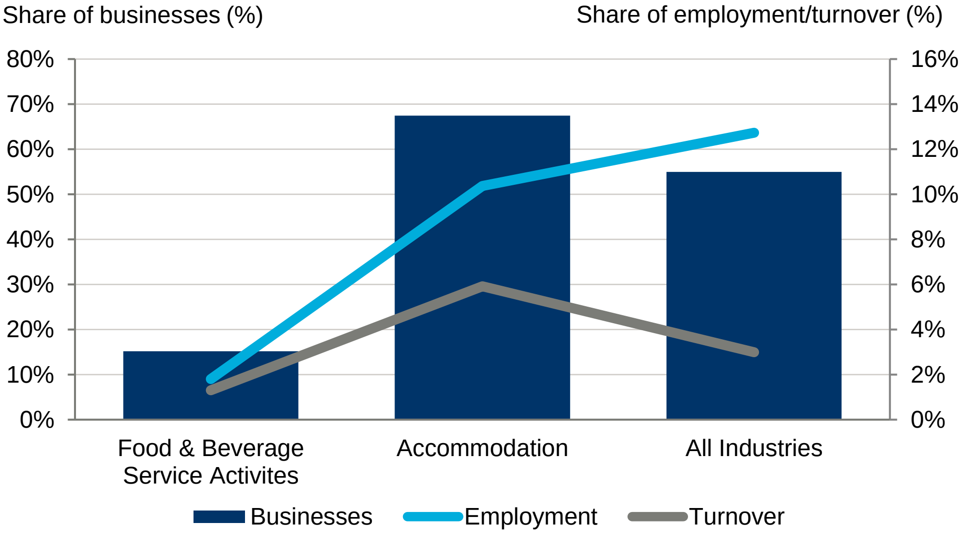
Source: NISRA

Therefore, the size and performance of the food and beverage, and accommodation sectors is perhaps the most important benchmark for tourism related performance in NI (outside traditional indicators of course such as visitor numbers, visitor spend, and average length of trip).

3.8 QUESTION 8: DO VAT AND APD IMPACT DIFFERENT TOURISM RELATED BUSINESSES IN DIFFERENT WAYS? FOR EXAMPLE, DO RESTAURANTS DERIVE A GREATER BENEFIT FROM THE UK'S HIGH REGISTRATION THRESHOLD THAN ACCOMMODATION PROVIDERS?

To explore the potential impact of changes to the VAT threshold on the tourism sector, we may compare the profile of 'unregistered' businesses (i.e. those operating below this threshold) compared to firms operating elsewhere in the economy. Analysis of data provided by the Department for Business, Energy and Industrial Strategy (BEIS)[52] allows for a comparison of the food & beverage and accommodation sectors to the whole UK economy.[53]

Fig. 18. Unregistered businesses as a share of all businesses in the UK, 2017



Source: BEIS

It shows that unregistered businesses form a large majority of those in the accommodation sector. Of the 51,160 firms operating in this sector in the UK, 34,510 (67 percent) operate below the VAT threshold. This rate is 12 percentage points higher than the respective figure for the UK economy as a whole (55 percent). Therefore, the proportion of turnover generated by unregistered firms in the accommodation sector (6 percent) is twice that of the UK average (3 percent), although the share of employment (10 percent) is 3 percentage points lower. By contrast, relatively few food & beverage firms are unregistered; of the 150,895 firms operating in this sector, only 15 percent

[52] BEIS, *Business population estimates 2017* (London: BEIS, 2017). https://www.gov.uk/government/statistics/business-population-estimates-2017
[53] Data is not available at a regional (NI) level for these sectors.

(22,855 firms) are unregistered, a rate almost four-times lower than the UK total.

However, the differing profile of these two sectors alone does not inform how firms may respond to changes in the VAT registration threshold. On the one hand, the high proportion of the accommodation sector that operates below the VAT threshold may suggest that these firms may be more affected by changes to the VAT threshold. On the other, the relatively low proportion of unregistered firms in the food & beverage sector may reflect the high levels of turnover required for these firms to operate (and justify their capital costs). If so, a relatively small reduction in the threshold may result in a relatively high number of businesses becoming liable to pay VAT.

3.9 QUESTION 9: WHAT EVIDENCE IS THERE THAT THE IMPACTS OF VAT AND APD ON TOURISM DIFFER FROM THE IMPACTS OF VAT AND APD ON OTHER SECTORS OF THE ECONOMY?

