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THE ECONOMIC RATIONALE FOR EXTENDING THE 9% VAT RATE BEYOND 28TH FEBRUARY 2023

A REPORT PREPARED FOR ITIC BY JIM POWER ECONOMICS, DECEMBER 1st 2022

EXECUTIVE SUMMARY

(1) The global economic outlook is currently characterised by intense uncertainty and there are clear downside risks. Inflation is at elevated levels; most central banks are tightening interest rates aggressively; the Ukrainian conflict is ongoing with no obvious end in sight; and recession in the US, UK and EU looks increasingly likely in 2023. The global economic outlook is intensely uncertain, but it appears likely that the downside risks are significant and 2023 will be a challenging year for the global economy.

(2) To date, the small open Irish economy has remained relatively immune from the strengthening global headwinds, but there are some emerging signs of pressure in parts of the economy. Consumer and business confidence have weakened significantly since the Russian invasion of Ukraine due to rising interest rates; the escalation in the cost of living and business costs, and intense uncertainty about the future. Business investment activity is becoming more cautious; and consumer spending is slowing, as demonstrated by an annual decline of 7 per cent in the volume of retail sales in September.

(3) It seems inevitable that growth will slow over the coming year. In an environment where personal disposable incomes are coming under increasing pressure, discretionary spending is likely to weaken. Hospitality, personal services and non-essential retail look like the most vulnerable sectors. 2023 is likely to be a more challenging year for the Irish economy. SME businesses in particular, will need as much support as possible.

(4) The Accommodation and Food Services Sector is a very important component of the Irish economy and the tourism product. It makes a very significant contribution to national and regional economic activity and employment. The future success of tourism is heavily dependent on the health and quality of the sector. This is now coming under intense pressure.

(5) In 2020, there were 19,062 active enterprises in the Accommodation and Food Services sector, with 157,946 persons engaged. This comprised of 3,692 active enterprises in the Accommodation sector, with 45,828 persons engaged; and 15,370 enterprises in the Food & Beverage Services, with 112,118 persons actively engaged. The latest labour force survey from the Central Statistics Office (CSO) estimated that employment in the Accommodation and Food Services sector stood at 170,000 in the third quarter of 2022, which is equivalent to 6.7 per cent of total employment in the economy. This is comprised of 125,800 employees in the Food and Beverage Service activities and 44,200 in the Accommodation sector. It is estimated that in the third quarter of 2022, approximately 246,500 people were employed in the broader tourism industry. This is based on CSO data showing 170,000 persons working in the

Accommodation & Food Services sector and the application of a 1.45 jobs multiplier for the broader tourism sector.

(6) For the tourism sector, competitiveness is of key significance. The proposed increase in the VAT rate from 9 per cent to 13.5 per cent (increase of 50 per cent) on 1st March 2023 would further undermine the competitiveness of the tourism sector. Given the margin pressures that hospitality and tourism-related businesses are currently enduring, it does not seem feasible that the incidence of the tax increase could be absorbed into margins, and it would be passed on to the end user or the consumer. If fully passed on to the consumer, it would increase the price of accommodation and food services by around 4.1 per cent. Coming at a time when there is such upward pressure on prices, this would be negative and would undoubtedly dampen demand further in the tourism and hospitality sector.

(7) Given the uncertainty that prevails going into 2023 and the lack of visibility, it is difficult to be very precise about the business and employment impact of an increase of 50 per cent in the VAT rate. It would further undermine the competitiveness of a sector that is currently under significant pressure and facing many challenges in 2023. Based on what we know now, and in the event of an increase in the VAT rate, a decline of 10 per cent in employment is possible in the tourism sector in 2023, which would represent a loss of around 24,000 jobs.

(8) For Irish tourism and hospitality businesses, the key challenges are:

- Elevated energy costs.
- A softening of demand as a result of global and domestic economic weakness.
- Labour market challenges.
- The elevated level of other input costs, particularly food.
- The lack of hotel capacity due to the Ukrainian refugee crisis.
- An increase in the VAT rate from 9 per cent to 13.5 per cent.

(9) The bottom line is that the risk of a downturn in international travel caused by a marked deterioration in the global economy is very real and could have serious implications for Ireland's tourism industry. It would threaten the viability of businesses still struggling to recover from the impact of Covid-19. Many more businesses could be forced to shut down and thousands of jobs could be lost. The real issue is that the global economic difficulties are coming on top of many business pressures emanating from dramatically higher input costs; cost of living pressures; labour shortages and rising interest rates. An increase in the VAT rate would exacerbate those pressures.

SECTION 1: THE ECONOMIC CONTEXT

The global economic outlook is currently characterised by intense uncertainty and there is a total lack of visibility about the future. Inflation is becoming embedded in most jurisdictions; most central banks are tightening interest rates aggressively; the Ukrainian conflict is ongoing with no obvious end in sight; and recession in the US, UK and EU looks increasingly likely in 2023. The Chinese economy is also under significant pressure. In summary, the global economic outlook is intensely uncertain, but it appears likely that the downside risks are significant and 2023 will be a challenging year for the global economy.

