Submission by the Irish Tourist Industry Confederation on Budget 2014

July 23, 2013

RECOMMENDATIONS:

- **Retain the Reduced VAT Rate of 9%**
- **Retain or Increase the Level of Funding for Overseas Marketing**
- **Support Investment for 'Shovel-Ready' Tourism Projects**
- **Help Restore Domestic Demand**
- **Enhance Competitiveness**

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Irish Tourist Industry Confederation
Ground Floor, Unit 5, Sandyford Office Park, Dublin 18
Tel: +353 1 2934950 / Email: itic@eircom.net / www.itic.ie

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1. INTRODUCTION AND SUMMARY

In 2011, the Irish tourism industry achieved a modest level of growth following three years of steep decline, and the improvement achieved in 2011 was consolidated in 2012, albeit with little further increase. More encouragingly, the figures for the first 5 months of 2013 show a gain of over 6% in visitor numbers over the same period in 2012. This gain was accompanied by a most welcome increase of 11% in revenue.

Pleasing as this upswing is, it far too early to proclaim an end to the hard years. Visitor numbers and revenue are still well below the peaks achieved before the economic recession, and the international market environment remains challenging and highly competitive. Domestic and international economic commentators are projecting, at best, a very slow return to growth in the major western economies, which are also our primary tourist markets. Moreover, there are many uncertainties in how these economies will progress over the coming 2-3 years, and they all are vulnerable to adverse movement. The high reliance of the industry on the domestic market is an ongoing concern as recovery here is clearly not imminent.

The Irish tourism industry will continue to push for growth in this tough environment. It is a major contributor to the economy, generating revenues of €3.7 billion from overseas tourism in 2012[1], and employing more than 180,000 people. It is a vital economic sector, particularly in regions remote from the main hubs of economic activity.

At this point, the industry needs every help it can get as it seeks to generate increased revenues and employment. While we recognise that there is some way to go in sorting out the public finances, the returns generated by the tourism industry and its potential for growth will more than repay all support that Government may provide. We have identified five key measures for inclusion in the budget calculations for 2014:

1) Retain the reduced VAT rate of 9% for tourism products and services.

2) Maintain or, preferably, increase the level of funding allocated to overseas marketing in 2014.

3) Make funds available to support shovel-ready tourism capital investment projects.

4) Avoid any new taxation measures that would further suppress domestic demand.

5) Avoid undermining recent gains in competitiveness by freezing excise duties and improving access to major tourism centres.

