



The Impact of Ending Tax Free Shopping in the UK

A Cebr report for the New West End Company and Global Blue

September 2020

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Contents

1.	Introduction and Summary	5
1.1.	Introduction	5
1.2.	Summary	5
2.	Background	7
2.1.	Introduction	7
2.2.	The Current UK system	7
2.3.	The proposed change to the system	8
2.4.	The scale of the system	9
3.	Methodology.....	10
3.1.	Introduction	10
3.2.	Methodology	10
3.3.	Impact on the number of tourists	10
3.4.	Impact on the amount of spending per tourist	10
3.5.	Economic impact	11
3.6.	Jobs impact	11
3.7.	Fiscal impact	11
4.	Results – the impact if the VAT Retail Export Scheme is abolished.....	12
4.1.	Introduction	12
4.2.	Impact on the number of visitors	12
4.3.	Impact on total spending of the additional visitors	13
4.4.	Impact on the average spending per visitor	13
4.5.	Total decrease in tourist spending	13
4.6.	Indirect effects	13
4.7.	The knock-on effects of tourism	13
4.8.	The impact on GVA of ending Tax Free Retail	14
4.9.	Jobs impact	14

4.10.	Fiscal impact	14
4.11.	Using a higher multiplier	15
5.	Results – the impact if the VAT Retail Export Scheme is extended to EU shoppers .	16
5.1.	Introduction	16
5.2.	Impact on the number of visitors	16
5.3.	Impact on the average spending per visitor	17
5.4.	Total increase in tourist spending	17
5.5.	Indirect effects	17
5.6.	The impact on GVA and jobs of extending Tax Free Retail	17
5.7.	Fiscal impact	17
5.8.	Using a higher multiplier	18
6.	Conclusions from Customer Research	19
6.1.	Introduction	19
6.2.	Impact on the number of visitors	20
6.3.	Impact on total spending of the additional visitors	20
6.4.	Impact on the average spending per visitor	20
6.5.	Total decrease in tourist spending	20
6.6.	Indirect effects	20
6.7.	The impact on GVA of ending Tax Free Retail	20
6.8.	Jobs impact	21
6.9.	Fiscal impact	21
7.	Conclusions	22
7.1.	Effects of abolishing the current scheme for non-EU visitors	22
7.2.	Extension of the scheme to EU visitors	22
7.3.	Conclusions	23

1. Introduction and Summary

1.1. Introduction

This report evaluates the costs and benefits of the proposed ending of Duty-Free Shopping for Non-EU visitors to the UK as an indirect result of the Brexit negotiations.

It compares looks at the two possible systems. First, the proposed situation where the VAT Retail Export Scheme is scrapped and secondly, the extension of the current scheme to tourists from the EU as well as from outside the EU.

The main research in Sections 2-5 use the elasticities approach where conventional elasticities from tourism and tax research by official bodies are applied. We estimate the deadweight revenue losses, the gains from tourism and spending and the net benefits in GVA and jobs and total tax revenue gains after netting off the deadweight losses.

Our calculations are based on an earlier report commissioned by Global Blue which Cebr prepared in 2017. Because of the urgency of the current report it assumes the same elasticities for the main research as were used in the earlier report.

Our normal approach would be to use data from the latest complete calendar year. For this report what would have been a standard practice has become a necessity since Covid-19 has so affected the data for 2020 as to make it atypical. Figures in this report are therefore for 2019 unless stated otherwise.

Section 2 provides background; Section 3 describes the methodology; Section 4 analyses the impact of scrapping the current scheme and Section 5 the impact of extending the current scheme to tourists from the EU.

Section 6 shows a different analysis based on Global Blue customer research. A significant proportion of the expenditure affected by the VAT Retail Export Scheme is concentrated on a small number of heavy hitters and so the behaviour of these heavy hitters is relevant. Global Blue has conducted some very up to date fieldwork on the possible behaviour of these people and the potential impact if the preferences which they state turn out to accurate in reality.

Section 7 shows the conclusions and how the options of extension and scrapping compare with each other.

1.2. Summary

Effects of abolishing the current scheme for non-EU visitors

We show in Section 4 the potential impact of ending the current VAT Retail Export Scheme for non-EU visitors estimated using the traditional elasticities for tourism and spending calculated by official bodies.

Even on these cautious assumptions the impacts are clearly negative:

- The number of non-EU visitors to the UK will be reduced by 7.3% or 1,168,000.
- The total decrease in spending by tourists resulting from the ending of the VAT Retail Export Scheme is estimated to be between £1.1 billion and £1.8 billion
- After taking account of knock on effects GVA is reduced by £1.8 -£2.8 billion.

- We estimate that between 27,000 and 41,000 jobs will be lost.
- And that far from gaining the theoretical £521 million, the loss of economic activity would mean that tax revenues were net reduced by £270 – 680 million.

But if the stated preferences emerging from the customer research carried out by Global Blue are correct, these estimates are far too low and the actual real-life impact will be very much higher.