To date, the small open Irish economy has remained relatively immune from the intense global headwinds. However, consumer and business confidence have weakened significantly against a background of rising interest rates; the escalation in the cost of living and the cost of doing business; and intense global economic uncertainty.

2023 looks set to be a challenging year for the global economy and the Irish economy is not likely to remain immune to those pressures.

THE UNCERTAIN GLOBAL ECONOMIC OUTLOOK

Global economic developments continue to be dominated by the ongoing war in Ukraine and the impact it is having on energy supply, inflation, interest rates and economic growth. Inflation continues to run at very elevated levels and while official forecasters generally believe that there will be some moderation in price pressures in 2023 on the back of slower global growth and an easing of energy prices, there is still an acceptance that inflation rates will remain well above what central bankers would desire for the foreseeable future.

There is a clearly a determination amongst most global central banks to bring inflation under control, even if that means forcing economies into recession and forcing unemployment higher. Such outcomes are regarded as a price worth paying to get inflation back under control.

The European Central Bank (ECB) increased its key re-financing rate by 0.75 per cent on October 27th. This took the key rate up to 2 per cent, following increases of 0.5 per cent at the end of July and 0.75 per cent in September. It seems highly likely that rates could increase by at least another 1 per cent over the coming months.

Since March, the US Federal Reserve Bank has increased its interest rates from zero to a target range for the key Federal Funds rate of 3.75 per cent to 4 per cent. It anticipates that interest rates will have to be increased further in the ongoing battle to bring inflation under control.

Since the beginning of the year the Bank of England increased has interest rates from 0.1 per cent to 3 per cent. The Bank of England is set to tighten rates further over the coming months. This interest rate environment is damaging global growth and there is a growing acceptance that the US, UK and the Euro Zone could experience recessionary conditions over the coming months.

The Paris-based OECD published its latest forecasts for the global economy in November. It painted a sobering picture, and reported that global growth has lost momentum; high inflation is proving persistent; confidence has weakened and uncertainty is high. The effects of the ongoing Ukraine war and its impact on energy and food and the tightening of interest rate policy around the world; and the particular pressures on emerging market economies were all highlighted. This latest forecast from an 'official' agency clearly spells out the challenging global environment businesses around the world are facing into in 2023.

The OECD is projecting global growth of just 2.2 per cent in 2023, down from 3.1 per cent this year. This global prognosis includes the strong possibility of recession in the US, EU and UK, the latter of which the OECD provides a very bleak assessment. The UK is projected to contract by 0.4 per cent in 2023 and to expand by just 0.2 per cent in 2024; the Euro Area is projected to grow by just 0.5 per cent in 2023 and by 1.4 per cent in 2024; Germany is projected to contract by 0.3 per cent in 2023 and to expand by 1.5 per cent in 2024; and the US is projected to grow by just 0.5 per cent in 2023 and by 1 per cent in 2024. The parting shot from the forecaster is that 'the uncertainty about the outlook is high, and the risks have become more skewed to the downside and more acute.'

There is little clarity or visibility now, and the outlook for the foreseeable future is intensely uncertain. The key global risk factors are:

- Recession
- Interest Rates & Inflation
- Politics
- Ukraine War & its Consequences
- China – economy is slowing sharply
- Financial markets – Equities, Bonds & Property – considerable volatility.

THE IRISH ECONOMIC OUTLOOK

To date, the small open Irish economy has remained relatively immune from the strengthening global headwinds. The economic growth momentum is still strong; the labour market is still very healthy, with an unemployment rate of just 4.4 per cent and a record level of employment at 2.554 million; the public finances are strong, with very buoyant growth in tax revenues; the export performance is very strong; and Budget 2023 contained a record fiscal expansion of €11.3 billion, which is being funded out of a budget surplus. This fiscal expansion will help support activity.

Figure 1: Consumer Confidence

Source: KBC Bank Ireland/ESRI

Not surprisingly, however, there are some emerging signs of pressure in parts of the economy. Consumer and business confidence have weakened significantly since the Russian invasion of Ukraine due to rising interest rates; the escalation in the cost of living and business costs, and intense uncertainty about the future. Business investment activity is becoming more cautious; and consumer spending is slowing, as demonstrated by an annual decline of 5.6 per cent in the volume of retail sales in September and a decline of 2.6 per cent in October.

Growth data for the third quarter of 2022 show that gross domestic product (GDP) increased by 2.2 per cent during the quarter. Consumer spending increased by a very modest 0.3 per cent, and modified domestic demand (MDD), which is a better indicator of real activity in the domestic economy, declined by 1.1 per cent. Output from Distribution, Transport, Hotels and restaurants declined by 0.3 per cent. The strong global headwinds are starting to impact on the domestic economy.

Despite the relative resilience of the Irish economy to date, it seems inevitable that growth will slow further over the coming year. In an environment where personal disposable incomes are coming under increasing pressure, discretionary spending is likely to weaken and in this regard hospitality, personal services, and non-essential retail look like the most vulnerable sectors.

