VAT Retail Export Scheme (VAT RES) abolition: updated estimate

Introduction

1.1 In the November 2020 *Economic and Fiscal Outlook*, the OBR certified the costing of the abolition of VAT RES and tax-free airside shopping, both of which applied to non-EU visitors to the UK. The reinstatement of these measures and their extension to both non-EU and EU visitors was announced as part of the September 2022 *Growth Plan*, but the costing was not scrutinised or certified by the OBR. The reinstatement was not confirmed as Government policy in the subsequent 2022 Autumn Statement or implemented, so we have never assessed its costing as our remit only allows us to consider confirmed Government policy.

1.2 We have chosen to conduct this review of the original 2020 costing of the abolition of VAT RES given the high degree of uncertainty around it.[1] We have focused on VAT RES rather than airside shopping because of its greater fiscal costs. Based on our own assessment and from responses received from external stakeholders, the behavioural uncertainties around VAT RES are more significant for our forecast than those surrounding airside shopping. But both measures operate via similar channels, and so our main analytical conclusions are also likely to be relevant for airside shopping.

Evidence considered

1.3 In doing this, we reviewed several different sources of information, including Oxford Economics analysis and report for the Association of International Retail on the *Growth Plan* measure.[2] We also reviewed the Government's document summarising the outcomes of and its response to its consultation on potential post-Brexit approaches to duty- and tax-free goods.[3] We also read the Centre for Economic and Business Research's summary of the impacts of introducing a similar measure.[4] Finally, the House of Commons library has published a summary of publicly-available parliamentary and other material relating to the measure.[5] This review has also benefited from several additional pieces of analysis and information, which were shared to us on a confidential basis. Finally, we are grateful for helpful discussions with HM Treasury and HMRC officials.

[1] For further detail on the circumstances surrounding the original costing, see the Chair of the OBR's letter to Sir Geoffrey Clifton-Brown MP, Deputy Chair of the House of Commons Public Accounts Committee on 22 December 2023.
[2] Oxford Economics, *Assessing the impact of tax-free shopping in the UK: a report for the Association of International Retail*, 2022.
[3] HM Treasury and HMRC, *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,* September 2020.
[4] Centre for Economic and Business Research, *Tax-free shopping in the UK*, 2023.
[5] House of Commons Library, *Tax-free shopping for international visitors*, 2023.

Timeline of policy changes

1.4 Since the 1970s, VAT has been paid on most goods and services consumed in the UK. The standard rate is now 20 per cent, although some goods and services attract reduced or zero rates, for a number of reasons.

1.5 Prior to January 2021, two relevant exemptions were:

- To align with 2006 EU legislation, the UK had operated a **tax-free shopping** scheme. The legislation exempted goods from VAT, provided three necessary conditions were all satisfied.[6] First, that they were purchased by a visitor that resided outside of the EU. Second, that they were removed from the country of purchase within a three-month period. And third, that they were worth more than €175. The UK's tax-free shopping scheme was known as the VAT Retail Export Scheme (VAT RES).

- A similar scheme known as **tax-free airside shopping**, allowed retailers in airports and ports to apply a zero rate of VAT to passengers leaving for destinations outside the EU.

1.6 In September 2020, the Government announced it was abolishing both VAT RES and tax-free airside shopping from January 2021 to align with World Trade Organisation (WTO) rules. The Government could alternatively have met WTO rules by extending the two schemes to visitors to the UK that resided in the EU. Stores can, and some do, still offer tax-free shopping to their customers, although only if they are delivered straight to an address outside the UK.

Our original costing

1.7 Table 1.1 shows the original 2020 costing of the withdrawal of VAT RES, which was estimated to raise around £460 million by 2025-26, reflecting:

- A **static saving** from the VAT which would no longer need to be refunded as a result of abolishing the scheme (around £620 million).

- A first direct behavioural cost from the scheme's withdrawal is that induces **fewer UK visitors, lowering the amount of previously VAT-refundable items that are purchased**. The smaller tax base reduces the overall savings from the measure by around £10 million.

- A second direct behavioural cost arises from the **lower spending of remaining UK visitors on previously VAT-refundable items,** which further reduces the tax base. This element lowers the overall savings by a further £140 million.

[6] The Council of the European Union, *Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax*, 2006. The EU's conditions are summarised in House of Commons Library, *Tax-free shopping for international visitors*, 2023. The UK's implementation of the scheme differed from that in some other countries. For instance, in 2019 the UK version did not have a minimum threshold.