- Abolition of tax free would reduce the number of visitors by 31% or 4.96 million.
- Their spending would be reduced by over £6 billion.
- GVA is £9.3 billion lower causing a reduction in employment of 138,423
- And after taking the gains from the abolition of the tax relief into account, tax revenues are £3,492 million lower¹.

If the survey data is anywhere near accurate, abolishing the scheme would be a massive negative for the economy at a time when this is least needed, hitting sectors that are especially vulnerable like tourism and retail.

Extension of the scheme to EU visitors

We have only used the elasticities approach to estimate the impact of extending the scheme to EU visitors and the detailed calculations are in Section 5.

Again, even on the cautious assumption that this implies, the net impact is that extending the scheme raises more tax revenue than it loses.

- We estimate that extending the scheme to visitors from the EU would increase the number of EU visitors by 3.8%. This would imply an additional 948,000 visitors who themselves would spend an additional £590-£890 million.
- We estimate that the increase in GVA of extending tax free retail to visitors from the EU will be between £900 and £1,360 million. The increase in jobs from the extension would be 13,500 and 20,200 jobs.
- The theoretical loss of revenue from extending Tax Free is £312 million of VAT estimated earlier. But this is offset by the income taxes, national insurance, indirect taxes, corporate taxes and rates that will be collected as a result of the additional tourist spending.
- So, extending the scheme, far from costing money, generates between £79 and £276 million in net additional taxes.

¹ We estimate that 32% of this tax lost is income tax, 17% NI contributions, 41% VAT and 10% corporation and other business taxes. The same ratios apply to the other estimates of tax revenues lost from the impact on GVA

2. Background

2.1. Introduction

On 17 September 2020 HM Treasury and HMRC published a response to the consultation announced by the Chancellor of the Exchequer Rishi Sunak in his Spring Budget about the post Brexit treatment of Duty Free². The announcement was greeted with much surprise by the industry and seemed unexpected in the context of the difficult economic position of both the international tourism sector and the UK mainstream retail sector caused by a mix of factors but especially the impact of Covid 19.

Paragraph 1.12 sets out the proposed new regime for the VAT Retail Export Scheme:

The VAT Retail Export Scheme will also not be extended to EU visitors and will be withdrawn for non-EU visitors in GB. This means that overseas visitors will no longer be able to obtain a VAT refund on items they buy in GB and take home with them in their luggage. Many stakeholders have told us about the operational challenges of the current system, and that they do not want to see an extension of the scheme to the EU in its current paper-based form. By contrast other stakeholders have explained the benefits that they see from the VAT RES and that they would like to see the scheme extended to the EU in digital form, which the government continued to explore in parallel with the consultation. However, the VAT RES is a costly relief which does not benefit the whole of GB equally, with current use of the scheme largely centred in London. Retailers will instead continue to be able to offer VAT-free shopping, consistent with international principles of taxation, to non-EU visitors who purchase items in store and have them sent direct to their overseas addresses. Following the end of transition period, this will also be available to EU visitors.

This section of the report is largely based on the equivalent section of Cebr's earlier report although the figures are updated.

2.2. The Current UK system

If you are a visitor to an EU Member State from outside the EU, then under the EU VAT guidelines you are entitled in certain circumstances to reclaim VAT paid on goods purchased within the EU³. Because the UK is in a transition phase from being an EU Member State the UK participates in this scheme and will do so until December 31, 2020.

² A consultation on the potential approach to duty- and tax-free goods arising from the UK's new relationship with the EU: Summary of responses HM Treasury and HM Revenue and Customs, September 2020

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/917005/Passengers_Consultation_Response.pdf

³ https://ec.europa.eu/taxation_customs/individuals/travelling/travellers-leaving-eu/guide-vat-refund-visitors-eu_en

The UK system for VAT reclaims was set out in VAT notice 704/1, Tax Free Shopping in the UK⁴. This sets out the specific rules that operate in the UK.

The scheme is restricted to eligible persons; to particular goods (not services); and to those following the appropriate procedures.

Eligible persons

Those eligible to use the scheme are: 1) Overseas visitors if their home is outside the EU and if they plan to take the goods outside the EU within 3 months of purchasing the good; 2) Overseas students and workers studying or working in the UK (again provided that they plan to take the goods out of the UK within 3 months); and 3) residents of the EU who will be staying outside the EU for the next twelve months who will take the goods out of the EU within 3 months.

Eligible goods

Eligible goods are all goods on which VAT has been paid except:

- 1) Those used or partly used in the EU (examples given are perfume and chocolates);
- 2) Motor vehicles or boats;
- 3) Goods over £600 in value that will be exported for business purposes (these are subject to VAT relief under a different system)
- 4) Goods that will be exported as freight or goods that need an export license (except antiques)
- 5) Unmounted gemstones and bullion (over 125 grams)
- 6) Mail order goods including internet sales
- 7) Services eg hotel bills

Eligible transactions

For the transaction to be eligible it generally has to be over a minimum amount to justify the administration (typically £75). The shopper has to be physically present when the purchase is made, should inform the person making the sale and must collect the relevant reclaim form at this time so that it can be stamped and must present the form to customs when leaving the country before being returned to the shop from which the good was purchased for the refund. This is best handled through an agent with experience in this sector of whom Global Blue is the market leader.