1 Excluding visitors from Northern Ireland

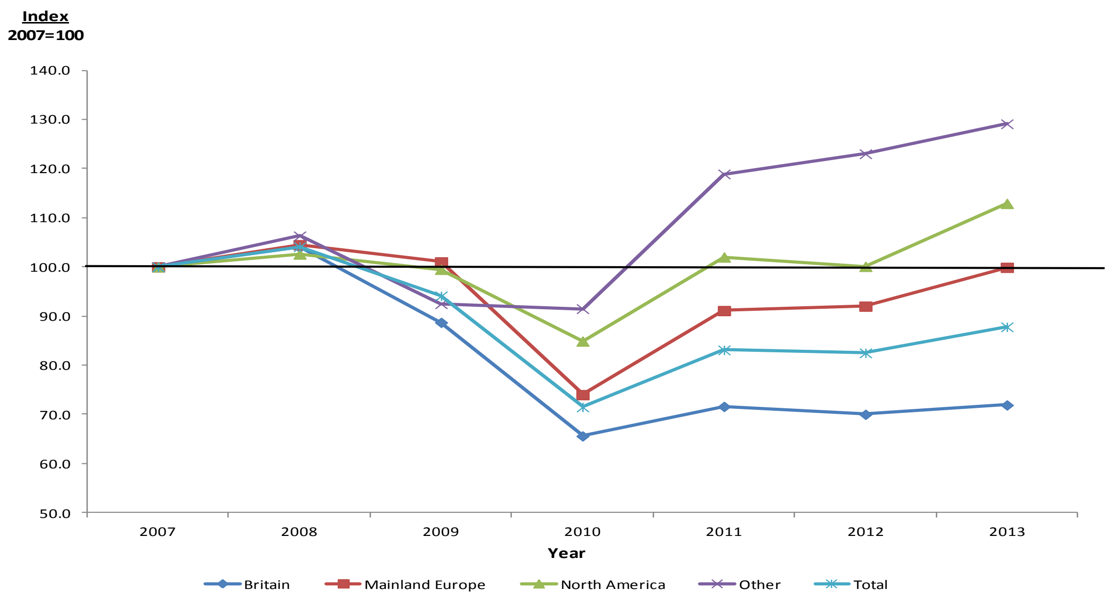
2. CURRENT POSITION

2.1 Trends in 2013

In its latest issue of Overseas Travel, covering the period March – May 2013, the CSO reports a very welcome upswing in tourist arrivals from overseas. Almost 2.5 million visits were made to Ireland during the first 5 months of the year, an increase of 150,000 visitors or 6.3% compared with the same period in 2012. The upswing included a modest improvement in demand from Britain, which has proven to be our most challenging market in recent years.

The demand trends by main market area over the past 6 years are illustrated in Figure 1. This compares the performance of different markets since 2007, which was the peak year for tourism. Following a slight gain in the first half of 2008, all markets trended downwards, with a particularly steep drop occurring in 2010, in part reflecting the impact of the giant ash cloud on air travel that year. Since that trough, there has been a good recovery from most markets, especially in arrivals from North America and 'Other' markets, although in volume terms the latter are very small. In contrast, the British market, which experienced the most severe contraction, has only made very limited gains since 2010. Because of Britain's large share of Ireland's overseas tourism market, this has meant that the overall volume of tourism remains around 12% below its level in 2007.