3.9.1 VAT threshold and tourism

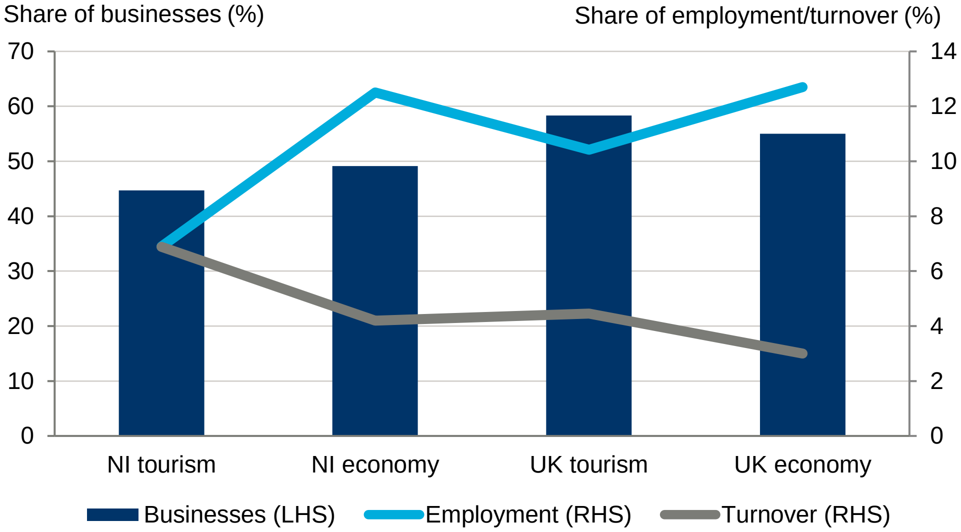
To explore the potential impact of changes to the VAT threshold on the tourism sector, we may compare the profile of ‘unregistered’ businesses (i.e. those operating below this threshold) compared to firms operating elsewhere in the economy. A common theme (discussed in response to Question 3) is that firms in the tourism sector tend to be relatively labour-intensive, and as such require a relatively high threshold of turnover to be viable. This consequently means that relatively few firms operate below the VAT threshold compared to elsewhere in the economy.

Data estimating the scale of unregistered business confirms this view. In 2017, the 3,455 unregistered businesses in the NI tourism[54] sector equates to 44.7 percent of the tourism total (7,730). This rate is below both the UK-equivalent (55 percent) and the overall NI economy (49.1 percent). However, the share of turnover (6.9 percent) is 2.7 and 2.4 percentage points higher than the overall NI economy and UK tourism sector equivalently. This reflects two main trends:

- Turnover tends to be relatively high for those businesses in the tourism sector that remain below the VAT threshold; and
- Turnover tends to be relatively low in NI. The average turnover per employee in tourism businesses in NI was £40,100, 71 percent lower than the UK equivalent (£68,300).

[54] Taken to include accommodation & food services, and arts, entertainment & recreation.

Fig. 19. Unregistered businesses as a share of all businesses, 2017



Source: BEIS

A fall in the rate of VAT may reduce the disincentives for firms below the threshold to expand, which will in turn reduce the size of the 'shadow economy'. The Nevin Associates (2014) study cites an example in France which estimates that VAT reductions have reduced the size of the shadow economy by €720 million per year. Across the UK the 'VAT gap' was estimated to be £12 billion, representing 9 percent of the total tax that could theoretically be levied, in 2016-17.[55]

However, the evidence that firms in the tourism sector may be more affected by reductions in VAT than firms elsewhere is inconclusive. Unregistered firms form a smaller share of the overall sector than across the NI economy, although their contribution to overall turnover is higher. This may however be due to the relatively low margins on which these firms operate, generating relatively low levels of turnover per worker.

3.9.2 Impact of APD

While access to external markets is important for NI exporters and potential investors, it is a key driver of tourism success. As already noted, 69 percent of visitors to NI arrive via plane, and nearly two thirds of all overnight visitors (62.9%) to NI come from GB. Therefore, APD affects the majority of visitors to NI.

A reduction or removal of APD would make travelling to NI airports more price competitive when compared to the alternative option of Dublin airport (which already benefits from a vastly greater number of routes.

3.10 QUESTION 10: HOW WOULD DIFFERENT VAT RULES FOR TOURISM RELATED ACTIVITIES IN NORTHERN IRELAND, AND/OR A LOWER RATE OF APD IN NORTHERN IRELAND AFFECT THE TOURISM INDUSTRY IN

[55] HM Revenue & Customs, *Second estimate of the VAT gap for 2016-17* (London: HM Revenue & Customs, 2018). https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/686983/2nd-est-vat-gap-2017.pdf

OTHER PARTS OF THE UK? WHAT IMPACT WOULD VAT AND/OR APD CHANGES HAVE ON BUSINESSES ADMINISTRATIVE BURDENS?