2.3. The proposed change to the system

The proposed change to the system would simply abolish it. HM Treasury added in the same paragraph quoted above that:

⁴ <https://www.gov.uk/government/publications/vat-notice-7041-tax-free-shopping-in-the-uk/vat-notice-7041-tax-free-shopping-in-the-uk>

Retailers will instead continue to be able to offer VAT-free shopping, consistent with international principles of taxation, to non-EU visitors who purchase items in store and have them sent direct to their overseas addresses. Following the end of transition period, this will also be available to EU visitors.

Given the countries of origin of many such visitors, it seems highly unlikely that this will encourage shoppers given the cost of dispatching such item and the likelihood that those purchasing on this basis will face uncertain charges when examined on arrival in their host countries. Moreover, shoppers in this way will have no option of taking advantage of normal duty-free allowances available when their goods travel with them. We therefore have made no allowance for any increased take up of this in our methodology.

2.4. The scale of the system

Cebr has used its contacts in the sector to make estimates of the scale of operation of the system for international VAT reclaims.

According to Visit Britain and the ONS⁵ the 40.8 million visitors to Great Britain⁶ spent £28.4 billion in the area in 2019. Of this total 24.8 million visitors were from the EU and they spent £10.6 billion while the 16.0 million visitors from outside the EU spent £17.8 billion.

Cebr's research in 2017 estimated that of this, the scale of purchases on which VAT was reclaimed was £2.8 billion in 2016, generating £466 million in VAT reclaimed. This calculation was backed up by the National Audit Office. In a letter from the Comptroller and Auditor General to Sir Geoffrey Clifton Brown MP the NAO estimated that the scheme cost £500 million⁷.

Scaling the Cebr figure up to 2019 levels suggests that the scheme cost £521 million in that year. Assuming all the spending was on goods with a VAT rate of 20% implies that this was generated by £3.1 billion of spending (including VAT before rebate) or slightly above £2.5 billion net of the rebate. This implies non-rebated tourism expenditure of £25.3 billion.

It is clear that non-EU tourism and spending has been buoyant in recent years. This is partly explained by the strong economic growth in some of the countries of origin for the tourists. But the scale of the growth in spending by such tourists hints that the VAT Retail Export Scheme may also be an important cause.

⁵ <https://www.visitbritain.org/2019-snapshot>

⁶ Under various agreements with the Irish Government and the devolved administration in Northern Ireland, tourism in the whole island of Ireland is handled by a single body. Post Brexit arrangements in Northern Ireland will differ from those in Britain and the effect on tax free shopping has not yet been decided.

⁷ Letter from Sir Amyas Morse, Comptroller and Auditor General to Sir Geoffrey Clifton-Brown MP dated 29 August 2018

3. Methodology

3.1. Introduction

This section describes how Cebr has calculated the economic impact of the VAT reclaim system. We use the same elasticities and the same methodology as we used in our 2017 report to estimate 1) the potential impact of ending the VAT Retail Export Scheme; and 2) the potential impact of extending the scheme to EU based shoppers.

3.2. Methodology

Our aim is to measure two items for each scenario, treating the current situation as the base case:

- 1) Impact of ending or extending Tax free shopping on number of inbound tourists to the UK
- 2) Impact of ending or extending Tax free shopping on average spend per tourist

Once we have measured these, we can calculate the additional tourist spending that takes place as a result of Tax-free shopping compared with the amount that would take place if Tax free shopping were not available.

We then run this through our economic impact model which measures how these changes flow through the economy in different sectors and how they multiply through the economy.

3.3. Impact on the number of tourists

We measure the impact on the number of tourists by translating the impact of Tax free into an assessed impact on the average cost of a visit to the UK for those tourists affected by it. We then multiply this by the elasticity of travel into the UK with respect to price. We do this by concentrating on those tourists (non-EU) who are affected by Tax Free. We have used an elasticity of 1.3 for tourist numbers with respect to the average cost of a visit⁸. This is a conventional elasticity used for tourism and is (see footnote⁴) the official elasticity quoted by the UK's Tourism Alliance.

3.4. Impact on the amount of spending per tourist

The impact on average spend can be calculated again by multiplying the effective impact on cost by the relevant elasticity. Cebr works with all the main retailers in the UK and is familiar with their internal assumptions about the sensitivity of spending to price.

⁸ Source: UK Tourism Statistics 2016, The Tourism Alliance Section 7
http://www.tourismalliance.com/downloads/TA_390_415.pdf

3.5. Economic impact

Having calculated the direct impacts on tourism and on spending, we then calculate the indirect impacts on GVA⁹. This is done using Cebr's Input Output Model which calculates how spending in any part of the economy feeds through to the rest of the economy. These impacts are broken down by sector. This is based on ONS data freely available¹⁰.

3.6. Jobs impact

The sectoral output from the model is then used to calculate the impact on employment by sector using the sectoral data relating jobs to GVA.