Figure 1: Trend in Tourist Arrivals by Market, Jan-May 2007-2013
2007=100

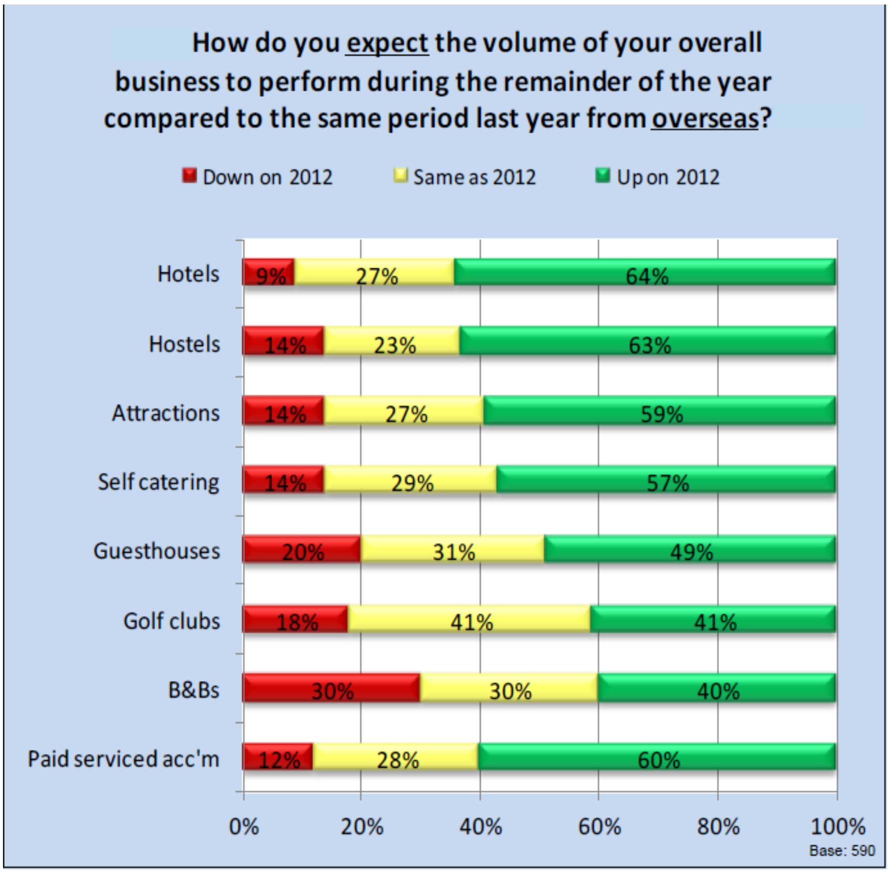


Sources: ITIC / Fáilte Ireland.

2.2 Outlook

The outlook for the rest of 2013 is positive, especially with regard to overseas markets. Industry expectations are the strongest in some years, as illustrated by the findings of the Fáilte Ireland Tourism Barometer published in May 2013. The Barometer summarises the expectations of some 590 tourism enterprises and, as the chart in Figure 2 shows, the majority of respondents expect their businesses to grow in 2013. While this outlook is not evenly distributed across different sectors, only a minority in all sectors have a negative perspective on business in 2013.

Figure 2: Tourism Industry Expectations for 2013 - Overseas Visitors

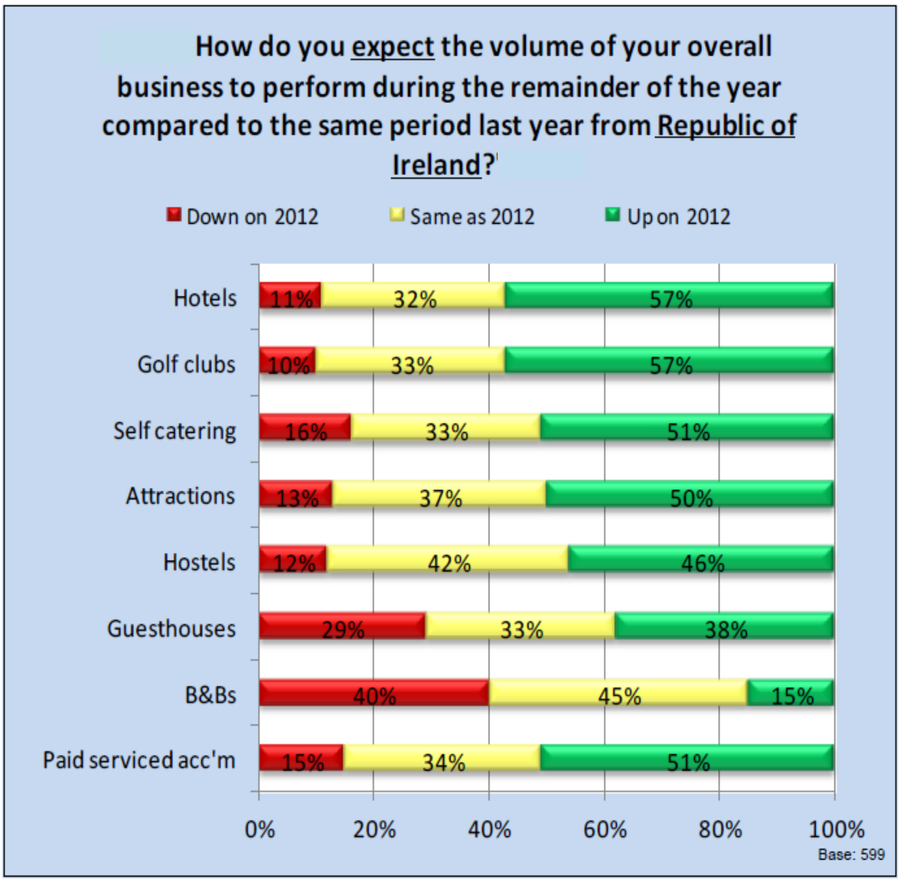


Source: Fáilte Ireland Tourism Barometer, May 2013

While the sense of optimism is not quite as strong, the industry outlook for the domestic market in 2013 has improved notwithstanding the continuing recession in the Irish economy. As shown by the chart in Figure 3, half, or slightly more than half, of the respondents in most sectors expect their domestic business to grow in 2013. However, weak domestic market demand is affecting many tourism businesses, and any further decline in consumers' will or ability to spend on holiday breaks will hit the industry hard.