3.10.1 Impact on elsewhere in the UK

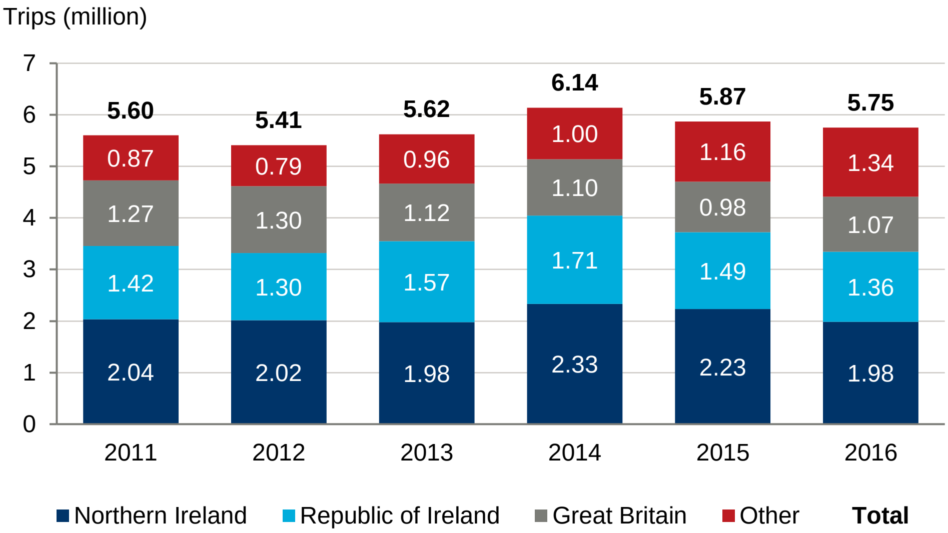
Reductions to VAT and APD may impact the GB tourism sector in several ways.

First, the proposed reductions in VAT on tourism-related goods and services reduces the cost of visiting NI relative to elsewhere in the UK (assuming these VAT cuts were only applied to NI). International tourists who would otherwise have visited or spent more time in Great Britain may now opt to visit NI. The consequence of this policy may therefore bring a reduction in tourism spending in Great Britain. However, the extent of this will be determined by substitutability; how many potential tourists view NI as an alternative destination to GB. Intelligence gathered through consultation suggests that this impact will only be partial, indicating that NI is more likely to displace tourist activity from the Republic of Ireland instead. Consultees were keen to stress that tourism is marketed at an all-island level rather than across the UK, so the displacement effects are likely to be very limited.

A reduction or abolition of short-haul APD also reduces the relative cost of travelling to and from NI. As APD is only applied on outbound flights from the UK, it will equally benefit both inbound and outbound UK-based tourists. As highlighted by the NICEP (2014) study, domestic consumers tend to be more price-sensitive than inbound visitors. This indicates that more journeys may be encouraged from NI to elsewhere in the UK than vice versa. Lower travel costs would also be welcomed by other sectors of the economy that trade or collaborate across the UK.

However, analysis of the outbound trips taken by NI residents shows that just 1.07 million overnight trips were taken to GB in 2016, 240,000 fewer than the equivalent in 2011, despite an increase in the overall number of trips. In 2016, GB represented under a fifth (19 percent) of overnight trip destinations by NI residents. Domestic overnight trips and the equivalent for the Republic of Ireland have also contracted, with visits to other destinations driving the growth of outbound tourist journeys. This evidence suggests that destinations in GB are less likely to benefit from any increases in outbound journeys by NI residents as a result of reducing APD.

Fig. 20. Overnight trips taken by Northern Ireland residents by destination, 2011 to 2016



Source: NISRA

By contrast, this change may increasingly encourage GB residents to visit NI. Whereas a NI-specific reduction in APD increases the affordability of all short-haul destinations for NI residents (to GB and elsewhere), for GB residents it only reduces the relative cost of visiting NI. As demonstrated earlier, GB residents represent a majority (53.7 percent) of overnight visitors to NI. A NI-specific policy is therefore likely to encourage additional journeys to NI, at least in part to the direct cost of reducing domestic visits within GB.

In summary, reductions in VAT and/or APD will encourage visits to NI. While the extent to which GB is viewed as an alternative destination to NI by foreign tourists is mixed, additional international journeys to NI are likely to come at a cost of forgone visits to the Republic of Ireland. Similarly, all factors held constant, GB tourists will be encouraged to visit NI at the expense of other domestic destinations. While this may be offset to an extent by additional outbound journeys from NI to elsewhere in the UK, trends show that GB has become a decreasingly attractive destination, and as such the additional outbound visits are more likely to occur elsewhere.