3.7. Fiscal impact

Having calculated the direct and indirect impacts, finally we calculate the fiscal impact again using Cebr's Input Output model. This works out the amount of tax (or government spending) that would be affected by these direct and indirect effects, taking all taxes into account like income tax, corporation tax, national insurance contributions and other taxes paid in the economy.

⁹ Essentially a sectoral GDP measure except that GVA is conventionally measured at producers' prices excluding taxes net of subsidies whereas GDP is typically measured at market prices, which are boosted by taxes but reduced by subsidies.

¹⁰

<https://www.ons.gov.uk/economy/nationalaccounts/supplyandusetables/datasets/ukinputoutputanalyticaltablesindustrybyindustry>

4. Results – the impact if the VAT Retail Export Scheme is abolished

4.1. Introduction

This section describes the direct impacts on tourism and spending if as planned Tax-Free Shopping is abolished. It compares the current position with what is projected to happen at 2019 levels of revenue and spending if the VAT Retail Export Scheme ends using the traditional elasticities calculated by official bodies.

4.2. Impact on the number of visitors

We estimate that in 2019 the UK had 40.8 million visitors of whom 16.0 million were from outside the EU¹¹. We also estimate that non-EU visitors will have spent £17.8 billion in 2019.

Shopping is one of the key reasons for international non-EU visitors to visit the UK and their average spend is high as is reflected in the £3.1 billion of shopping on which VAT was reclaimed (compared with an estimated £7.1 billion spending on ALL shopping by ALL (including EU-based visitors) to the UK. It is noted that the UK is one of the premier shopping destinations in the world¹². Our calculations based on the amount of tax free reclaimed suggest that for non-EU visitors 33.8% of their total spend within the UK is on tax free shopping¹³, reflecting the UK's premier position as an attractive destination for shopping, especially when it is tax free. We have estimated that the impact of Tax-Free shopping is to reduce the cost of a visit to the UK for non-EU visitors (including money spent on shopping) by 5.6%. This calculation takes account of the cost of travel to the UK as well as the spending in the UK¹⁴.

We estimate that the impact of Tax Free Shopping is to boost the number of visitors to the UK by 7.3% (equal to 5.6% from above times the elasticity of 1.3 from Section 3.3 above) of the total number of non-EU visitors; this gives a total of 1,168,000. This is equal to a 2.9% increase in the total number of visitors. So if tax free shopping were to end, it would be likely that the number of visitors would fall by 2.9%.

¹¹ Source ONS see footnote 10

¹² Global Blue's December 2016 Newsletter quotes 'global shoppers cement London's status as Europe's most affordable luxury shopping destination'

¹³ This share looks high and might reflect the fact that the data comes from inconsistent sources. However, for the purposes of the calculation in the report it does not actually matter whether the real share is a lower share of a higher number. If this were so it would give the same overall result.

¹⁴ We have calculated the average savings from Tax Free and expressed this as a proportion of the total spend.

4.3. Impact on total spending of the additional visitors

We assume that the reduced number of visitors *ceteris paribus* would reduce spending by 2.9%, not taking account of any additional spending per visitor. This amounts to an £813 million reduction in expenditure.

4.4. Impact on the average spending per visitor

This calculation is derived by working backwards from the OBR's calculation of the estimated impact of rises in VAT, it would appear that they assume an elasticity of spending volumes of around 0.5 with respect to VAT changes¹⁵. We have used the same figure to estimate the impact of Tax-Free status for non-EU visitors. This implies that Tax Free spending increases the amount of spending that would have taken place had the number of tourists remained the same by £380 million¹⁶. And that overall

This estimate is very much on the low side and in real life we suspect that the impact is noticeably greater (using an elasticity the same for that of the sensitivity of overall tourism – 1.3 – gives an impact of £1.0 billion). But the lower figure, even if an underestimate, is clearly more defensible.

4.5. Total decrease in tourist spending

The total decrease in spending by tourists resulting from the ending of the VAT Retail Export Scheme is therefore the sum of the impact of the reduced number of visitors and the reduction in the spending per visitor. This is £813+380 millions = £1,193 million. So, if the scheme abolished as planned, this is our estimate of the reduction in total tourist spending.

4.6. Indirect effects

We describe below how Cebr's input output model was used for Cebr's report for the Association of British Travel Agents (ABTA) in July 2014 'Understanding the tourism and travel labour market'¹⁷. Section 4.7 uses the conclusions in the initial part of this chapter combined with this model to derive the indirect economic effects on the UK economy from Tax Free shopping. Section 4.8 shows the jobs impact and Section 4.9 uses the same analysis to derive the fiscal impacts on the UK economy. Section 4.10 recalculates this analysis assuming a higher elasticity of spending with respect to VAT.

4.7. The knock-on effects of tourism

The travel and tourism industry, comprising portions of the many sectors set out in Section 1, is a significant contributor of employment for the UK labour market. Cebr's calculation for ABTA shows

¹⁵ The OBR (Office for Budget Responsibility) is the official UK body charged with understanding the impact of fiscal changes. Its latest estimates which include the impact for changes in VAT are shown in this publication:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571367/Nov16_Direct_effects_illustrative_tax_changes_bulletin_final.pdf

¹⁶ Multiplying the percentage change in cost by the spending by the tourists concerned and then by the elasticity.