1.8 We have reviewed and updated our estimates of these three channels in this review. We have also considered two other '**indirect effects**' which are the possible impact of measures on aggregate demand in the wider economy and/or on the supply potential of the economy.[7] As discussed further below, we generally consider such demand effects at an aggregate level through looking at the overall changes in tax and spending at any fiscal event (and did so in November 2020).[8] And we only isolate the supply effects of individual measures where there is clear evidence that they are significant, additional and durable. In this review we have looked again at the evidence on the potential indirect effects of the VAT RES measure though two channels:

- First, the extent to which reductions in visitors to the UK or changes in the spending habits of undeterred visitors due to changes in the VAT RES scheme also **impacts spending on other, non-VAT-refundable goods and services** (and in turn the tax receipts from that spending), which we have incorporated in our updated estimate.

- Second, a possible **supply-side reduction** from the potential loss of the 'additional' gross value added of increased tourist spending supporting employment and investment in affected sectors, which in our updated estimate we continue to assess is not likely to be significant in this case, for reasons discussed below.

Table 1.1: Original 2020 VAT RES costing

	£ million					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Static costing	**-42**	**-262**	**-412**	**-535**	**-584**	**-617**
Behaviour and other effects	**9**	**66**	**103**	**134**	**146**	**154**
Fewer visitors: spending on previously VAT refundable goods	1	5	8	11	12	12
Fewer visitors: spending on other goods	0	0	0	0	0	0
Remaining visitors: spending on previously VAT refundable goods	8	59	93	120	131	139
Remaining visitors: displaced spending on other goods	0	0	0	0	0	0
Reduced air passenger duty receipts	0	1	2	3	3	3
Final costing	**-33**	**-196**	**-309**	**-401**	**-438**	**-462**

Note: This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Reassessing our 2020 assumptions

1.9 In this section, we review the three main elements from our original costing in turn, as well as the two 'indirect effects' which we did not originally capture. The first-year cost was estimated on an in-year basis, and assumed only a quarter of 2020-21 would be affected due to the measure not coming into effect until January 2021. This assumption continues to remain a reasonable approximation and so is not discussed in any further detail below. We

[7] For a summary of our approach, see OBR, *Briefing paper No.8: Forecasting potential output – the supply side of the economy*, November 2022.
[8] For a summary of our approach, see OBR, *Dynamic scoring of policy measures in OBR forecasts*, November 2023.

also continue to judge that any impacts on air passenger duty receipts are close to negligible and so do not discuss this assumption below in any detail.

Direct effect on VAT RES: static costing

2020 calculation

1.10 The initial estimate of both the static and behavioural costs were grown over the scorecard period using forecasts for both retail prices index (RPI) inflation and non-EU passenger numbers. Specifically, we:

- Took the £525 million observed value of VAT RES refunds in 2019.
- Grew it by 17 per cent to reach £620 million by 2025-26. The growth in passenger numbers accounts for 2 percentage points of the growth (our November 2020 forecast expected that that air travel volumes, which had been reduced sharply by the pandemic, would recover entirely by 2025). Therefore, the remaining 15 percentage points of growth is due to RPI.

Updated estimate

1.11 As shown in Table 1.2, our updated estimate is that the static cost will be £68 million (11 per cent) higher by 2025-26 than it was in the original costing. In the event, the pandemic suppressed visitor numbers for longer than we expected but numbers then rebounded more sharply so that, in cumulative terms, visitor numbers are now expected to be slightly higher (4 per cent) by 2025-26 than we thought in November 2020. RPI inflation is used to uprate our air passenger duty forecast, but cumulative CPI inflation is likely to be a more appropriate measure for capturing changes in consumer prices, due to methodological and compositional differences. We have therefore switched to using CPI in this estimate. Growth to 2025-26 is higher (16 percentage points) than in our November 2020 forecast. The combined impact of these changes is to raise our estimate of the static costing to £685 million.

Table 1.2: Static costing

	£ million					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Original costing	-42	-262	-412	-535	-584	-617
Updated estimate	-31	-179	-463	-586	-633	-685
Difference	**12**	**82**	**-51**	**-52**	**-49**	**-68**

[1] This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Direct effect: fewer visitors lowers spending on previously VAT-refundable goods

2020 calculation

1.12 The scheme's removal mechanically raised receipts from previously refund-eligible items, representing a static saving to the UK Government. But it also lowered the incentive for some travellers to come to the UK. As these deterred travellers would no longer purchase any previously refund-eligible goods in the UK, our behavioural costing stripped the value of their VAT out from the static costing via an elasticity-based approach, in which we:

- Took the number of VAT RES forms observed (5,755,000 in 2019) and **the number of unique VAT RES travellers** that generates them (1,154,000). This implies that the number of returns submitted per traveller is around five.

- Divided the static cost (£525 million) over the number of VAT RES forms observed, less the administrative fees for processing refunds (estimated at 20 per cent based on industry returns), to calculate the **average cash value of each refund form** (£73).

