Should hospitality pay less VAT? The border helps make the case

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Every hospitality trade body in the UK wants a lower rate of VAT and every Chancellor for the past decade has said no. The Treasury's reasons are well rehearsed, a sectoral VAT cut is expensive, it is politically very difficult to reverse and it creates a queue of other sectors asking for the same treatment. The one exception was the temporary cut to 5 per cent during the pandemic, which was withdrawn in 2022 having cost more than £8 billion. For now, hospitality across the UK remains on the standard 20 per cent rate.

Can a special case be made for Northern Ireland? The Westminster Northern Ireland Affairs Committee are currently considering this question and it requires a better response than “rising cost pressures”. Restaurants in the North East of England also face higher wages and energy bills, but the key difference is that the North East of England does not have a land border with a jurisdiction that has just cut its own VAT rate.

Since 1 July, a restaurant meal in the south has a VAT rate of 9 per cent and a hotel room carries a 13.5 per cent rate compared to our single 20 per cent rate. The comparison runs the other way on alcohol, where the 23 per cent standard rate applies, but overall we have the higher tax burden.

Importantly the VAT differential matters more here than anywhere else in the UK, for two reasons. Firstly, the visitor economy is marketed abroad as a single island destination and most international visitors arrive on the island through Dublin. A tour operator assembling an itinerary will compare prices between north and south in a way that does not happen when comparing Cardiff and Bristol. In effect, our competitor jurisdiction is also the gatekeeper.

Secondly, the south is not just a competitor, it is also one of our most important markets. Last year saw a record 1.3 million overnight trips from southern visitors, a growth of 12 per cent in a single year. But consumer behaviour can change quickly. Sterling fell sharply against the euro following the financial crisis in 2008 and the number of southern registered cars travelling north increased significantly. The direction of travel can reverse just as quickly.

The second strand of the argument is that UK-wide cost pressures land more heavily here. Median weekly earnings are lower here than the UK average and as a result, the increases to the National Living Wage and employer National Insurance Contributions have a larger proportionate impact.

There is also a gap of our own making. England, Scotland and Wales have all provided some form of business rates relief for retail, hospitality and leisure in recent years. That is a NI Executive decision which chooses to give rates relief to the manufacturing sector instead and it weakens the hand of anyone asking Westminster for help.

The sector has responded to these cost pressures in a range of ways but not, for the most part, through redundancies. Operators struggled to recruit after the pandemic and are now reluctant to let staff go, when rehiring again could be a challenge. The adjustment has come instead through fewer opening days, higher prices and reduced investment. That last response is the most damaging because it is invisible, a refurbishment that never happens does not make the headlines, but over time it reduces the quality of the tourism product.

The fiscal cost is the other constraint, a 5 per cent VAT rate across all UK hospitality would cost an estimated £17 billion a year. A Northern Ireland-only rate would be a small fraction of that, but given the Executive is unable to agree a budget in the current circumstances, any further reduction in the Block Grant to fund a VAT reduction seems implausible. Therefore, the sensible request to the UK Government is a properly costed and tested pilot, to provide the evidence to inform a longer term policy decision.

Importantly, if the objective is to increase investment across the sector, then the pilot period would need to run for a reasonable period of time, probably four to five years. Anything shorter and operators may conclude that the VAT rate would be increasing again, at the same time as their new investments were just ready to open.

Alternatively, if the objective is to reduce prices, then the Treasury has just run a useful experiment. Its Great British Summer Savings scheme cut VAT to 5 per cent on children's meals and family attractions between late June and the start of September. Publishing the impact on prices during that period would tell us a great deal about price pass-through in this market.

As always there are other measures Westminster could take. First amongst them is reaching a new agreed fiscal framework which would give the Executive greater financial stability. In addition, Stormont also has choices. Although rates relief for hospitality is fully within its gift, it is not currently a realistic prospect. Building on the momentum of The Open last year and The Fleadh this summer, other measures include developing a long-term calendar of major events to attract international visitors. In addition, working with the sector to create an enhanced skills and careers pathway so it becomes a sector of choice for many young people.

Overall, the border creates a special case, but a special case is not a simple case and whilst a lower VAT rate would undoubtedly help the sector grow, measures that do not need Westminster permission should remain our focus.

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