3.10.2 Administrative burden of VAT

Businesses have indicated that VAT holds a large administrative burden. Analysis by the Federation of Small Businesses (2017) shows that small business owners spend an average of 44 hours (equivalent to six working days) managing VAT registration each year.[56] Alongside reductions, any opportunities for improving the efficiency of these taxes is also identified as a key measure that could improve the productivity of firms both in the tourism sector and across the rest of the economy.

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[56] Federation of Small Businesses, *Lowering VAT threshold would drain small firms of time and money* (Blackpool: Federation of Small Businesses, 2017). https://www.fsb.org.uk/media-centre/press-releases/lowering-vat-threshold-would-drain-small-firms-of-time-and-money

There may also be opportunities for changes to the VAT threshold. Owing to the labour-intensive nature of the tourism sector, the minimum threshold of turnover for a small business to be viable is quite high; small firms are therefore generally above the existing VAT threshold. A 'tapered' approach is proposed by some consultees, which would reduce the immediate burden of crossing this threshold, while reducing the disincentive to expand for firms below the threshold. However, it is acknowledged that additional variations in the VAT rate across different goods and services may in turn increase the administrative burden of this tax.

It has been suggested through the consultation exercise that NI may be a suitable area to trial such a policy. Given its relatively small size, any changes to VAT would have limited impact on overall tax revenues, limiting the risk for the Exchequer. Further, as it is non-contiguous to the rest of the UK, the impact of the displacement of domestic firms from elsewhere may be relatively limited – especially if the tax amendment is only temporary.

3.11 QUESTION 11: WOULD A LOWER RATE OF APD ENCOURAGE OUTBOUND TOURISM FROM NORTHERN IRELAND? WHAT EFFECT WOULD THIS HAVE ON THE TOURISM INDUSTRY THERE?

3.11.1 Impact on tourism numbers

As demonstrated by evidence on price elasticity of demand, air travel is shown to be a 'normal good'. As reductions in APD reduce the cost of travel, this will have a positive impact on demand. While this will lead to additional journeys into NI from tourists based elsewhere, it will also generate a reverse effect. The overall balance between these contrasting effects – whether APD cuts will increase the net inflow of tourists – concerns much of the literature. A key study in this regard comes from the NICEP (2014). This study applied the price elasticities – detailed earlier in this report – modelling the future of a 50 percent reduction, total abolition, and a 10 percent increase in APD on passenger numbers.

This paper suggests that the impact of APD changes is more significant for outbound travel (by residents of NI) than inbound travel from elsewhere. Across each scenario, the estimated percentage change in forecast passenger numbers for outbound journeys from NI airports is at least twice that for inbound journeys. This indicates that domestic consumers tend to be more price sensitive than foreign travellers.

This study also considered the 'net' impact on passenger numbers. This includes an estimate of the number of journeys that are displaced from non-NI airports (e.g. Dublin Airport) that would have occurred anyway. The study estimates that around 20 to 25 percent of the impact on passenger numbers resulting from APD changes are new journeys, with the remaining majority resulting from displacement.[57] The Republic of Ireland's airports are currently a key source of tourists to NI; in 2015, 67 percent of overseas visitors (excluding those from Great Britain) who stayed overnight in NI did so via entry points in the Republic, equivalent to 447,000 visits.[12] NI's proximity to Dublin Airport

[57] Removing the incentive to travel via Dublin Airport may be more allocatively efficient. For instance, NI consumers travelling to a domestic airport may benefit from journey time and cost savings.

mean that it may be better placed than elsewhere in the UK to benefit from this policy, as its airports have greater scope to attract journeys otherwise taken abroad than those in Great Britain.

Further, many current visitors to NI may incorporate this as part of a holiday in the Republic of Ireland. While reducing APD may increase inbound passenger numbers to NI airports, encouraging additional visits to NI, some of these tourists may otherwise have visited NI while travelling through Dublin. The substitution of journeys from Dublin to NI airports may therefore overstate the true number of additional visitors to NI resulting from this policy.[58]

Evidence of the Dutch Government's temporary Air Passenger Tax, levied between July 2008 and July 2009, provides further evidence of the impacts of APD on passenger numbers. Following the introduction of the tax, there was a notable fall in the number of passengers flying out of Schiphol compared to transfer passenger numbers, who were not liable to pay the tax. Analysis by the KiM Netherlands Institute for Transport Policy Analysis (2011) estimates that the tax led to nearly two million fewer passengers travelling from Schiphol Airport, while passenger numbers in the remainder of 2009 following resetting this tax to €0 were down by close to a million passengers.[59]

Although the report acknowledges difficulties in determining the exact impact of this tax, due to it coinciding with the global economic crisis and other developments in the aviation sector, this nevertheless provides a clear indication that the price of flights has a direct impact on the behaviour of consumers. Results of a survey conducted through this research demonstrates the impact of such a tax on passenger choices, with 14 percent of respondents confirming the tax had influenced their travel behaviour. Of those, approximately half opted to travel instead via foreign airports – mirroring the tendency for NI residents to travel via Dublin Airport – while the remaining half either chose an alternative means of transport, such as by car or train, or cancelled their journey altogether.