The weakest outlook is in the Bed & Breakfast sector where only 15% of respondents are expecting an improvement while 40% expect a further decline.

Figure 3: Tourism Industry Expectations for 2013 - Domestic Visitors



Source: Fáilte Ireland Tourism Barometer, May 2013

A number of factors are contributing to the growth in tourism in 2013, and the positive outlook for the remainder of the year. These include:

- improved economic performance of certain key markets, including USA and Germany.
- expanded access capacity from most major market areas, apart from Britain.
- more competitive product, with value-for-money ratings by visitors improving sharply during the past two years, helped in no small measure by the Government’s initiatives in the tourism sector.
- impact of The Gathering
- expansion of air access capacity, especially on transatlantic routes where summer capacity has increased by 26% in 2013.

Looking to 2014, while there continues to be considerable uncertainties regarding the global economy, commentators are expecting an acceleration of growth in the US economy to levels last seen in 2005. In Germany, consumer confidence is at its highest level in 6 years, and the outlook for 2014 is encouraging. On the other hand, the Eurozone is expected, at best, to achieve very weak growth in 2014 following a further contraction in 2013 – the expected growth in Germany will be offset by anaemic performance in the French, Italian and Spanish economies. While the outlook for the UK economy is more positive, commentators have reined in their optimism in recent months. The domestic economy is unlikely to show more than a very modest gain, with consumer demand remaining subdued.

Overall, the economic outlook in our major markets indicates that Irish tourism will continue to operate in a tough market environment in which it must place renewed emphasis on competitiveness in pricing and product quality together with an intensified marketing effort to sustain the upturn of 2013. These are the priorities on which our recommendations in this submission are focused.

3. RECOMMENDATIONS FOR BUDGET 2014

The Irish Tourist Industry Confederation has five key recommendations for the 2014 Budget. These are:

- Retain the reduced VAT rate of 9% for tourism products and services.
- Maintain or, preferably, increase the level of funding allocated to overseas marketing.
- Make funds available to support shovel-ready tourism capital investment projects.
- Avoid any new taxation measures that would further suppress domestic demand.
- Avoid undermining recent gains in competitiveness by freezing excise duties and improving access to major tourism centres.

These are essential measures required to protect and sustain the budding but still vulnerable recovery in tourism, which is one of the most important generators of employment throughout the country.

3.1 Retain the Reduced VAT Rate of 9%

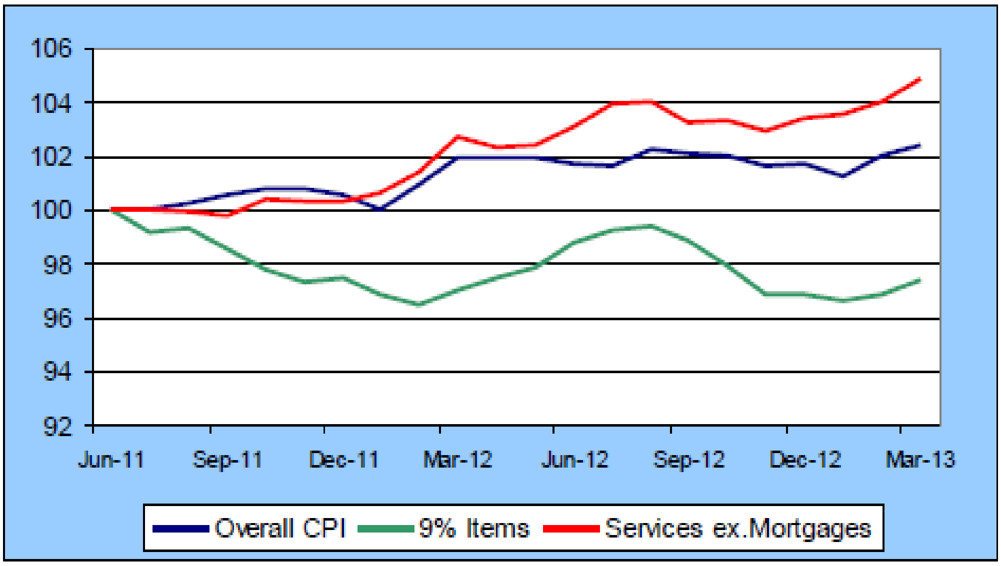
The improvement in the competitiveness of Ireland as a tourist destination has been noted in Section 2.2. A very important contributor to this improvement has been the application of a 9% VAT rate to employment intensive tourism products and services. This reduced rate was introduced in July 2011, but is due to expire at the end of 2013. It is vital that it is extended indefinitely, as any raising of the VAT rate will cause an immediate increase in prices and this would impact heavily on our ability to compete in an international market environment that continues to be highly price sensitive.