- Estimate **the percentage change in overall visit costs for travellers from the rest of the world due to the change in policy** at 2.8 per cent. This was done by first estimating the cash value of VAT refunds as a share of the sale price (16.7 per cent), assuming that 20 per cent of this was taken up by administrative fees related to processing refunds, so that refunds-net-of-fees were ultimately worth 13.3 per cent per transaction to consumers. Based on refund data and visitor spending figures from the International Passenger Survey (IPS), travellers' spending on refund-eligible goods were, on average, worth 21 per cent of travellers' from the rest of the world's total spending, so multiplying this figure by 13.3 yielded a 2.8 per cent increase in visit costs.

- Applied the assumed scaled-up -1.9 elasticity to the change in the total cost of travel to obtain the **demand response to the VAT RES withdrawal** (-5.3 per cent) for those VAT RES users who may have their behaviour impacted.[9]

- Calculated **the reduction in travellers,** by applying this demand response to a 0.5 million sized population, by scaling down the 1.2 million refund-claiming travellers by 53 per cent (to account for the share of trips reported as being purely for 'holiday purposes') to estimate the implied reduction in the number of travellers at around 29,000.[10]

- Multiplied the 29,000 reduction in the number of travellers by the estimated average of five returns submitted per traveller, and the £73 average cash value of each refund form value to obtain **the cost of reduced visitors** (of *minus* £13 million).

[9] This 1.9 elasticity used in our 2020 costing reflected a 50 per cent scale up of a UK-specific estimate relating to tourism in general (1.28) in recognition of the likely greater responsiveness of those affected by the measure. This elasticity is examined in more detail below.
[10] This step of the calculation is further examined below.

1.13 This £10 million behavioural effect is equivalent to the VAT the deterred passengers would have paid on VAT-refundable goods (had they come to the UK and bought the same value of goods). The profile of the behavioural effect reflected our November 2020 forecast's assumptions for growth in air travel and RPI inflation over our forecast horizon.

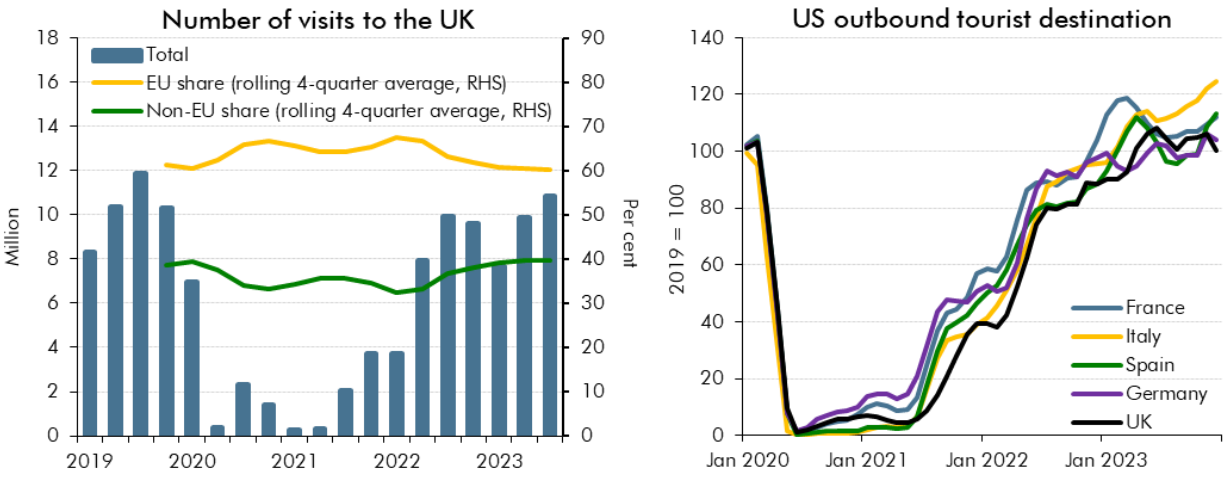
Updated estimate

1.14 The roughly 30,000 reduction in the number of VAT RES claimants, our estimate of those deterred from travelling purely due to the policy change, was a key assumption for our original costing. To review it, we have assessed data on traveller numbers to the UK since the policy's introduction and reviewed studies on the price elasticity of demand for tourism.

1.15 Visit numbers are driven by a wide range of factors and the policy change occurred during the pandemic and in the immediate aftermath of Brexit. This means that it is very difficult to isolate the effect of this tax policy from the data. That said, we do not see any clear evidence that would lead us to change our initial assessment, although there is clearly still significant uncertainty around all these estimates:

- The left-hand panel of Chart 1.1 shows that recent visit numbers have approached pre-pandemic levels, as well as pre-VAT-RES-abolition levels.
- It also shows that the non-EU share of visits has, if anything, risen slightly (rather than making up a significantly smaller percentage of visits than before as might be expected had VAT RES had a material effect on these figures).
- And the right-hand panel of Chart 1.1 shows that visits to the UK from the US have now risen broadly in line with visits to other European destinations (rather than lagging significantly behind, as might be expected had the policy had a significantly greater than expected effect on visitor numbers).