¹⁷ http://67d8396e010decf37f33-5facf23e658215b1771a91c2df41e9fe.r14.cf3.rackcdn.com/publications/Cebr_-_employment_study_160714.pdf

that in 2012 (see footnote ¹³), tourism activity within the UK supported the employment of 1.7 million people, amounting to around 5.8% of total employment.

As well as the *direct* employment discussed above, the travel and tourism industry also has further employment impacts. For example, in the sectors which provide goods and services to the travel and tourism sector, there will be *indirect* employment sustained. This describes the additional employment within the sector's supply chain, which is dependent upon intermediate demand presented by the travel and tourism sector. ¹⁸

In order to quantify this indirect employment, we use Cebr's input-output models. These are used to calculate employment 'multipliers' for each of the detailed industries in the ONS' supply-use tables. We first disaggregated the travel and tourism industry's FTE employment into its constituent SIC 2007 sectors, before applying these SIC sectors' employment multipliers to these sub-totals. This allowed us to quantify how much additional employment is sustained within the travel and tourism industry's supply chain, as a result of the scale of direct employment. Obviously, the results depend on these models (which we cannot describe in detail since they are Cebr's own intellectual property) but they have been used for other work in the field and have not been challenged.

The outcome of this process was an employment multiplier of 1.51 – this implies that, for each 1 FTE employed within the travel and tourism industry, the employment of a further 0.51 FTEs is supported elsewhere in the economy, through the industry's interrelationships with other sectors. As such, the gross impact of this effect is therefore estimated at an additional 680,000 FTEs.

4.8. The impact on GVA of ending Tax Free Retail

In 2017 we calculated that the VAT Retail Export Scheme boosted GVA in 2016 including the indirect effects by £1.33 billion. Because of the sharp increase in spending by non-EU UK visitors since, we estimate that the impact in 2019 had risen to £1.82 billion.

This is our estimate of the amount of GVA that will be lost if the scheme is abolished.

It should be noted that while the locations of the retail spend are concentrated in a few areas, especially London and certain retail outlets, this is not true of the indirect effects which are spread around the country. It is therefore misleading to think of the economic benefits as largely London based.

4.9. Jobs impact

2017 we calculated that the VAT Retail Export Scheme boosted the number of UK jobs in 2016 including the indirect effects by 20,820. Because of the sharp increase in spending by non-EU UK visitors since but allowing for the change in productivity since we estimate that the employment impact in 2019 had risen to 27,159.

4.10. Fiscal impact

This section looks at the total taxation impact from Tax Free. It may seem perverse that a tax relief generates additional revenue, but this is because the extra economic activity that is generated

¹⁸ Intermediate demand refers to business' demands for goods and services which they require in order to produce their output.

causes additional tax revenues for the economy. Tax Free drives increased tourism AND increased spending, both of which have multiplier effects and the impacts of these offset the direct loss of tax.

The theoretical loss of revenue from Tax Free is the £521 millions of VAT estimated earlier. But this is offset by the income taxes, national insurance, indirect taxes, corporate taxes and rates that are paid as a result of the direct and the indirect effects of the expenditure and also the VAT generated by other tourist spending. In total these amount to £788¹⁹ million, calculated using the model.

So, ending the scheme would cost net in taxes £267 million.

In other words, for every £1 rebated in Tax Free, the government gains £1.51 in tax revenue in return.

4.11. Using a higher multiplier

We have also reworked the calculations above using the higher elasticity of 1.3 which is often used for tourist price sensitivity for the calculation on visitor shopping spend. Because there is no direct research on the impact of VAT for inbound tourists from outside the EU specifically it is hard to prove which number is nearest to being correct. It is quite likely however that the elasticity is at least 1, since it would be unlikely that tourists would spend significantly more in cash terms if VAT were applied to their spending.

This calculation using the 1.3 elasticity suggests the direct total decrease in spending resulting from Tax Free would be therefore £1,813 million rather than the £1,193 million calculated using the lower elasticity.

The impact on value add or GDP is £2.77 billion rather than £1.82 billion.

The impact on jobs is 41,340 rather than 27,159

The impact on tax receipts is £1,199 million rather than £788 million, giving a tax multiplier of 2.30 times as much additional revenue gained as revenue directly lost from Tax Free. These would imply a total tax loss of £678 million if the scheme is abolished.

¹⁹ We estimate that 32% of this tax lost is income tax, 17% NI contributions, 41% VAT and 10% corporation and other business taxes. The same ratios apply to the other estimates of tax revenues lost from the impact on GVA

5. Results – the impact if the VAT Retail Export Scheme is extended to EU shoppers

5.1. Introduction

This section describes the direct impacts on tourism and spending if Tax Free Shopping is extended to all visitors including those from the EU rather than being abolished. It compares what might happen if the VAT Retail Export Scheme is extended to EU visitors with the current situation and with the position where the scheme is abolished.