ITIC has commissioned an analysis of the impact of the VAT reduction, undertaken by the leading economist, Jim O'Leary. This analysis, which draws, inter alia, on an earlier analysis completed by a senior economist in the Department of Finance[2], reveals the following:

- **During the period from the introduction of the 9% rate up to March 2013, the prices of goods and services covered by the lower rate fell by 2.7% on average**, in sharp contrast to the increase of 2.4% recorded for the overall Consumer Price Index – see Figure 4. This reduction has been achieved despite the rise in the cost of many inputs to the tourism sector, including energy and alcohol prices. Members of ITIC have confirmed that the VAT reduction has been fully reflected in their own prices.

[2] *Measuring the Impact of the Jobs Initiative: Was the VAT Reduction Passed on and Were Jobs Created?'* Brendan O'Connor, Dept. of Finance, 2012.

Figure 4: Trends in Price Indices, June 2011 - March 2013



Source: ITIC

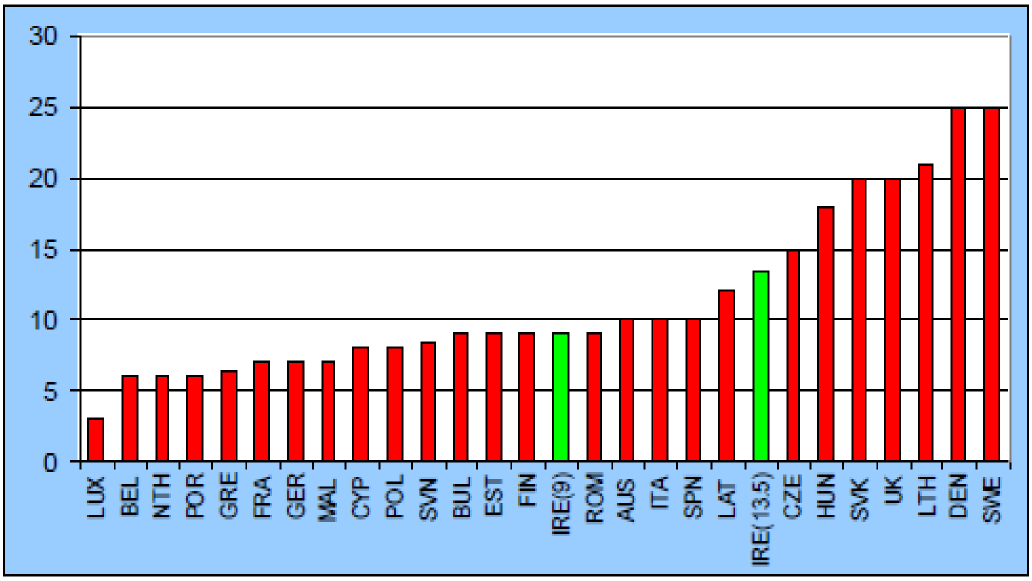
- **Employment in the accommodation and food services sector has risen by 5.3% during the period since the introduction of the 9% rate;** there was zero growth in total employment during this period. In total, some 6,100 additional jobs were created in the accommodation and food services sector. As this sector accounts for about two-thirds of total employment in tourism, this implies that some 9,000 jobs have been created in tourism overall. IBEC have constructed a detailed counterfactual scenario which shows that, if employment in accommodation and food services had followed the same trend as overall private sector employment during the period since June 2011, employment in accommodation and services would now be 17,000 people fewer than it actually is. This suggests that employment in tourism overall is greater by some 25,000 jobs as a result of the Jobs Initiative measures (changes to VAT and PRSI).