Chart 1.1: Numbers and composition of visits



Notes: A rolling 4-quarter (LHS) and 3-month (RHS) average is used to smooth out volatility. Visit volumes are rebased with reference to the corresponding month in 2019.

1.16 To assess our assumed demand response, we have also surveyed a range of studies into the price elasticity of demand for UK tourism. We think that a central estimate is likely to lie in the -2 to 0 range (although these estimates depend on methodological approaches, the precise explanatory and explained variables picked, and other modelling choices). For instance, a 'central' airfare elasticity of demand of -0.35 (within a range from 0 to -0.7), measures the "*responsiveness of the demand for air travel to changes in the price of air travel*" in one Home Office Review.[11] A 2021 Scottish Government evidence review finds only two UK specific studies, from which it determines a median UK elasticity of -1.53. This is much higher than some of the median elasticities found in other comparable European destinations, such as Italy (-0.32), France (-0.52), and Germany (-0.19), although higher elasticities are found in Switzerland, Belgium, and Denmark.[12] But given that groups of shopping-motivated travellers are likely to be more price sensitive than average, and may see greater-than-average increases in travel costs, the judgement that our elasticity should not lie at the bottom of this range remains appropriate.

1.17 This is a group of visitors that spends an estimated £2,700 on average on VAT RES goods on their trips, which suggests they are also likely to spend more overall on their trips than other holidaymakers. However, the IPS-implied level of spending on non-VAT RES items seems high when compared to other data sources, including more recent ONS surveys of visitor spending, which implies much lower average spending from all non-EU travellers. This suggests that the estimated 2.8 per cent increase in the overall cost of a trip (discussed above) might be slightly high. However, once we factor in that the 1.9 elasticity that was used in the original estimate was also at the higher end of the plausible range, and having reviewed wider evidence and elasticities, we still think that the original 5.3 per cent demand response looks plausible and central, so have retained it in our updated costing. But recognising the uncertainty around this element of the calculation, we conduct sensitivity analysis to show the impact of changing both the numbers of visitors and the amount of non-VAT RES spending (see below).

1.18 We judged that 540,000 people would be able to alter their behaviour in the original costing (47 per cent of all VAT RES claimants). This was based on the proportion of visitors that reported coming for 'holiday' reasons. As some travellers that report coming for other reasons (such as on business trips or in order to see family) may nonetheless still be able to divert their trip in response to price changes, we have increased the overall figure to 52 per cent to produce a more central estimate.[13] Applying this revised judgement results in an updated estimate of around 34,000 fewer VAT RES claimants in 2025-26 (5,000 more than the original estimate) which, in isolation, increases this behavioural cost to £13 million (£12 million originally in 2025-26). Taking onboard the latest forecast determinants, as described above, results in the updated figure of £15 million presented in Table 1.3.

[11] Home Office, A review of evidence relating to the elasticity of demand for visas in the UK, March 2020.
[12] Scottish Government, Review of Evidence of Elasticities Relevant to Tourism in Scotland, June 2021.
[13] As discussed below, we also now assume that VAT RES claimants travel as part of a wider group and so bring with them, on average, one additional traveller (although as these travellers by definition do not purchase VAT RES eligible goods they only affect the measure's indirect, and not its direct, fiscal costs). Some recent external estimates consider responses from both EU and non-EU visitors, which would not be appropriate for our revised estimate given that the 2020 measure only applied to non-EU visitors. Nonetheless, given the significant uncertainty around this figure, we discuss some plausible alternate assumptions in further detail below.

Table 1.3: Fewer visitors: spending on previously VAT-refundable goods

	£ million					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Original costing	1	5	8	11	12	12
Updated estimate	1	4	10	13	14	15
Difference	**0**	**-1**	**2**	**2**	**2**	**3**

[1] This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Direct and indirect effects: fewer visitors reduces spending on other goods and services

2020 calculation

1.19 Travellers buy other goods and services, including those that are not eligible for VAT RES, during their visits. In 2020, our costing did not explicitly account for the 'indirect effect' on our fiscal forecast from the reduction in consumption more generally from these dissuaded travellers (beyond the impact captured by the demand multipliers applied to the Spending Review 2020 policy package as a whole). We would not normally separately quantify the indirect effect of relatively small measures on our overall fiscal forecast.

Updated estimate

1.20 For completeness, our updated estimate now identifies this channel explicitly alongside the costing. In doing so, we judged that looking just at spending of refund-claiming travellers is likely to underestimate associated tax receipts, as they often travel as members of a wider party. The amount of spending each traveller does is highly uncertain. For instance, the average spend of non-EU travellers on a 11 night trip to the UK is £1,272 according to the ONS.[14] Many shopping trips are shorter in duration than that. Nonetheless, given that, on average, VAT RES travellers spend £2,700 on eligible goods, we judge that their spending on other goods and services is also likely to be higher than average.