2023 is likely to be a more challenging year for the Irish economy. SME businesses, especially, will need as much support as possible.

The Department of Finance is projecting GDP growth of 4.7 per cent in 2023 and growth of just 1.2 per cent in Modified Domestic Demand (MDD), which provides a more realistic assessment of real activity in the economy.

While there is considerable uncertainty about the economic growth outlook, the outlook for inflation is even more uncertain. Following projected annual inflation of 8.5 per cent in 2022, average inflation is projected to moderate to 7.1 per cent in 2023 and 2.4 per cent in 2024. Unfortunately, much of this will be determined by factors that are outside of Ireland’s control.

Table 1: Economic Forecasts Underlying Budget 2023

	2022f	2023f	2024f	2025f
GDP	10.0%	4.7%	3.3%	3.8%
GNP	8.9%	4.2%	2.8%	3.3%
Modified Domestic Demand	7.7%	1.2%	3.3%	3.6%
Modified Gross National Income (GNI*)	5.1%	0.4%	2.7%	3.1%
Inflation (HICP)	8.5%	7.1%	2.4%	1.8%
Personal Consumption	5.5%	1.8%	4.6%	4.2%
Government Consumption	2.9%	-1.5%	-1.1%	1.5%
Modified Investment	17.7%	2.2%	3.8%	4.1%
Exports Goods & Services	12.5%	5.5%	3.9%	4.4%
Employment (000s)	2,531	2,563	2,603	2,650
Unemployment Rate	5.2%	5.1%	5.0%	4.7%
Compensation of Employees	12.3%	7.2%	6.6%	6.7%

Source: Department of Finance, Budget 2023, 27th September 2022

SECTION 2: CONTRIBUTION OF TOURISM & THE HOSPITALITY SECTOR

The hospitality sector is the most important component of Ireland's tourism industry. Tourism is a major service export and provides considerable employment throughout the country and it represents the mainstay of many rural areas. The economic contribution comes through employment and the taxes generated for the Exchequer. In an environment where foreign direct investment represents a considerable concentration risk for Irish employment and tax revenues into the future, the importance of the two key indigenous economic sectors – agri-food and tourism – has to be recognised and supported.

TOURISM

2019 was the last normal year for Irish tourism as 2020 and 2021 were badly affected by Covid-19. In 2019, Fáilte Ireland data show that 9.67 million tourists visited Ireland from overseas. A further 1.28 million visitors arrived from Northern Ireland, giving total out-of-state visitors of 10.95 million tourists. A further 11.6 million domestic tourists are estimated by Fáilte Ireland.

It is estimated that the overseas tourists spent €7.39 billion, while domestic tourists spent a further €2.14 billion, giving total tourism receipts of €9.53 billion. In 2019, tourism was worth €9.53 billion to the Irish economy.

Table 2: Overseas Tourist Numbers to Ireland (2019)

REGION	NUMBER OF TOURISTS (000s)	MARKET SHARE
Great Britain	3,487	36.0%
Mainland Europe	3,609	37.3%
North America	1,902	19.7%
Rest of world	676	7.0%
Total	9,674	100.0%

Source: Key Tourism Facts 2019, Fáilte Ireland, March 2021

Estimates from ITIC suggest that 5.8 million visitors arrived in Ireland in the first 8 months of 2022 and it is anticipating in the region of 7.5 million tourists (staying for 1 night) for the full year.[i] This compares to 9.67 million tourists in 2019.

The economic contribution of tourism is very significant at both a regional and national level. Fáilte Ireland estimates that every €1 million of tourist expenditure helps to support 27 tourism jobs; 1,000 additional overseas tourists support 20 jobs in the tourism industry; and for every euro spent on tourism, both domestic and overseas, 23 cent is generated in tax revenues.

It is estimated that in 2022, approximately 243,900 people were employed in the tourism industry. This is based on CSO data showing 168,200 persons working in the Accommodation & Food Services sector and the application of a 1.45 jobs multiplier for the broader tourism sector.