- **The gross cost of the measure, originally estimated at €350 million in a full year, has actually worked out at less than €160 million a year;** the budgetary cost of the measure as it applies specifically to tourism-related products and services is about €90 million. Indeed, the analysis set out in IBEC's pre-budget submission suggests that the employment gains generated by the Jobs Initiative's combination of the cut in VAT and halving of the lower PRSI rate has been large enough to deliver a net gain to the Exchequer.

- **Only 4 EU Member States – the UK, Denmark, Slovakia and Lithuania – have not reduced VAT on tourist accommodation;** many Member States, including France, Germany, Netherlands, Belgium, Portugal and Greece, apply an even lower rate than

9% - see Figure 5. In a highly price-sensitive environment, where our competitiveness in Britain, in particular, is already under pressure from a weakening of Sterling, it is vital that avoidable price increases are not inflicted on tourism.

Figure 5: VAT Rates on Hotel Accommodation in the EU



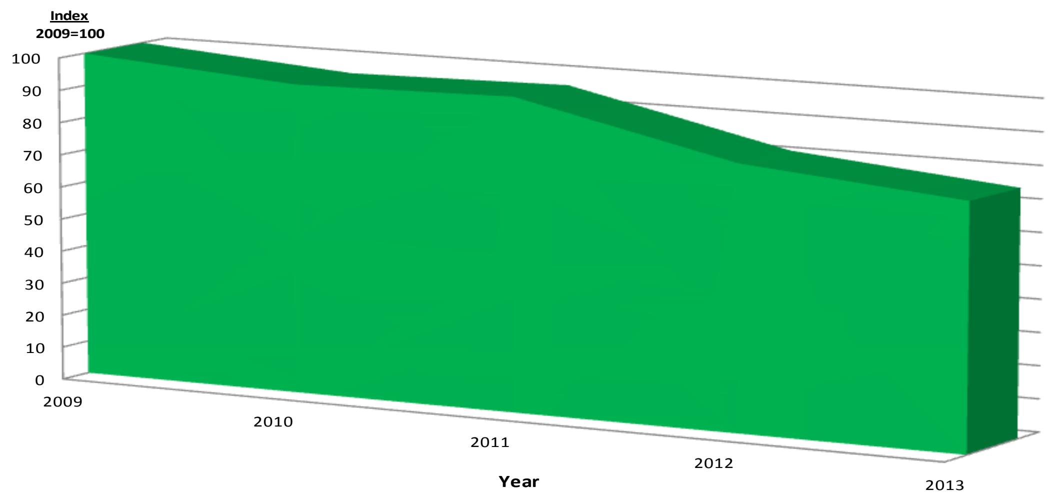
Source: ITIC

3.2 Retain or Increase the Level of Funding for Overseas Marketing

The Gathering is proving to be a successful marketing initiative which has achieved both a widespread buy-in among Irish people and the Irish tourism industry, and an enthusiastic response from our overseas markets. Maintaining the momentum generated by The Gathering, and continuing to raise awareness of Ireland in our overseas markets and motivating people to visit, will require a renewed commitment by the industry and a further intensification of the national marketing effort.