1.21 The £24 million shown in Table 1.4 reflects:

- The around 34,000 fewer **VAT RES claimants** we now expect to be dissuaded from travelling to the UK due to the policy.
- The judgement that, on average, each deterred visitor travels with one companion, bringing the total number of **visitors** that will be dissuaded by the policy to 69,000.[15]
- The assumption that additional spending on non-VAT RES items that year was around £1,750 per person, so the average *group's* VAT RES spending on travel, accommodation, and other costs is a little more than it spends on VAT RES. This estimate is very uncertain.

[14] See ONS, *Estimates of overseas residents' visits and spending in the UK*, 2024.
[15] Rounding explains why this is not 68,000 (i.e. 34,000 x 2).

- The assumption that this group would have paid VAT at 20 per cent (and so one sixth of this spending would have resulted in higher VAT receipts).

- The profile of this behavioural effect also reflects our latest forecast's assumptions for growth in air travel and CPI inflation over our forecast horizon.

Table 1.4: Fewer visitors: spending on other goods

	£ million					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Original costing	0	0	0	0	0	0
Updated estimate	1	6	16	21	23	24
Difference	**1**	**6**	**16**	**21**	**23**	**24**

[1] This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Direct and indirect effects: remaining visitors spend less on both previously VAT-refundable goods and other goods and services

2020 calculation

1.22 As described above, removing VAT RES raised VAT receipts, representing a static saving to the UK Government. But it also raised the price for travellers of previously-refundable goods, which should result in travellers that still come to the UK purchasing fewer of these goods. So, as some purchases of goods that had been eligible for refunds no longer take place, the purchases do not generate VAT and so our behavioural costing stripped this out of our estimate of the savings associated with cancelling VAT RES.

1.23 Our 2020 costing also calculated the change in spending by travellers to the UK (that were not deterred by the change in policy) by:

- As a simplifying assumption, assuming the spending levels of non-European visitors would fall part of the way toward European levels in response to the equalisation of their treatment in the VAT regime (discussed below). This lowered spending by around £360, taking per-visit spending levels from the £1,243 observed for non-European visitors to £885 (halfway to the figure for European visitors), a 29 per cent **reduction in spending**.

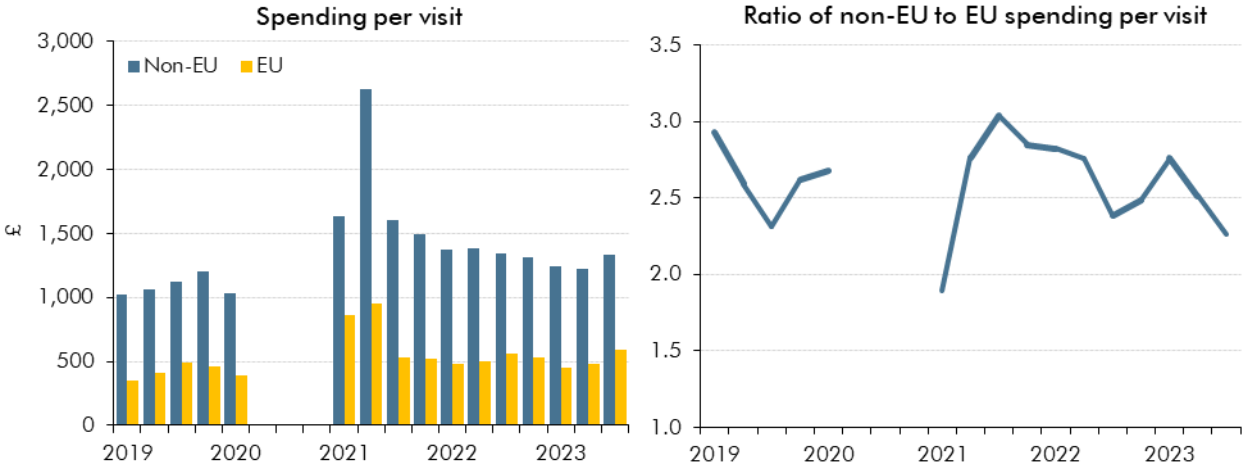
- Taking the £73 figure calculated above and multiplying it by the 29 per cent reduction in spending to estimate the **per claim reduction in the static savings from this behavioural response** (£21 in 2019).

- Taking the average £ value loss of each refund form and multiplying it by both the number of undeterred refund-claiming travellers (1,125,000) and the five returns submitted per traveller to obtain the **cost of reduced spending**.