3.11.2 Impact on net tourism spend

The impact of changes to APD concerns not just tourism numbers but their overall spend. The relative patterns of consumption for residents of NI and tourists can further inform the nature of this impact.

The main implication of the NICEP (2014) is a net outflow of spending from the NI economy. It calculates that domestic consumers are encouraged to travel abroad, thus increasing the leakage of spending – that would otherwise occur in NI – to elsewhere. However, the impact on the tourism sector alone is unclear. While many new outbound journeys may result from residents substituting domestic holidays for trips abroad, others may be new holidays, at the opportunity cost of spending that would otherwise have gone on non-

[58] Although it is acknowledged that the duration of stay in NI, and therefore aggregate spend, may be longer if tourists travel through a NI airport as opposed to Dublin.
[59] KiM Netherlands Institute for Transport Policy Analysis, *Effects of the Air Passenger Tax: Behavioural responses of passengers, airlines and airports* (Den Haag: Ministry of Infrastructure and the Environment, 2011).

tourism goods. The balance of these two effects will indicate the extent to which the tourism sector alone may be directly impacted from an additional net outflow of tourists.

A report on the Scottish Air Departure Tax (ADT), equivalent to the APD, for the Common Weal think-tank, provides an alternative means by which this policy may adversely affect the domestic economy.[60] It cites evidence in the PwC report, which notes that foreign tourists *"tend to purchase a more limited range of lower value-added goods and services"* than domestic consumers. Therefore, even if the additional inbound tourists were able to match the spending power of outbound tourists, this could have an overall negative impact on the NI economy.

3.12 QUESTION 12: WHAT WOULD BE THE INDIVIDUAL AND/OR COLLECTIVE IMPACT OF A CHANGE TO VAT ON: ACCOMMODATION, LEISURE ACTIVITIES AND RESTAURANTS, OTHER TOURISM RELATED ACTIVITIES AND/OR A CHANGE TO APD RATES IN NORTHERN IRELAND ON TAX REVENUE AND THE WIDER ECONOMY?

3.12.1 Impact of VAT

While the process by which VAT cuts can boost output and employment are not disputed, the literature in this field tends to concern the net impact of this policy on tax revenues. Studies by the Campaign for Reduced Tourism VAT presents evidence of a positive net impact of VAT rate cuts to tourism services to Treasury revenues, both at a UK (2017)[61] and NI (2018) level. It argues that higher rates of VAT mean that NI loses out to tourism activity from the Republic of Ireland, citing the observation that tourism revenues are eight times higher in the Republic, despite a population just 2.8 times larger than in NI.

This report models a reduction in VAT from 20 percent to 5 percent[62] on visitor accommodation and attractions in NI, and estimates that the loss of Treasury income in the first year would be £11.3 million in NI (or £439 million to £479 million across the UK). However, as the positive effects filter through the economy, the net impact on tax incomes is forecast to become positive; equating to £13 million in the first five years after the intervention (in net present value terms), and £90 million over a ten-year period. The cumulative improvement to NI's balance of payments is estimated to be £119 million over this ten-year period. This reduction in VAT will also have a positive impact on employment, generating over 3,200 jobs over the first ten years, of which almost 1,200 additional jobs are directly created in the visitor accommodation and visitor attractions sectors.

Cut Tourism VAT (2018b) similarly estimated the impacts of a VAT cut to 5 percent on the out-of-home meals sector.[63] It estimates that such a policy alone

[60] Dr. Craig Dalzell, *Air Departure Tax: A Post-Brexit Analysis* (Glasgow: Common Weal Policy, 2017).

[61] Campaign for Reduced Tourism VAT, *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* (London: British Hospitality Association, 2012).

[62] The lowest possible rate under EU VAT law.

[63] Cut Tourism VAT, *VAT on Out-of-Home Meals in Northern Ireland* (London: Tourism Respect & Nevin Associates Ltd, 2018).

would result in fiscal surplus of £8.3 million after a single year, and £1.03 billion cumulatively over the first ten-years. This sector would also benefit from a significant boost in employment; such a policy is argued to generate 21,100 additional jobs, of which 7,600 are directly created in the out-of-home meals sector.