This is not the time to cut the allocation of funds to overseas marketing. We are facing an unprecedented level of competition from competing destinations. For example, the Scottish Government is increasing Visit Scotland's budget over the coming two years, in recognition of the economic and social importance of tourism in Scotland. In contrast, the Departmental allocation for the Tourism Marketing Fund has fallen steadily from €47.25 million in 2009 to €37.25 million in 2013 – a cut of more than 21%. In real terms, as adjusted for inflation, the cut in marketing funds has been 25% (see Figure 6).

Figure 6: Trend in Tourism Marketing Fund
(2009 prices)



Source: Estimates for the Public Service, successive years.

There is no doubt that the battle for market share will demand well-resourced and well-targeted campaigns to build on this year's progress and to propel tourism forward as a major contributor to the Irish economy and employment. Moreover, the expansion of international air access capacity and routes, including the significant additions to transatlantic services in 2014 recently announced by Aer Lingus, will not produce the desired results in the absence of destination marketing support.

3.3 Support Investment for 'Shovel–Ready' Tourism Projects

The Tourism Capital Incentive Programme (TCIP) has enabled the development of numerous valuable improvements and additions to the Irish tourism product over the past 5 years. Introduced as part of the National Development Plan 2007-2013, the TCIP has supported a wide range of projects including significant interventions such as the Great Western Greenway in Mayo, Waterford Viking Triangle, Athlone Castle, King John's Castle in Limerick, the Boyne Valley Drive and the new Dubline project. There are many more examples of developments throughout the country that are delivering an excellent experience to visitors, thereby enhancing Ireland's appeal and reputation as a tourist destination and providing much needed local economic activity and employment.

The majority of the grant-supported developments in recent years have been promoted by public sector bodies, which is unsurprising given the difficulties of raising project finance from banking sources. Commentators are expressing reservations about much change occurring in the banking environment and Peter Breuer, the IMF's representative in Ireland, recently warned that the Irish banks were not building sufficient capital to support new lending[3].

The opportunities for developing worthwhile new projects, and for enhancing existing operations, are now increasing, if anything. Funding available from the TCIP more or less dried up a year ago, but there are several projects now at design stage which cannot progress further in the absence of capital commitments. More will be ready to come on stream over the coming year. It is essential for the future of Irish tourism that we continue to promote and support investment in the tourism product. We are confident that capital made available for shovel-ready projects will generate a productive return in incomes, employment and tax revenues.

3.4 Help Restore Domestic Demand

The good health of the domestic market is vital to the well-being of Irish tourism. It is a very important source of demand for many tourism businesses, especially outside the peak season.

Household disposable income has been squeezed over the past 5 years by a combination of:

- Substantial increases in taxes
- Cuts in wages and salaries
- High unemployment.

In the face of these factors and great economic uncertainty, households have also increased their savings. The CSO reports that the gross savings ratio rose from 10.7% in 2011 to 12.5% in 2012. A major consequence of these developments has been a steady drop in the value and volume of retail sales since 2007. This is illustrated by the graph in Figure 7 overleaf which shows that the value and volume of retail sales in May 2013 were, respectively, 26% and 21% below the averages recorded in 2007.