Updated estimate

1.24 Convergence in spending levels is a key assumption which underpins our estimate of this behavioural cost. Spending by non-EU visits is, and has been, between two to three times higher than EU visits across the available data. However, whilst recent outturns since the withdrawal of VAT RES show some convergence in spending levels (as shown in the left-hand panel of Chart 1.2 and again in ratios in the right-hand panel), here again the impact of the policy change is difficult to isolate.[16]

Chart 1.2: Per-visit spending levels (EU and non-EU)



Note: The gap in data in both charts is due to no disaggregated data being available from the ONS.

1.25 A price elasticity of demand approach would also be an appropriate way to estimate this behavioural response. The available literature largely attributes the price elasticities of demand described above to the extensive margin (visitors deciding whether or not to come) rather than the intensive margin (how much to spend on arrival). The VAT RES demand response from this (undeterred) group should more accurately reflect the 16 per cent rise in the price of VAT RES eligible goods, rather than the overall cost of their trip.[17] So, the implicit -1.8 intensive margin elasticity implied by the 29 per cent reduction in spending that we assumed in 2020 is arguably high (given we expect *these* travellers to be undeterred by the changing costs of their trips). But the literature does not generally look explicitly at shoppers using these schemes who we might expect to be relatively more price sensitive.

1.26 The price rise might lead some shoppers to switch from VAT RES to non-VAT RES spending via a substitution effect. This effect was not explicitly accounted for in the 2020 costing, however a degree of displacement (reflecting travellers' desire to maintain a certain level of utility) seems plausible. There is little empirical evidence to determine what proportion of this spending will be displaced. But as many of the qualifying goods are by definition high-value, they are less likely to be close substitutes for other goods and services consumed by

[16] Exchange rate movements, for example, can impact visitors' willingness to spend. Sterling has appreciated 0.8 per cent relative to the Euro from 2019 to 2023, compared to a 2.8 per cent increase in the effective exchange rate.
[17] This figure reflects the abolition of VAT RES raising effective prices by 20 per cent, scaled by 80 per cent, to account for administrative fees as outlined above.

holidaymakers. We have, therefore, made the judgement that only a third of the 29 per cent reduction in VAT RES spending will be diverted elsewhere. This lowers the implied elasticity of this group's spending to -1.2, which we consider to be more central. Again, this channel is relatively uncertain.

1.27 Reflecting this, and the latest forecast determinants, as described above, we have revised down the total loss in receipts from those non-EU visitors that still travel to the UK to £102 million in 2025-26, £36 million lower than the 2020 costing, largely due to including the impact of spending that is displaced to non-VAT RES sectors.

Table 1.5: Remaining visitors: spending on previously VAT-refundable goods and other goods and services

		£ million					
		2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Previously VAT refundable	Original costing	8	59	93	120	131	139
	Updated estimate	7	40	104	132	142	154
	Difference	**-2**	**-19**	**11**	**11**	**11**	**15**
Other goods and services	Original costing	0	0	0	0	0	0
	Updated estimate	-2	-13	-35	-44	-47	-51
	Difference	**-2**	**-13**	**-35**	**-44**	**-47**	**-51**
Total	Original costing	8	59	93	120	131	139
	Updated estimate	5	27	69	88	95	102
	Difference	**-4**	**-32**	**-23**	**-33**	**-37**	**-36**

[1] This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Indirect effect: broader effects via our economy forecast

1.28 In November 2020, the impacts of the VAT RES measure on demand in the economy was captured via our fiscal multipliers framework. This assumed that higher receipts from no-longer-refunded VAT refunds would reduce GDP in the near-term. As usual, this effect tapered to zero by the forecast horizon, in line with our usual assumption that monetary policy would take action to return inflation to target and bring output in line with the economy's potential capacity. Given that this measure's impacts were small relative to the overall size of the policy package (worth tens of billions of pounds in November 2020), its effects were included in the aggregate change in tax receipts, and this fed into the aggregate change in GDP.

1.29 Nonetheless, given, the purpose of this review, we have considered the mechanisms through which we expect this policy to affect the economy in further detail:

- This measure would clearly have significant negative impacts on the **gross sales of affected businesses**, as a result of the two behavioural responses set out above: fewer VAT RES claimants and other group travellers and lower sales (partly offset by spending that is diverted elsewhere).

- VAT RES eligible goods and tourism are reflected in the national accounts as demand for exports of goods and services. So, fewer tourists would reduce **net external demand**

in the near term. To fully account for the transmission of changes to the gross sales of affected businesses to the wider economy we would also need to adjust for the import content of many of these goods, which would reduce the impact on net external demand. For example, the British Retail Consortium reports that total sales in the retail sector in 2022 were £436 billion but that the value added by these sales was only £183 billion (roughly 40 per cent of this).[18] Some of the difference will reflect intermediate consumption of goods produced in the UK, but much will reflect the intermediate consumption of goods produced elsewhere. This is likely to be particularly pronounced in some sectors: for instance, for 'garments' and 'footwear including repairs', imported goods ultimately make up almost 50 per cent of all purchases in the UK.