The Nevin Associates (2014) report also argues that forgone tax levied on the visitor accommodation and attractions sector is more than offset by the knock-on indirect benefits. It argues that increased output boosts corporation tax receipts, while higher incomes generating additional income tax revenues and job creation will reduce benefit payments. Despite an estimated direct loss of £1.56 billion in VAT receipts across the UK, once these indirect effects are accounted for, the report estimates a £45 million net gain in tax revenues each year.

However, there is some dispute over the accuracy of these estimates. Speaking in 2015, the then Exchequer Secretary, David Gauke MP, argued that reducing VAT to 5 percent on catering services would reduce tax revenues across the UK between £9 billion to £10 billion per year, far exceeding the estimates above, while a similar cut to accommodation would cost an additional £2 billion per year.[64] The scale of additional tax revenues identified in both the Campaign for Reduced Tourism VAT (2017) (for the UK as a whole) and Nevin Associates (2014) studies would be insufficient to offset these costs.

3.12.2 Impact of APD

There is differing evidence on the net economic impact of changes to APD. The 2013 PwC report on the impact of abolishing APD on the UK economy identified several positive economic outcomes. It estimates that abolishing APD would provide an initial short-term boost in UK GDP of 0.45 percent in the first year, while averaging 0.3 percent per annum over the first three years. This increase in output is associated with an overall increase in investment and exports of 6 percent and 5 percent respectively over this period. It would further provide the potential for almost 60,000 additional jobs across the UK over the period from 2013 to 2020.

The PwC (2013) report also argues that abolishing APD would result in a net positive gain of tax revenues. While the initial direct costs of this policy are estimated at around £3 to 4 billion per annum, the report argues that additional revenue from other tax sources – generated by increased UK business growth, better trade linkages and greater employment – will more than offset this, resulting in an estimated positive fiscal gain of £250 million per annum.

However, this evidence is contradicted by a subsequent study by the NICEP (2014). This study estimates an overall negative net impact on the economic contribution of tourism to the NI economy following a reduction in APD. The overall long-term impact is estimated to equate to £2.7 million and £5.4 million for a 50 percent reduction and total abolition in 2026 respectively (in 2014 prices).

[64] Seely, A., *Briefing Paper Number 6812: VAT on tourism* (London: House of Commons Library, 2017).

This report also indicates that reducing APD would have an adverse net impact on tax revenues in NI. In testing both the 50 percent reduction and abolition scenarios, the positive income effect of money retained by passengers and subsequent boost in consumption is insufficient to offset the initial loss of tax revenues. The magnitude of the negative net impact is estimated to be £19.3 million and £42.9 million respectively for these scenarios in 2026.

3.13 QUESTION 13: HOW WOULD BUSINESSES IN THE TOURISM SECTOR RESPOND TO VAT AND APD CHANGES AND TO WHAT EXTENT WOULD THOSE CHANGES WOULD BE PASSED THROUGH TO CONSUMERS IN THE FORM OF LOWER PRICES?

Targeted reductions to VAT and/or APD has the potential to increase tourism-related turnover. Proponents of tax reductions argue that this loss of Government income will be offset by indirect tax revenues generated by increased business turnover, which in turn will have an induced positive impact on the wider economy. However, owing to a variety of factors, such as price stickiness[65] and inflexibility in the labour market, this positive impact tends not to be immediate, and requires a period of several years to be realised.

The extent to which this policy might achieve this aim will be determined by the following two factors, in combination:

- **The impact on prices:** There is a range of evidence on the price sensitivity of goods and services to tax changes. The ‘pass-through rate’ measures the extent to which prices fall in line with the rate reduction; and
- **The impact on consumer behaviour:** This considers how consumers will adapt to lower prices, measuring to which the level of demand changes as a result. This is termed the ‘price elasticity of demand’. Price elasticities tend to vary depending on the nature of goods.[66]

3.13.1 VAT

As detailed previously, the extent to which these economic benefits are realised will be partially determined by the pass-through rate.

A 2007 report by Copenhagen Economics considered the impacts of reduced VAT across the Member States of the EU.[67] It indicates that the permanent lowering of VAT tends to result in an equivalent fall in prices, as VAT changes have a *“strong tendency towards full pass-thorough”*. Based on this evidence, we might expect a cut in tourism VAT in NI to be fully reflected by adjusted prices.

Evidence from our consultations with the hotel’s sector would reinforce the above findings. Hostellers we spoke with that operate in both jurisdictions of

[65] The tendency for prices to remain unchanged or adjust slowly to changes in the costs of producing and selling goods.
[66] Where a fall in the price is associated with a greater-than-proportionate increase in the quantity purchased, the demand for these goods is termed price elastic, while conversely where the impact on quantity is less-than-proportionate, demand is price-inelastic.
[67] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union* (Copenhagen: Copenhagen Economics, 2007).