5.2. Impact on the number of visitors

We estimate that in 2019 the UK had 40.8 million visitors of whom 16.0 million were from outside the EU²⁰. We also estimate that non-EU visitors will have spent £17.8 billion while the 24.8 million visitors from the EU spent £10.6 billion, all in 2019.

While shopping is currently one of the key reasons for international non-EU visitors to visit the UK and their average spend is high as is reflected in the £3.1 billion of shopping on which VAT was reclaimed (compared with an estimated £7.1 billion spending on ALL shopping by ALL (including EU-based visitors) to the UK, until now shopping has not been a major driving force behind EU visits to the UK. It has been noted that the UK is one of the premier shopping destinations in the world²¹. Our calculations based on the amount of Duty Free reclaimed suggest that for non-EU visitors 33.8% of their spend within the UK is on tax free shopping²², reflecting the UK's premier position as an attractive destination for shopping, especially when it is tax free.

Clearly, we have to make a hypothetical calculation to estimate the impact of the potential VAT rebate on visitor numbers and visitor spend for visitors from the EU.

Currently we estimate that EU shoppers spend £2.7 billion in shopping. If the extension of Tax Free shopping were to mean that 70% of this were to be spent on tax free shopping, this would imply a reduction in the cost of a trip to the UK of 2.9% but with a deadweight cost in VAT of a loss of £312 million.

Using the same elasticity of 1.3 as in our other calculations this would imply an increase in the number of visitors of 3.8%. This would imply an additional 948,000 visitors who themselves would spend an additional £405 million.

²⁰ Source ONS see footnote 9

²¹ Global Blue's December 2016 Newsletter quotes 'global shoppers cement London's status as Europe's most affordable luxury shopping destination'

²² This share looks high and might reflect the fact that the data comes from inconsistent sources. However, for the purposes of the calculation in the report it does not actually matter whether the real share is a lower share of a higher number. If this were so it would give the same overall result.

5.3. Impact on the average spending per visitor

This calculation is derived by working backwards from the OBR's calculation of the estimated impact of rises in VAT, it would appear that they assume an elasticity of spending volumes of around 0.5 with respect to VAT changes²³. We have used the same figure to estimate the impact of Tax-Free status for EU visitors. This implies that Tax Free spending increases the amount of spending that would have taken place had the number of tourists remained the same by £187 million²⁴.

This estimate is very much on the low side and in real life we suspect that the impact is noticeably greater (using an elasticity the same for that of the sensitivity of overall tourism – 1.3 – gives an impact of £486 million).

5.4. Total increase in tourist spending

The total decrease in spending by tourists resulting from the ending of the VAT Retail Export Scheme is therefore the sum of the impact of the reduced number of visitors and the reduction in the spending per visitor. This is £405+187 millions = £592 million. So, if the scheme is extended, this is our estimate of the increase in total tourist spending.

Obviously, these numbers are heavily based on present behaviour where EU visitors do not get tax relieved shopping and tend to come to the UK for other reasons. It is likely that in reality if EU visitors become eligible for tax relief there would be additional tourism attracted by the availability of the relief. So, we believe that the calculation below using a higher elasticity than that suggested by the OBR would be appropriate.

5.5. Indirect effects

We have calculated the indirect effects in the same way as in the previous section.

5.6. The impact on GVA and jobs of extending Tax Free Retail

We estimate that the increase in GVA of extending tax free retail to visitors from the EU will be £903 million. The increase in jobs from the extension would be 13,462 jobs.

5.7. Fiscal impact

This section looks at the total taxation impact from extending the Tax-Free scheme. It may seem perverse that a tax relief generates additional revenue, but this is because the extra economic activity that is generated causes additional tax revenues for the economy. Tax Free drives increased

²³ The OBR (Office for Budget Responsibility) is the official UK body charged with understanding the impact of fiscal changes. Its latest estimates which include the impact for changes in VAT are shown in this publication: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571367/Nov16_Direct_effects_illustrative_tax_changes_bulletin_final.pdf

²⁴ Multiplying the percentage change in cost by the spending by the tourists concerned and then by the elasticity.

tourism AND increased spending, both of which have multiplier effects and the impacts of these offset the direct loss of tax.

The theoretical loss of revenue from Tax Free is the £312 millions of VAT estimated earlier. But this is offset by the income taxes, national insurance, indirect taxes, corporate taxes and rates that are paid as a result of the direct and the indirect effects of the expenditure and also the VAT generated by other tourist spending. In total these amount to £391 million, calculated using the model.

So, extending the scheme, far from costing money, generates £79 million in net additional taxes.

5.8. Using a higher multiplier

We have also redone the calculations above using the higher elasticity of 1.3 which is often used for tourist price sensitivity for the calculation on visitor shopping spend. Because there is no direct research on the impact of VAT for inbound tourists from the EU specifically it is hard to prove which number is nearest to being correct. It is quite likely however that the elasticity is at least 1, since it would be unlikely that tourists would spend significantly less in cash terms if VAT rebated from their spending.