- In the near-term, changes in external demand for these exports could lead to output and employment operating below its productive capacity (or reducing the degree to which the economy is operating above its capacity). So, changes in external demand would **temporarily affect the output gap**, pushing down on inflation. We judge that this effect would taper away to zero over time as the exchange rate, wages and prices, and monetary policy adjust to bring inflation to target and output in line with potential.

- In considering the **potential supply impact** we only assume changes in fiscal policy have permanent impacts on the level of real potential GDP, when strong evidence suggests that the effects on the value added in the UK are significant, durable, and additional. We do not judge there is evidence that this would be the case for this policy. With unemployment having remained broadly in line with our estimate of its neutral rate and with vacancies high, we judge that this measure is more likely to have reallocated employment and activity between the UK's sectors and regions. To assume instead that some people in the UK, and some part of UK infrastructure and capital, no longer employed in creating and selling VAT-free goods are permanently left unemployed would not be consistent with any evidence we have seen.

Summary

1.30 Table 1.6 summarises our updated estimate. A static costing of £685 million in 2025-26 is lowered by £146 million via both direct and indirect behavioural responses. The most significant of these is from the reduced spending by non-EU visitors that still travel to the UK which, after accounting for displaced spending, lowers the static cost by £102 million. Spending by deterred visitors further lowers the static cost through lost tax receipts from spending on a combination of previously VAT refundable goods (£15 million) and other goods and services (£24 million). As a result, our updated estimate is that the withdrawal of VAT RES has led to a saving for the Exchequer of around £540 million by 2025-26 (compared to £460 million previously).

[18] As reported in British Retail Consortium, *Retail in Numbers*, accessed 8 March 2024.

Table 1.6: Our updated estimate

	£ million					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Static costing	**-31**	**-179**	**-463**	**-586**	**-633**	**-685**
Behaviour and other effects	**7**	**38**	**99**	**125**	**135**	**146**
Fewer visitors: spending on previously VAT refundable goods	1	4	10	13	14	15
Fewer visitors: spending on other goods	1	6	16	21	23	24
Remaining visitors: spending on previously VAT refundable goods	7	40	104	132	142	154
Remaining visitors: displaced spending on other goods	-2	-13	-35	-44	-47	-51
Reduced air passenger duty receipts	0	1	3	3	3	4
Final costing	**-24**	**-141**	**-364**	**-462**	**-498**	**-539**

Note: This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

1.31 Table 1.7 summarises the changes since our 2020 costing. Higher-than-expected inflation and slightly higher-than-forecast cumulative growth in visitor numbers is the primary driver of the higher tax yield, contributing to a £68 million higher static cost in 2025-26 compared to our original costing. In addition, the net effect of including additional 'indirect' behavioural responses as part of this review – both wider spending from deterred visitors and displaced spending from remaining visitors – is a further source of change (£27 million). Lastly, our revised estimates of the direct behavioural effects (fewer visitors and lower spending by remaining visitors) have led to a £18 million change since our original costing.

Table 1.7: Changes since our 2020 costing

	£ million in 2025-26		
	Original	Revised	Difference
Static costing	**-617**	**-685**	**-68**
Behaviour and other effects	**154**	**146**	**-9**
Fewer visitors: spending on previously VAT refundable goods	12	15	3
Fewer visitors: spending on other goods	0	24	24
Remaining visitors: spending on previously VAT refundable goods	139	154	15
Remaining visitors: displaced spending on other goods	0	-51	-51
Reduced air passenger duty receipts	3	4	0
Final costing	**-462**	**-539**	**-77**

Note: This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Sensitivity analysis

1.32 We judge that our updated costing represents a reasonable and central estimate of the savings to the Government from the policy. This is supported by the aggregate data on visitor numbers that do not readily identify differential trends in economy-wide visitor numbers or spending between the groups that have and have not been affected by this policy which are not already captured in our costing. Nonetheless, the uncertainties surrounding the costing are significant. We assign an uncertainty rating to all certified policy

costings, with our original costing being given a 'high' rating – an assessment we maintain following this review.[19] To illustrate the potential impact of these uncertainties, we have undertaken sensitivity analysis on some of the key judgments in the costing (Table 1.8).

1.33 The number of **deterred visitors** (69,000) is a key assumption in this costing, with an associated £40 million (£15 million from the tax that would have been due on VAT RES spending and £24 million from the tax lost from non-VAT RES spending) behavioural offset to the static cost in our central estimate (Table 1.8, top panel). This figure is a result of an assumed 5.3 per cent demand response discussed above, from the 604,000 visitors we expected to be affected. However, if:

- The withdrawal of VAT RES led to double the number of deterred visitors, reflecting a greater demand response than we have assumed, the static savings from this policy would be around £40 million lower.

