A 13% VAT Rate on Hospitality Food and Drinks: Fiscal, Employment and Household Exposure Assessment*

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Executive summary

Reducing VAT on in-house hospitality food and drinks (including alcoholic beverages) from 20% to 13% would operate primarily as an emergency fiscal stabilisation measure, rather than a high-powered demand stimulus. Under revised and empirically grounded assumptions, approximately 34-38% of the gross fiscal cost is recovered through higher tax receipts and improved compliance, implying a net annual Exchequer cost of approximately £5.3-5.5bn [1][2].

The policy targets a highly labour-intensive and regionally exposed sector, supporting approximately 2.6 million direct jobs and contributing around £270bn (≈10%) of UK GDP through tourism-related activities [3][4]. Fiscal effects are driven predominantly by employment retention and firm survival, rather than by large increases in consumer demand. Household exposure is therefore material, particularly in lower-income, coastal, rural, and tourism-dependent areas [5][6].

While formal scoring would remain a matter for the Office for Budget Responsibility (OBR), this analysis suggests that an emergency VAT reduction, with a formal review after 6 months and a permanent reduction expected, could deliver employment and regional stabilisation benefits at a bounded and manageable fiscal cost.

* This document presents independent academic analysis prepared in response to requests from sector organisations for evidential support. It does not constitute policy advice, official Treasury analysis, or a formal fiscal costing. Any representations made to HM Treasury based on this analysis are the responsibility of the submitting organisations.

1. Policy context and rationale

UK hospitality continues to experience sustained margin pressure following the withdrawal of pandemic-era VAT and business-rates relief, rising labour and employer National Insurance costs, elevated energy and food input prices, and the full reinstatement of business rates [5][7][8]. Insolvency data and sector evidence indicate that these pressures are disproportionately affecting food-led and lower-margin operators, increasing closure risk among otherwise viable firms and accelerating job losses, particularly in tourism-dependent regions [5][9]. The proposed VAT reduction is intended as an emergency stabilisation intervention, operating primarily through cash-flow relief, employment retention, and reduced closure risk, with partial price pass-through and modest demand support. It is not designed as a permanent subsidy or a demand-maximisation policy [10][11].

2. Policy scope and VAT base

In-house hospitality food and drinks (including alcoholic beverages), applicable to restaurants, pubs, cafes, hotels, canteens, and other hospitality venues serving such items for on-premises consumption (excluding takeaway, delivery, or off-site sales, which remain at the standard rate). This targets operators in the food service and accommodation sectors where the majority of turnover is derived from seated or in-house dining experiences, with the inclusion of alcoholic drinks broadening relief to wet-led venues like pubs and bars.

- VAT base: £105bn annual VAT-exclusive turnover [7].
- Rate change: 20% → 13% (7 percentage-point reduction).
- All turnover figures are VAT-exclusive unless otherwise stated.

3. Model inputs and assumptions

The model combines mechanical VAT effects with conservative behavioural responses, drawing on UK and international evidence. The scope reflects the sector's dynamics (e.g., slightly lower elasticity for alcoholic beverages). Average wage reflects 2025 ONS data for full-time employees in accommodation and food services (median annual earnings approximately £25,000 based on £12.76 hourly rate and standard full-time hours).

Parameter	Central	Range	Source
VAT-exclusive turnover	£105bn	–	[7]
VAT pass-through	55%	40-70%	[10][11]
Demand elasticity	−0.6	−0.5 to −1.0	[11]
Volume response	+2.0%	1.2-2.8%	Derived
Direct jobs protected	200,000	175-225k	[5][7]
Employment multiplier	1.86	1.8-2.2	[12][3]
Average hospitality wage	£25,000	–	[6]
PAYE + NI effective rate	27%	–	[13]
Collectible HMRC arrears base	£5bn	–	[14][7]
Arrears recovery rate	13%	10-15%	[14]

- *Partial pass-through:* Evidence indicates that hospitality firms typically pass through around half of VAT changes to consumer prices, retaining the remainder to offset fixed costs, debt servicing, and liquidity pressures [10][11]. For alcoholic drinks, pass-through may be slightly lower due to excise duties and pricing stickiness.

- *Dynamic adjustment:* Pass-through is treated as an annual average. Short-run pass-through may be lower due to menu costs and uncertainty, with gradual adjustment over time.
- *Input-cost constraints:* Elevated energy, food, and labour costs, together with irrecoverable VAT on some inputs, constrain pricing flexibility and reinforce partial pass-through assumptions.
- *Firm survival:* Employment effects are used as a proxy for firm survival and avoided closures. The model does not separately quantify the preservation of future VAT bases, implying that estimated fiscal recovery may be conservative.