This calculation using the 1.3 elasticity suggests the direct total increase in spending resulting from extending Tax Free is therefore £891 million rather than the £592 million calculated using the lower elasticity.

The impact on value add or GDP is £1,359 million rather than £903 million.

The impact on jobs is 20,261 rather than 13,462.

The impact on tax receipts is £588 million rather than £391 million. These would imply a total tax gain of £276 million if the scheme is extended.

6. Conclusions from Customer Research

Table 1 Global Blue Survey

Global Blue Survey of International Travellers
Undertaken September 16th 2020 (HM Treasury announcement on VAT RES was on September 11th)
4,843 respondents

Questions	Responses	All 4,843	Far East ¹ 843	Middle East ² 634	USA 491	Russia 256	Other ³ 2,619	Elite ⁴ 321	Frequent ⁵ 1,673	Infrequent ⁶ 2,808
Q1. Do you expect the removal of VAT refunds will affect your decision to visit the UK in the future?	Yes, I'm less likely to visit the UK	62%	70%	76%	61%	27%	60%	80%	63%	59%
	No, it will not change my plans	38%	30%	24%	39%	73%	40%	20%	37%	41%
Q2. Do you expect that the removal of VAT refunds will affect how much you spend on shopping on your next visit to the UK?	I'm likely to spend less	95%	96%	96%	97%	89%	95%	99%	96%	94%
	I'm likely to spend more	1%	0%	2%	0%	0%	0%	0%	1%	1%
	No change	4%	4%	2%	3%	10%	5%	1%	3%	5%
Q3. As a result of this news, do you think you will change where you do your overseas shopping?	Yes	93%	94%	96%	95%	83%	93%	98%	94%	92%
	No	7%	6%	4%	5%	17%	7%	2%	6%	8%
Q4. Instead of the UK, which other European country do you expect you'll change to for shopping in the future?	France	41%	40%	42%	53%	19%	38%	54%	43%	38%
	Italy	29%	25%	29%	29%	46%	29%	32%	32%	28%
	Germany	11%	11%	15%	4%	16%	11%	3%	9%	13%
	Spain	9%	8%	6%	6%	9%	10%	4%	8%	10%
	Other	10%	7%	9%	8%	11%	12%	7%	8%	12%

Note – visitors from the Middle East and Far East are the major spenders on shopping in the UK

¹ China, Taiwan, Macau, Hong Kong

² GCC – Bahrain, Kuwait, Oman, UAE, Saudi Arabia

³ All other travellers outside from non-EU countries

⁴ Elite shopper: <1% of travellers, 59,300 euros average spend 2019, 20% of all tax-free shopping spend

⁵ Frequent shopper: 12% of travellers, 2,750 euros average spend 2019, 24% of all tax-free shopping spend

⁶ Infrequent shopper: 87% of travellers, 910 euros average spend 2019, 56% of all tax-free shopping spend

6.1. Introduction

Tax rebated spending by international visitors is highly concentrated. Fewer than 1% of non-EU visitors account for 20% of spending while the next 12% account for the next 24% of spending. It is therefore appropriate to survey these people to understand what they claim will be their likely behaviour if tax free shopping is abolished. The results of a survey of 4,843 inbound tourists by Global Blue is shown in Table 1.

These survey results suggest a potential impact from abolition of the VAT Retail Export Scheme for non-EU tourists well in excess of those calculated from traditional elasticities. We have therefore reworked the calculations in Section 4 to evaluate what might be the implications if much higher numbers of tourists are put off coming to the UK by abolition of duty free and the spend of those who do come is reduced by more, based on the responses shown in Table 1.

6.2. Impact on the number of visitors

As noted in Section 4, we estimate that in 2019 the UK had 40.8 million visitors of whom 16.0 million were from outside the EU²⁵. We also estimate that non-EU visitors will have spent £17.8 billion in 2019.

The calculation in Section 4 indicated that the impact of Tax-Free Shopping using the traditional elasticities approach might be to boost the number of visitors to the UK by 7.3% (of the total number of non-EU visitors; this gives a total of 1.17 million.

But the responses in Table 1 show that 62% of non-EU visitors surveyed claim that they would be less likely to visit the UK. If we assume that a half of the 62% actually stop visiting in any one year, this would reduce the number of non-EU visitors by as much as 31% reducing the number of visitors by 4.96 million rather than the 7.3% and 1.17 million calculated by the elasticity approach.

6.3. Impact on total spending of the additional visitors

We assume that a 31% reduction in the number of non-EU visitors ceteris paribus would reduce spending by 31%, not taking account of any further reductions in spending per visitor. This amounts to an £5.5 billion reduction in expenditure.

6.4. Impact on the average spending per visitor

Table 1 shows that 95% of non-EU visitors say that the abolition of tax-free means that they will reduce their spending as well. If we assume this means a 30% reduction in shopping expenditure of those who still come to the UK, this reduces spending by a further £558 million.