- The withdrawal of VAT RES led to half the number of deterred visitors, perhaps to reflect a lack of close substitutes to many British shopping destinations, the overall savings from this policy would be around £20 million higher.

1.34 The **spending level of deterred visitors** is another important, and particularly uncertain, assumption (Table 1.8, second panel). In our central estimate, we have assumed that groups of deterred travellers would have spent an additional £1,750 per person on non-VAT RES items, on top of the roughly £2,700 on VAT-RES goods we expect them to purchase.

- Holding the number of deterred visitors fixed at our central estimate, if non-VAT RES spending was twice the level we have assumed in our updated estimate (£3,500 per person), then wider spending from undeterred passengers would lower the final costing from £539 million to around £515 million in 2025-26.

- Using the same approach, lowering spending on non-VAT-RES items in 2025-26 to £875 per person would raise the costing to £551 million. Of course, if VAT RES spending takes up a higher proportion of groups' overall trip costs, then changes in its price might have a greater impact on the number of deterred trips than we have assumed.

1.35 The reduction in **spending levels of undeterred visitors** is also a key assumption in this policy costing (Table 1.8, third panel). We judge that a third of the 29 per cent reduction in VAT RES spending will be diverted to non-VAT RES items, lowering the implied elasticity of spending to -1.2, resulting in a £102 million behavioural offset in 2025-26. However, if:

[19] See our online *Policy costings uncertainty ratings* database.

- The reduction in spending is double the size we have assumed (a 58 per cent reduction, implying an elasticity of -3.5), the higher resulting behavioural response would lower the savings from this policy by around £100 million.

- The reduction in spending was half the size we have assumed (a 14 per cent reduction, implying an elasticity of -0.9), the lower resulting behavioural response would raise the final costing by an extra £50 million.

1.36 The bottom panel of Table 1.8 compares the combined 'high' and 'low' estimates across all three elements of our sensitivity analysis to our central estimate. While there are several highly uncertain elements to this costing, our sensitivity analysis suggests that it is unlikely the scale of the behavioural response will fully offset our central estimate of a £685 million static cost of the measure. The number of deterred visitors would need to be almost 1 million for this measure to be fiscally neutral, which is slightly more than 15 times higher than we have assumed and broadly equivalent to the total number of visitors from China in 2019.

1.37 As a further illustration of this, the assumptions that we have used to calculate group costs imply that, on average, groups spend around £2,700 on VAT RES goods and £3,500 on other goods and services, so abolishing VAT RES raises the effective cost of their trips by around 6 per cent (based on a £350 average refund amount). Even under the assumption that the *entire* 1.2 million population of VAT RES claimants were able to change their behaviour in response to this 6 per cent change, and their response was in line with the *largest* elasticity that we think is reasonable from the evidence that we have assessed (minus 2), and that *each* claimant brought one guest with them, this would still lead to an increase in visitors of less than 300,000, far less than the 1 million needed for the measure to be fiscally neutral.

Table 1.8: Sensitivity analysis

		£ million in 2025-26	
		Behavioural cost	Final costing
Deterred visitors	High estimate: 137,000 fewer visitors	80	-498
	Central estimate: 69,000 fewer visitors	**40**	**-539**
	Low estimate: 34,000 fewer visitors	20	-559
Wider spending of deterred visitors	High estimate: £3,500 per person	48	-515
	Central estimate: £1,750 per person	**24**	**-539**
	Low estimate: £875 per person	12	-555
Reduced spending of undeterred visitors	High estimate: -3.5 implied elasticity	205	-435
	Central estimate: -1.2 implied elasticity	**102**	**-539**
	Low estimate: -0.9 implied elasticity	51	-590
All categories	High estimate	327	-350
	Central estimate	**142**	**-539**
	Low estimate	66	-615

[1] This table uses the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Conclusion

1.38 On review, our 2020 methodology still appears reasonable, and our costing to have been a central estimate. We have updated that estimate to account for the impacts of visitors' spending on non-VAT RES spending, but continue to believe that this measure is unlikely to affect significantly the productive capacity of the economy. These estimates are surrounded by considerable uncertainty. However, for the resulting behavioural cost to the Government to outweigh the policy's static savings, this group's responsiveness would need to be very significantly higher than is suggested by any of the evidence we have considered.

1.39 We have focused on VAT RES rather than airside shopping because of its greater fiscal costs. Based on our own assessment and from responses received from external stakeholders the behavioural uncertainties around VAT RES are more significant for our forecast than those surrounding airside shopping. But both measures operate via similar channels, and so our main analytical conclusions are also likely to also be relevant for airside shopping.