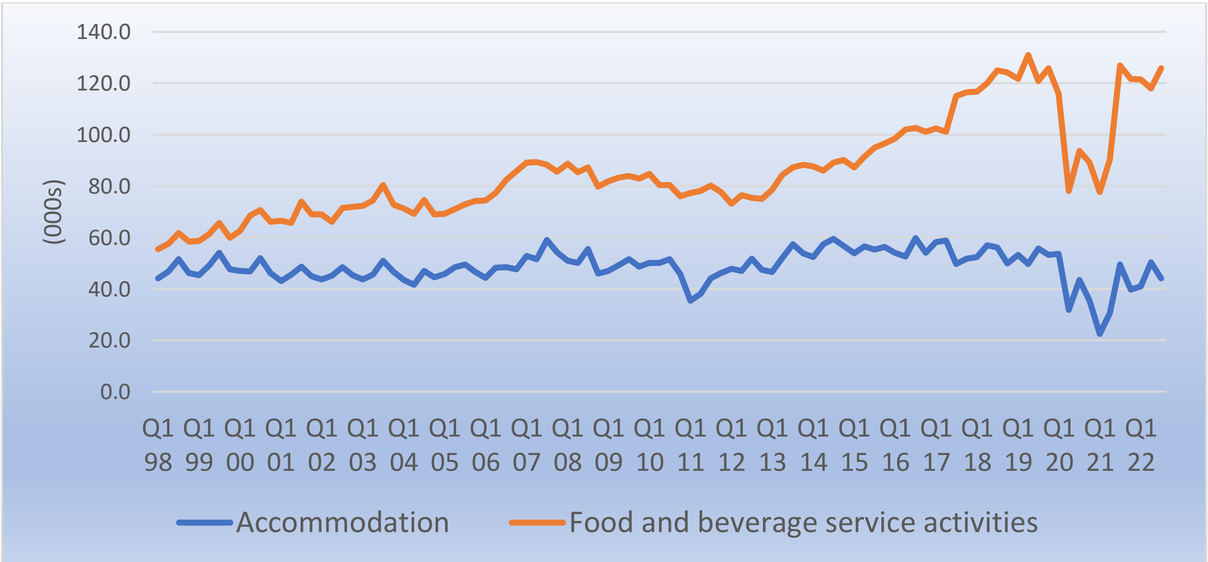
THE ACCOMMODATION & FOOD SERVICES SECTOR (HOSPITALITY)

The Accommodation and Food Services Sector is a very important component of the Irish economy and the tourism product. It makes a very significant contribution to national and regional economic activity and employment. The future success of tourism is heavily dependent on the health and quality of the sector. This is now coming under intense pressure.

The CSO estimates that in 2019, prior to Covid-19, there were 19,418 active enterprises in the Accommodation and Food Services sector, with 222,716 persons engaged. In 2020, there were 19,062 active enterprises in the Accommodation and Food Services sector, with 157,946 persons engaged. This comprised of 3,692 active enterprises in the Accommodation sector, with 45,828 persons engaged; and 15,370 enterprises in the Food & Beverage Services, with 112,118 persons actively engaged.[ii]

The latest labour force survey from the Central Statistics Office (CSO) estimated that employment in the Accommodation and Food services sector stood at 170,000 in the third quarter of 2022, which is equivalent to 6.7 per cent of total employment in the economy. This is comprised of 125,800 employees in the Food and Beverage Service activities and 44,200 in the Accommodation sector.

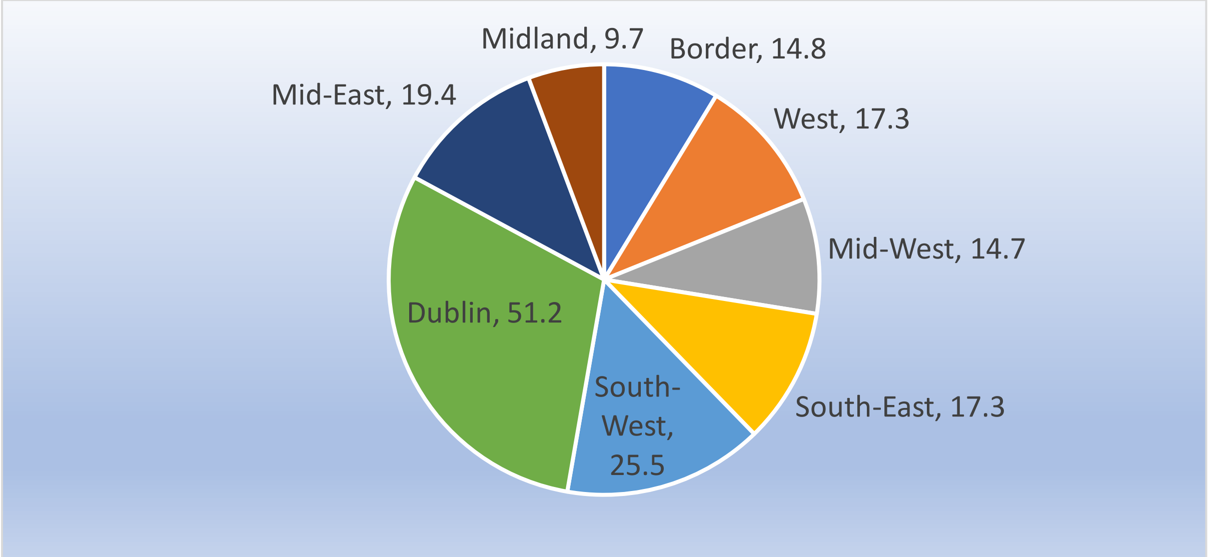
Figure 2: Employment in the Accommodation and Food Services Sector



Source: CSO, Labour Force Survey Quarter 3 2022.