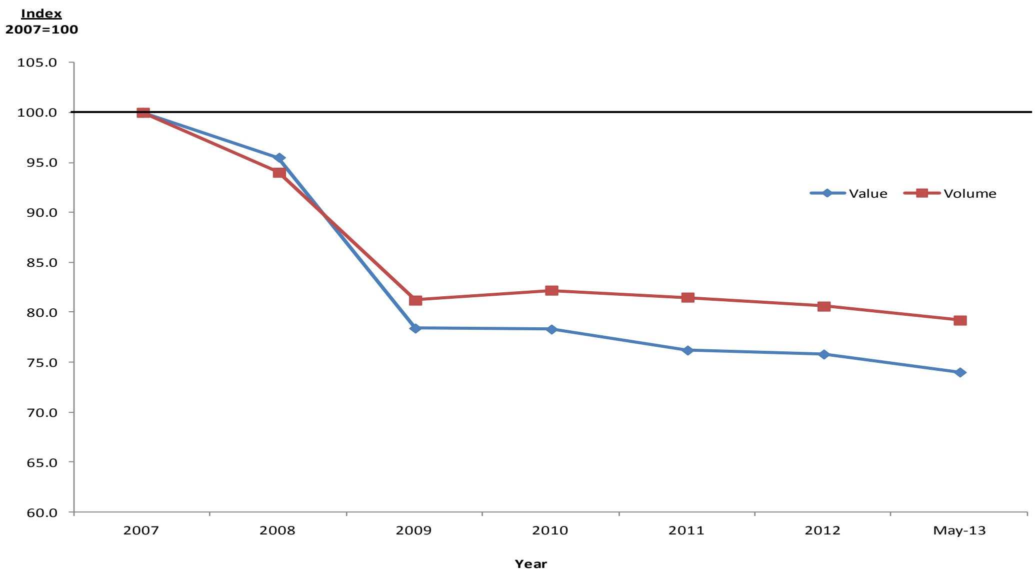
The picture on the domestic tourism market is similar: the latest figures released by the CSO show that domestic trips by Irish residents were down 7.3% in the first quarter of 2013 compared with the same period in 2012. Domestic holiday trips decreased by almost 16%.

It is essential to our economic recovery that household incomes are not squeezed any further and, moreover, that they are encouraged to release some of their savings. Key measures are:

[3] Budget Perspectives 2014 – ESRI Conference, 25th June 2013.

- No further tax increases in 2014: as IBEC have identified in their pre-Budget submission, tax increases are not necessary for the Government's achievement of its budget deficit target.
- Maintain the 9% VAT rate on tourist products and services.
- Promote a return to more normal levels of activity in the property market, including the introduction of fiscal incentives for home improvement works. Where such schemes were introduced elsewhere the evidence shows that they succeeded in boosting expenditure and formalising parts of the black economy, thus boosting tax buoyancy.

Figure 7: Trends in Retail Sales, 2007 - 2013



Source: CSO

3.5 Competitiveness

Competitiveness is a complex concept when applied to tourism, and is influenced by a wide range of variables, including relative costs and prices and touring infrastructure. We have already referred to the importance of maintaining the 9% rate of VAT on tourism products and services. We have also highlighted the need to avoid further depression of the domestic market through unnecessary tax increases. Two additional measures arise for consideration in budgetary planning with regard to protecting the still-vulnerable improvement in price competitiveness achieved during the past three years and to improving regional access.
These are:

- **Avoid further increases in excise duties on alcohol:** surveys of visitors show that their perceptions of value-for-money have improved considerably since 2009. However, this overall improvement hides the level of surprise and dissatisfaction with the price of drink in Ireland. High excise duties are prime contributors to these high prices – Ireland has the highest rate of duty on wine in the EU, the second highest on cider and third and fourth highest on spirits and beer respectively. There is no scope for further increases in excise duties – as it is, the exceptionally high rates imposed on alcoholic drinks directly affect our competitive positioning.

- **Infrastructure:** Key secondary roads need continuous investment for maintenance and improvement. There are a small number of critically important routes where such investment would provide a major gain in access to key tourism areas. About 85% of our international visitors arrive in Ireland by air to Dublin, Cork and Shannon Airports. Access from these airports to the tourism destinations of Kerry/West Cork, Galway/Mayo, and Sligo/Donegal would be greatly and permanently enhanced by Government commitment to the following roads initiatives:

    - M20 Cork to Limerick: has enormous potential to provide all of Kerry with easy access to Cork and Shannon Airports. Town bypasses at Adare, Abbeyfeale and Macroom would deliver very significant improvement.
    - N4: Realignment of the section of this road between Castlebaldwin and Colooney is long overdue, would greatly enhance safety, and facilitate easier access to Sligo and Donegal.