4. Fiscal impact

4.1. Gross Exchequer cost

Item	£bn
Mechanical VAT loss (£105bn × 7pp)	7.35
Working gross cost (conservative)	8.40

The £8.4bn working figure allows for base uncertainty and behavioural scaling and avoids understating fiscal exposure relative to the mechanical estimate [1].

4.2. Fiscal recovery channels

Four fiscal feedback channels are modelled. Welfare savings from avoided unemployment are excluded to avoid double-counting with PAYE and National Insurance effects [13][2].

Channel	Mechanism	£bn (central)
a) Corporation tax	Improved profitability	0.80
b) VAT growth	Higher volumes at 13%	0.25
c) PAYE & NI	Jobs preserved	1.35
d) HMRC arrears	Improved repayment	0.65
Total recovery		**3.05**

PAYE and NI recovery is the dominant channel, reflecting the sector's labour intensity and the stabilisation of existing employment relationships [6]. VAT recovery is modest due to partial pass-through, capacity constraints, and household budget pressures [11]. Corporation tax and arrears recovery remain uncertain and are therefore treated conservatively [14][2].

5. Scenario analysis

Scenario	Recovery (£bn)	Net cost (£bn)	Self-funded
Downside	2.55	5.85	30%
Central	3.05	5.35	36%
Upside	3.50	4.90	42%
Worst case	2.15	6.25	26%

The downside reflects weak demand response and limited arrears recovery. The upside assumes stronger employment retention and compliance. The worst case combines recessionary conditions with accelerated firm failures and is included to bound fiscal risk [2]. A six-month policy would imply a central net cost of approximately £2.7bn.

6. Employment and distributional impacts

Hospitality is among the UK's most labour-intensive sectors, employing approximately 2.6 million workers directly, with total tourism-related employment of around 3.8 million [3][4][6].

- Direct jobs protected: ~200,000
- Total jobs supported: ~372,000 (including indirect and induced effects) [12]

From a fiscal perspective, employment effects are central because job losses reduce PAYE and NI receipts and increase pressure on welfare systems [13]. Only direct tax effects are included in the quantified recovery.

Cost per job (central):

- £26,750 per direct job preserved
- £14,380 per total job supported

7. Regional impacts

Tourism and hospitality account for 10-12% of national employment and up to 15-20% in some coastal, rural, and visitor-dependent regions [3][12]. These areas typically have fewer alternative employment options, increasing vulnerability to sector-specific shocks and amplifying local impacts [5][9].

8. Household exposure (contextual)

Applying average household size data suggests that 7-8 million individuals live in households where hospitality or tourism provides the primary source of income [6][3]. A high proportion of food-led and drink-led hospitality businesses are owner-operated or family-run, linking household income directly to business viability [5][7]. Exposure is uneven, with higher concentrations in:

- coastal and rural constituencies,
- city centres with strong tourism dependence, and
- regions with lower median incomes [3][12].

9. International competitiveness context

Many OECD and EU countries apply reduced VAT rates of approximately 9-13% to hospitality, while the UK applies the standard 20% rate [10][11]. This differential affects operator margins and inbound tourism competitiveness. A 13% rate would narrow, though not eliminate, this gap, with greater alignment for alcoholic-inclusive services.

10. Risks and mitigation

Key risks:

- Lower-than-assumed demand elasticity, particularly for alcoholic drinks [11]
- Weaker employment retention than expected [5]
- Limited arrears recovery if insolvencies accelerate [14]

Mitigation options:

- Formal review after 6 months, with a permanent reduction expected if conditions stabilise
- Statutory review using VAT receipts, insolvencies, and employment data [1][2]
- Alignment with business-rates reform and productivity measures [7][1]

11. Overall assessment

Under conservative and empirically grounded assumptions, drawing on historical VAT elasticity studies, a 13% VAT rate on hospitality food and drinks would be approximately 34-38% self-funding. This partial offset arises from enhanced tax receipts via sustained employment, reduced reliance on unemployment benefits, and improved compliance within the sector, yielding a net annual Exchequer cost of around £5.3-5.5bn. The policy's primary value lies in employment retention, firm survival, and regional stabilisation, particularly in vulnerable areas facing acute pressures from inflationary cycles and supply chain disruptions, rather than in large-scale demand expansion that could risk overheating the broader economy.

The core policy judgement is whether these stabilisation and distributional benefits, targeting a sector that employs over 3.8 million workers and supports disproportionately affected demographics in lower-income, coastal, and rural communities, justify an emergency residual fiscal cost. This would be implemented with a formal review after 6 months to assess efficacy against key metrics such as job retention rates, insolvency trends, and regional GDP contributions, with a permanent reduction expected if conditions stabilise. The design inherently allows for review, adjustment, or withdrawal if macroeconomic conditions deteriorate, ensuring fiscal prudence while providing targeted relief in line with Treasury priorities for balanced recovery.

References

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