The Accommodation and Food Services sector makes a strong regional contribution to employment and economic activity. Figure 3 shows the breakdown of employment in the sector by region. Dublin accounts for 30.1 per cent of total employment in the sector, but employment is spread across the regions and makes a very strong economic and social contribution to rural and regional economies. In the context of the priority that is being given to achieving more balanced regional economic and social development in official government policy, and the very damaging regional impact of COVID-19 on the hospitality sector, the strong contribution from the sector is very important.

Figure 3: Employment in Accommodation & Food Services Sector by Region Q3 '22 (000s)



Source: CSO PxStat, Labour Force Survey Quarter 3 2022.

Table 3 shoes the regional breakdown of employment in the Accommodation and Food Services sector and the broader tourism sector. The regional contribution is very significant.

Table 3: Tourism Employment by Region

Region	Accommodation & Food Services	Tourism
Border	14,800	21,500
West	17,300	25,100
Mid-West	14,700	21,300
South-East	17,300	25,100
South-West	25,500	37,000
Dublin	51,200	74,200
Mid-East	19,400	28,100
Midland	9,700	14,100
Total	170,000	246,400

Source: CSO & Jim power Economics

The restaurant sector is a key component of the Accommodation and Food Services sector. It is estimated that the sector contributes over €3 billion per annum to the Irish economy in terms of wages and purchases of inputs. There are over 3,500 restaurants in Ireland, employing over 70,000 people. The sector is also a significant employer of part-time workers, particularly students. For many young people, experience in the restaurant sector is their first exposure to customer service and as such provides a very solid education and training for young people who want to move on to other careers.

The restaurant sector went through a very difficult adjustment period from 2008 through to 2013 in line with the rest of the economy. The sector was particularly vulnerable as it is very dependent on inward tourism and domestic discretionary spending, both of which came under significant pressure during the severe economic downturn. However, the sector reacted strongly to the changed and much more difficult economic environment, by reducing costs and menu prices, and improving the quality of the offering. This approach, when combined with the Government decision to cut the VAT rate to 9% in July 2011, enabled the sector to come through the difficult economic circumstances and re-establish itself.

The sector is now once again under renewed intense pressure.

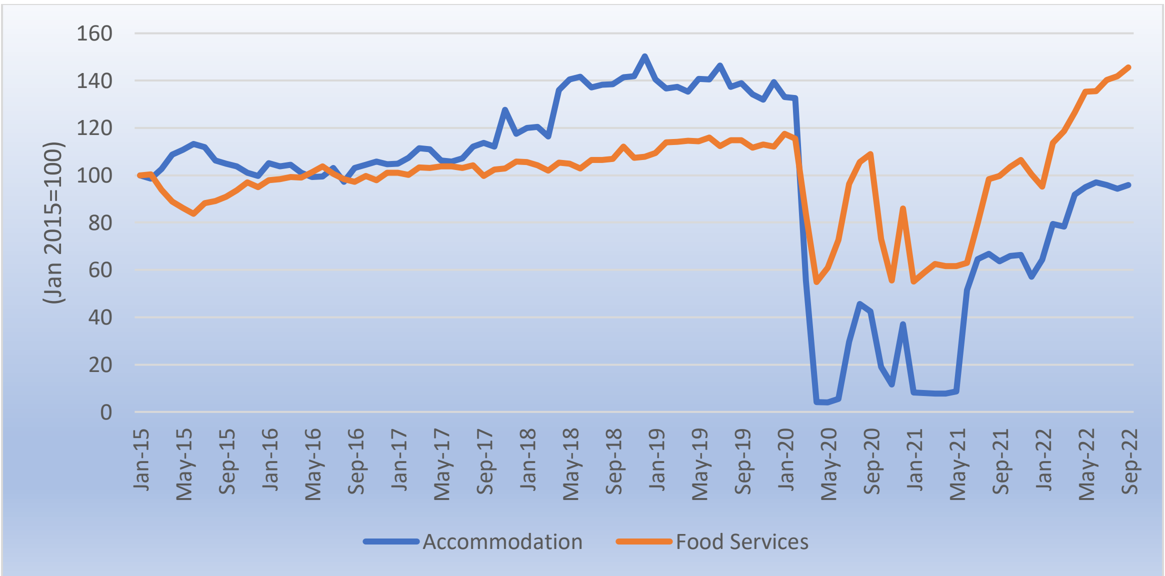
SECTION 3: THE OPERATING ENVIRONMENT FOR TOURISM AND HOSPITALITY

Hotels, restaurants and pubs are key components of the Irish tourism product and have been integral to the success of Irish tourism over the past decade. Tourism played a key role in re-building the Irish economy from 2011 onwards and has generated considerable employment and economic activity at a national and more particularly at a regional level.

The operating environment has been very challenging since the beginning of 2020 due to a combination of Brexit, the global pandemic and its associated restrictions, and more recently the impact of the Russian invasion of Ukraine.

Figure 4 shows the trend in output at current prices of a sample of enterprises in the Accommodation and in the Food Services sector since January 2015. It shows clearly the strong recovery in output from 2015 out to the end of 2019. It then fell sharply during the Pandemic, but has been recovering since the second half of 2021.