Ireland, reported the tax cut in the Republic of Ireland were passed on to customers. As noted earlier international tour operators who book substernal volumes of rooms in the Republic of Ireland (and NI) hotels, expected the tax cuts to passed through to customers. In the event they weren't they would move their business elsewhere (a signal that price plays an important role in the sector).

However, evidence from an Indecon (2017) study assessing the impact of VAT cuts in the Republic of Ireland shows evidence of only partial pass-through rates. A 4.5 percentage point reduction in VAT was estimated to result in a price reduction of between 2.6 to 4.5 percent in the food services sector, although just 1.2 to 2.4 percent in accommodation services. However, the report acknowledges the difficulty in accurately estimating these rates, as the counterfactual position – had VAT remained at a higher rate – may only be assumed. Despite this, the evidence of this report indicates only partial pass-through of VAT changes.

Again, the consultations were informative. Hoteliers informed us that with the tax reduction, and the resulting additional income (whether from the tax savings or from additional demand from external visitors), they were able to bring forward refurbishments and investments. This created jobs during construction and once operational, and also improved the quality of offer. The Northern Ireland Hotels Federation has indicated that it would be prepared to sign up to a charter that would commit its members to reducing prices and increasing investment if VAT were reduced, increasing the certainty that cuts will pass-through to lower costs for consumers.

The context within which VAT is reduced may be of importance. While the Copenhagen Economics study drew upon data for an era of relatively stable growth across the EU, the Indecon (2017) study considers a policy intervention that aims to stimulate employment during an economic downturn. In this context, firms may be more inclined to absorb the additional revenue associated with VAT cuts, rather than pass these on to consumers through the form of reduced prices. Similarly, the Copenhagen Economics study considers VAT cuts across a range of goods; the partial pass-through rates demonstrated by Indecon may simply reflect the relatively low operating margin of firms in the tourism sector.

3.13.2 APD

Research by the NICEP (2014) acknowledges the tendency of prices to be slow to adapt. In modelling the impact of changes to APD, they assume that changes in APD would be passed on incrementally over a two-year period. This suggests that the economic impacts of such a policy will take a number of years to be fully realised. This implies full pass-through of tax cuts to prices, which is likely given the low-margin, competitive nature of the short-haul aviation market.

Unlike changes to VAT, which concern a wide variety of goods, amendments to APD concern air travel alone. We are therefore able to consider the price elasticity of demand associated with this specific good. The NICEP (2014) report summarises a range of price elasticities for air travel in the UK, based on a literature review of studies including Dargay & Hanley (2001)[68] and Cairns, Dargay & Menaz (2006).[69] The paper presents estimates of the price elasticities for short and long-haul travel for both leisure and business in the UK, alongside evidence for those outside of the UK (i.e. in the Republic of Ireland). It shows three clear patterns:

(1) Price elasticities tend to be negative, indicating that a fall in price is associated with an increase in demand (air travel is a 'normal' good);
(2) Short-haul travel tends to be more price elastic than long-haul travel; and
(3) Leisure travel tends to be more price elastic than business travel.

The price elasticities show that the demand for air travel tends to be relatively price inelastic. The study applies a range of price-elasticities of -0.7 to -0.8 for short-haul leisure travel, indicating that a 10 percent fall in the price will result in a 7 to 8 percent increase in demand. These measures are over twice the equivalent for both long-haul leisure travel (-0.3) and short-haul business travel (-0.2 to -0.3).

3.14 QUESTION 14: WHAT EVIDENCE IS THERE THAT VAT AND/OR APD RATE CHANGES ARE A RELATIVELY COST-EFFECTIVE MEANS OF SUPPORTING THE TOURISM INDUSTRY?

According to information provided by Hospitality Ulster, and owing in part to abolishing long-haul APD, NI contributes just £55 million (or 1.4 percent) of the £3.9 billion of receipts APD generates annually for HM Treasury. However, without comprehensive evidence on the impact of all other alternative means of supporting the tourism industry, we cannot conclusively say whether VAT and/or APD rate changes are cost effective.

The PwC (2013) report however provides an assessment of the suitability of APD as a tax. This considered the extent to which APD fulfils the Treasury's four 'core tax principles': practicality, stability, certainty and coherence. It states that APD performs poorly in terms of 'basic fairness' and 'supporting growth and encouraging competition', arguing that *"the UK has the highest rate of air passenger taxes in the world"* while APD is relatively distortive. However, in procedural terms, the report notes that APD has *"legal clarity and is simple to collect and administer"*. Similarly, forecast revenues generated by APD are relatively stable over time, while administrative costs are low.