6.5. Total decrease in tourist spending

The total decrease in spending by tourists resulting from the ending of the VAT Retail Export Scheme based on the survey information is the sum of the impact of the reduced number of visitors and the reduction in the spending per visitor. This is £5,518+558 millions = £6,076 million. So, if the scheme abolished as planned and the visitors respond as suggested in the survey, total tourist spending will be reduced by over £6 billion.

6.6. Indirect effects

We calculate the indirect effects on the same basis as in Section 4.

6.7. The impact on GVA of ending Tax Free Retail

Using the figures for reduction in tourist spend above (£6.076 billion), we estimate that the indirect effects are such that the abolition of the scheme will reduce GVA by £9.3 billion.

It should be noted that while the locations of the retail spend are concentrated in a few areas, especially London and certain retail outlets, this is not true of the indirect effects which are spread around the country. It is therefore misleading to think of the economic impacts as largely London based.

²⁵ Source ONS see footnote 10

6.8. Jobs impact

Again, based on the higher impacts on tourism spend estimated in this section, we estimate that the jobs effect of abolition of tax free is a reduction in employment of 138,423

6.9. Fiscal impact

This section looks at the total taxation impact from the abolition of Tax Free. It may seem perverse that abolishing a tax relief reduces revenue, but this is because the loss of extra economic activity that the relief generates causes the loss of tax revenues for the economy.

The theoretical gain in revenue from abolishing Tax Free is the £521 millions of VAT estimated earlier. But this is offset by the income taxes, national insurance, indirect taxes, corporate taxes and rates that are paid as a result of the direct and the indirect effects of the expenditure and also the VAT generated by other tourist spending. In total, using the assumptions in this section these amount to £4,013 million, calculated using the model.²⁶

So, ending the scheme would cost net in taxes £3,492 million.

7. Conclusions

7.1. Effects of abolishing the current scheme for non-EU visitors

We show in Section 4 the potential impact of ending the current VAT Retail Export Scheme for non-EU visitors estimated using the traditional elasticities for tourism and spending calculated by official bodies.

Even on these assumptions the impacts are clearly negative:

- The number of non-EU visitors to the UK will be reduced by 7.3% or 1,168,000.
- The total decrease in spending by tourists resulting from the ending of the VAT Retail Export Scheme is estimated to be between £1.1 billion and £1.8 billion
- After taking account of knock on effects GVA is reduced by £1.8 -£2.8 billion.
- We estimate that between 27,000 and 41,000 jobs will be lost.
- And that far from gaining the theoretical £521 million, the loss of economic activity would mean that tax revenues were net reduced by £270 – 680 million.

But if the stated preferences emerging from the survey carried out by Global Blue are correct, these estimates are far too low and the actual real-life impact will be very much higher.

- Abolition of tax free would reduce the number of visitors by 31% or 4.96 million.
- Their spending is reduced by over £6 billion.
- GVA is £9.3 billion lower causing a reduction in employment of 138,423
- And after taking the gains from the abolition of the tax relief into account, tax revenues are £3,492 million.

If the survey data is anywhere near accurate, abolishing the scheme would be a massive negative for the economy at a time when this is least needed, hitting sectors that are especially vulnerable like tourism and retail.

7.2. Extension of the scheme to EU visitors

We have only used the elasticities approach to estimate the impact of extending the scheme to EU visitors and the detailed calculations are in Section 5.

Again, even on the cautious assumption that this implies, the net impact is that extending the scheme raises more tax revenue than it loses.

- We estimate that extending the scheme to visitors from the EU would increase the number of EU visitors by 3.8%. This would imply an additional 948,000 visitors who themselves would spend an additional £590-£890 million.
- We estimate that the increase in GVA of extending tax free retail to visitors from the EU will be between £900 and £1,360 million. The increase in jobs from the extension would be 13,500 and 20,200 jobs.
- The theoretical loss of revenue from extending Tax Free is £312 million of VAT estimated earlier. But this is offset by the income taxes, national insurance, indirect taxes, corporate taxes and rates that will be collected as a result of the additional tourist spending.
- So, extending the scheme, far from costing money, generates between £79 and £276 million in net additional taxes.

7.3. Conclusions

In practice, the choice that the government is likely to face is between building on the success of the current VAT Retail Export Scheme and extending it to tourists from the EU or scrapping the scheme.

Even in normal times, our calculations above would make a powerful case for the extension of the scheme.

But at a time when both the retail sector and the tourism sector are facing a huge challenge because of the impact of Covid 19, failure to extend the scheme would exacerbate both sectors' problems significantly.

It has been claimed that any impact from the scheme mainly affects London and that this for some reason means that the scheme is inappropriate. At a time when retail spend in London is severely depressed, this argument has less validity.

And indeed the fact that the retail outlets most affected are concentrated in particular areas like Knightsbridge, Oxford Street and Bicester Village means that in current circumstances the impact on these outlets could be very significant and potentially existential.

Moreover, only part of the impact is through the retail sector. The indirect effects will be felt by producers and suppliers throughout the country.

Given the calculations described in this report, it would be damaging to the economy, to employment and to public finances if the scheme is abolished rather than extended.