Figure 4: Services Index Value



Source: CSO PxStat, Services Value Index.

However, the environment for the tourism sector in general is now very challenging, due to both external and domestic developments.

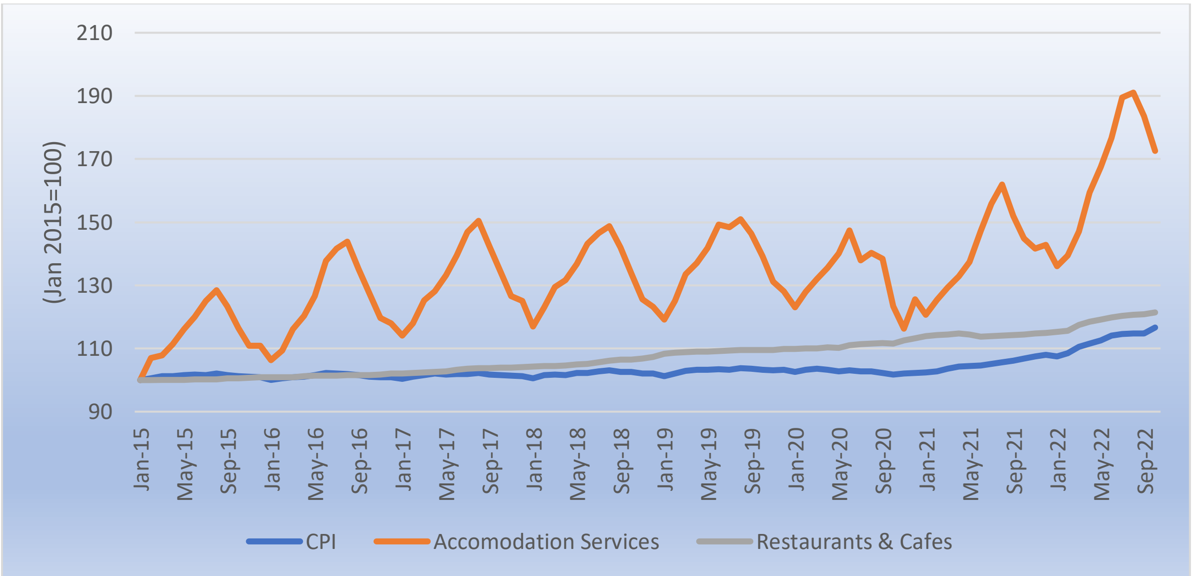
The hospitality sector experienced a strong rebound in activity as the Covid-19 restrictions were eased. However, the trading environment is now very challenging on a number of fronts. Staffing issues are very problematical and costs across the board are rising strongly. Unfortunately, it is difficult to see any of these business pressures abating any time soon. The sector is trading in a very challenging environment, and this looks set to continue.

In an economy approaching full-employment and in a sector that saw a significant exit of skilled personnel during the Covid-19 restrictions, the recruitment and retention of labour is proving a major challenge. Wage costs are rising strongly. However, of greater concern is the fact that many restaurants and other hospitality businesses are under significant pressure to provide a full service due to staff shortages across all occupations within the sector. The capacity to deliver 'business as normal' is proving very challenging for many businesses.

In addition to the significant staffing issues, other costs such as energy and raw material prices such as food are rising strongly.

In the face of these input cost increases, there is pressure on businesses to increase prices in order to protect margins and ensure business survival.

Figure 5: Consumer Price trends in Accommodation & Food Services Sector



Source: CSO PxStat

The latest inflation data from the CSO show that in the year to October 2022:

- Average consumer prices increased by 9.2 per cent.
- Consumer prices in 'Restaurants, Cafes and the like' increased by 6.1 per cent.
- The consumer price of 'Accommodation Services' increased by 19.1 per cent.

Between January 2021 and October 2022:

- Average consumer prices increased by 13.9 per cent.
- Consumer prices in 'Restaurants, Cafes and the like' increased by 6.5 per cent.

- The consumer price of 'Accommodation Services' increased by 43 per cent.

Global air travel has recovered following the pandemic, but data from the International Civil Aviation Organisation (ICAO) data reveal that air transport seat capacity and passenger totals globally have reached an estimated 80 per cent of pre-pandemic levels, with passenger revenue at around 72 per cent of its 2019 high point.[iii] This global backdrop makes it clear the challenges facing the Irish tourism industry.

SECTION 4: THE POTENTIAL IMPACT OF INCREASING THE VAT RATE

As highlighted, the tourism industry is a very significant component of the Irish economy. It makes a significant contribution to service exports; it generates considerable Exchequer revenues; it supports a high level of employment; and is a vital component of economic and social vibrancy in rural Ireland.

The Department of Tourism, Culture, Arts, Gaeltacht, Sport & Media has a number of objectives for the sector. The aim is to support a vibrant sector that contributes to employment across the country; that is economically, socially and environmentally sustainable; that helps promote a positive image of Ireland overseas; and is a sector in which people want to work.