The NICEP (2014) study provides further commentary on the effectiveness of tax cuts as a policy intervention. In modelling the impact of reductions to APD, it notes a high 'deadweight' cost. While APD cuts of either 50 percent or total abolition are estimated to encourage an 8 to 12 percent growth in passenger numbers respectively, the remaining passengers will also receive this tax reduction. This implies that 88 to 92 percent of passengers will no longer contribute tax due to this intervention without any material change in behaviour, or benefit to the domestic tourism sector. A similar principle applies to a

[68] Dargay, J. & Hanly, M., *The Determinants of the Demand for International Air Travel to and from the UK* (London: University College London, 2001).
[69] Cairns, S., Dargay, J. and Hanly, M., *Attitudes to Aviation and Climate Change* (Leeds: Commission for Integrated Transport, 2006).

potential reduction in the rate of VAT, unless consumers spend all of the cost saving, either on the same of different goods.

3.15 QUESTION 15: HOW WOULD A UK-WIDE CHANGE TO VAT OR APD BENEFIT THE TOURISM INDUSTRY? HOW WOULD THE INDUSTRY IN NORTHERN IRELAND BENEFIT RELATIVE TO OTHER REGIONS IN THE UK?

3.15.1 Impact of UK-wide changes to VAT or APD

As detailed in the response to Question 12, there are some estimates available of the UK-wide impacts of changes to VAT or APD. The Cut Tourism VAT (2017) estimates that reducing VAT to 5 percent on tourist accommodation and attractions would create 121,000 additional jobs in the UK over a ten-year period. The policy is estimated to generate £363 million for the Exchequer three years after implementation, with £4.6 billion gained across the first ten years. This report also estimates a £3.5 billion improvement in the UK's balance of payments ten years after introducing this policy, due to a combination of growth in overseas visitors and reduced spending abroad by residents who take holidays in the UK instead.

The PwC (2013) report provides a similar estimate for a UK-wide abolition of APD. As detailed previously, this study estimates that abolishing APD would provide an initial short-term boost in UK GDP of 0.45 percent in the first year, while averaging 0.3 percent per annum over the first three years. This increase in output is associated with an overall increase in investment and exports of 6 percent and 5 percent respectively over this period. It would further provide the potential for almost 60,000 additional jobs across the UK over the period from 2013 to 2020.

The PwC (2013) report also argues that abolishing APD would result in a net positive gain of tax revenues. While the initial direct costs of this policy are estimated at around £3 to 4 billion per annum, the report argues that additional revenue from other tax sources – generated by increased UK business growth, better trade linkages and greater employment – will more than offset this, resulting in an estimated positive fiscal gain of £250 million per annum.

3.15.2 Impact on NI relative to elsewhere in the UK

As demonstrated Fig. 8 and Fig. 9, tourism is relatively under-represented in NI. The tourism ratio, a measure of the economic importance of tourism, is lowest of all regions in the UK, while similarly the direct GVA generated by the tourism sector is significantly lower than elsewhere.

Consultees have indicated that NI's sector may be suppressed by the cost differences relative to the Republic of Ireland that result from APD and higher rates of VAT. While GB does not have a contiguous land border and as such tends to be seen as a single tourism market, the island of Ireland tends to be perceived as a destination in itself; trips to NI and the Republic of Ireland are in this sense substitutable.

Reductions in VAT, APD or both may boost the tourism sector in each of the UK's regions in two ways: through encouraging new inbound journeys from foreign tourists who would otherwise have visited elsewhere, and increasing the affordability of domestic holidays, therefore reducing the leakage of spending abroad through outbound foreign travel. Considering NI's land border with the Republic of Ireland, it is particularly well placed of the UK's regions to encourage new visitors.

Similarly, given the relatively low cost of internal travel across the island relative to more expensive air fares (even excluding the contribution of APD), NI may be particularly well placed to attract journeys displaced from the Republic of Ireland. This finding is supported by the analysis of the NICEP (2014) study, which showed that passenger growth from reductions in APD would largely result from leakage from Dublin Airport.

Therefore, while tourism forms a relatively low proportion of the NI economy, this may partially be driven by cost differentials born at least in part by APD and a relatively high rate of VAT. Reductions of one or both taxes is likely to boost tourism across all of the UK's regions. The evidence on whether NI is better placed than other regions in the UK is inconclusive. On the one hand, other regions such as London or the South East have larger and more established tourism sectors, and may be better placed to attract new visitors. On the other, owing NI's unique position close to the Republic of Ireland, removing the cost differentials may enable NI to 'catch-up' to a greater extent through attracting a greater share of the visitors to the island of Ireland.

4. APPENDIX A: BIBLIOGRAPHY

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