The government's overall goals in relation to tourism are to:

- increase revenue from overseas visitors
- increase employment in the tourism sector
- promote Ireland as an attractive location for tourists from all over the world.[iv]

To achieve these objectives, it is vital that the economics of the operators in the sector are as positive as possible. The plan to increase the VAT rate from 9 per cent to 13.5 per cent on 1st March 2023 is not consistent with these objectives. Given the global and domestic challenges facing the sector, the timing of the proposed increase could not be more damaging.

BACKGROUND TO 9 PER CENT VAT RATE

In July 2011, a special reduced VAT rate of 9 per cent was introduced in order to provide support and boost employment in a range of areas, including Accommodation and Food services. Between the second quarter of 2011 and the final quarter of 2018, employment in the sector increased by 57,800 or 49.7 per cent. Many factors were responsible for this increase in employment, but the reduced VAT rate did contribute as it helped control prices and help business margins. It was also introduced at a time when the sector was in a very difficult situation.

In Budget 2019, the special VAT rate was increased to 13.5 per cent for tourism activities, with effect from 1st January 2019. The timing of this increase was unfortunate as it coincided with intense uncertainty relating to Brexit, sterling weakness, and then the declaration of a global pandemic in March 2020. Employment in the Accommodation and Food Services sector declined by 49,600 or 28.5 per cent between the final quarter of 2018 and the final quarter of 2020. The increase in the VAT rate was not the main reason for the reduction in employment, but it did not help.

In Budget 2021, a reduced 9 per cent VAT rate was re-introduced for restaurant supplies, tourist accommodation, cinemas, theatres, museums, historic houses, open farms, amusement parks, and hairdressing, as well as certain printed matter such as brochures, leaflets, programmes and catalogues. This measure was intended to help sectors that had been very badly affected by the Pandemic get back to a normal trading environment.

The reduced VAT rate was applicable from 1st November 2020 to 31st December 2021 at an estimated cost of €401 million. In Budget 2022, the measure was extended to 31st August 2022 at a further estimated cost of €251 million. In May 2022, the measure was further extended to 28th February 2023, at an estimated further cost of €250 million. It is envisaged that the 13.5 per cent rate will apply to all affected sectors on 1st March 2023.

IS AN INCREASE IN THE 9 PER CENT VAT RATE A SENSIBLE POLICY OPTION?

In a dynamic environment with many moving parts, it is always difficult to isolate the impact of one specific policy measure. Consequently, it is difficult to be very specific about the impact that the reduction in the VAT rate to 9 per cent had after 2011 or indeed since it was re-introduced in late 2020. However, on both occasions it was introduced at a time of considerable stress for the hospitality and tourism sectors and it helped preserve margins and control consumer prices. It was a supportive measure that helped the sector recover and more importantly to contribute to national economic recovery.

The current 9 per cent VAT rate for tourism activities is due to revert to 13.5 per cent on 1st March 2023. The timing of this planned increase is not good, for a variety of reasons.

The economic outlook both externally and domestically does look very risky and challenging, and relevant businesses here in Ireland are under considerable pressure and the outlook is very uncertain and the risk are quite intense.

From an external economic perspective, the risks are very clear:

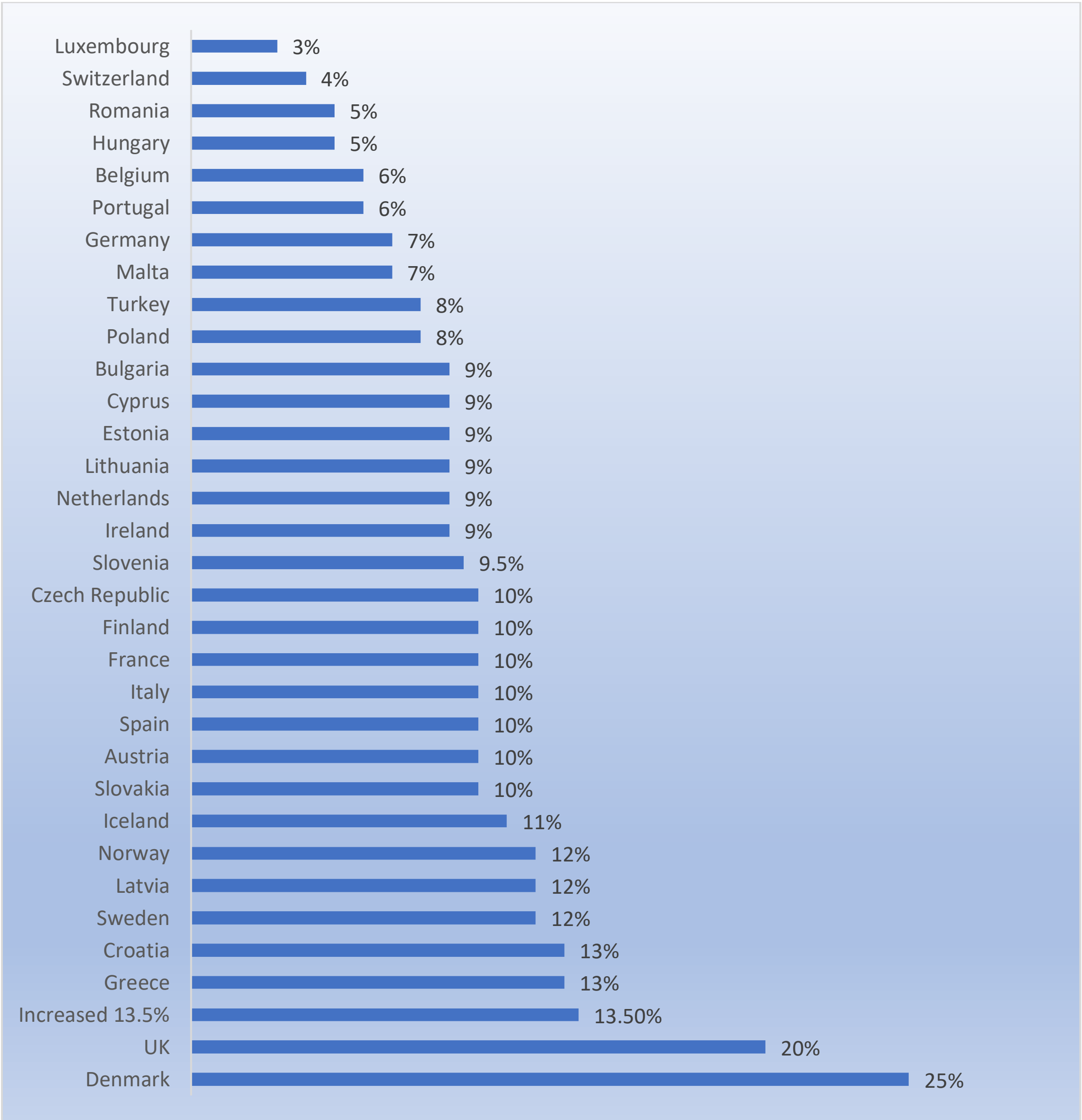
Global economic activity is now under considerable pressure due to a combination of the highest levels of inflation in four decades; the monetary policy activities of most global central banks; and intense global geo-political uncertainty. The Ukraine war is ongoing and there is no realistic end in sight.

Economic growth is slowing everywhere and three of Ireland's most important tourism markets – the United States, the EU and the United Kingdom have slowed significantly in the second half of 2022 and are all likely to experience recessionary conditions in 2023.

The UK is a particular cause for concern. The Autumn Budget in the UK will result in a significant tightening of fiscal policy and will serve to exacerbate the economic pressures that are now apparent. The Office for Budgetary Responsibility (OBR) is forecasting a decline of 1.4 per cent in UK GDP in 2023 and an increase in the unemployment rate to 4.9 per cent, compared to 3.6 per cent now. The OBR is also projecting that real household disposable income per person could fall more than 7 per cent over the next 2 years.[v] This would represent a dramatic decline in disposable incomes and would have a serious impact on discretionary spending, such as tourism.

From a tourism perspective, economic recession generally causes a decline in demand for international travel. The UK market looks particularly vulnerable, but all external markets are likely to come under significant pressure during 2023. It promises to be a more challenging global tourism year.

Figure 6: International VAT Comparison



Source: HOTREC, EU Commission

Figure 6 Shows the international comparison for VAT rates in the accommodation sector.

From a domestic perspective:

Although the Irish economy is still showing positive momentum, it seems inevitable that growth will slow in 2023 due to a combination of a deterioration in global economic activity; rising interest rates; the escalation in the cost of living; and higher business input costs.

Consumer discretionary spending is likely to be most vulnerable. Consumer confidence has fallen sharply since the beginning of the year and much more cautious consumer behaviour is likely in 2023. Spending in areas such as hospitality, non-essential retail and personal services are likely to be most adversely affected.

The costs of doing business for small businesses have been particularly challenging over the past year. Electricity, other energy costs and raw material costs have increased sharply and margins have been squeezed. The recruitment and retention of labour is another significant challenge. In summary, the environment for SMEs is challenging now and is likely to become more challenging in 2023. Most tourism businesses are classified as SME.

The restaurant sector is now under particular pressure and we have seen a growing number of restaurant closures in recent months. This is a worrying trend, because the quality, availability and variety of restaurants represent an important element of Ireland's overall tourism offering.

POTENTIAL IMPACT OF INCREASING 9 PER CENT VAT RATE

Competitiveness is a vital element of economic and business success. In its most recent competitiveness report, the National Competitiveness & Productivity Council (NCPC) summed the situation up very well and warned that *'Inflationary pressures have been mounting globally since the latter half of 2021, due to the rapid recovery in consumption in the aftermath of COVID-19, international supply chain bottlenecks, and base effects relating to weak price trends in 2020. The Russian invasion of Ukraine in February 2022 has put further strong upward pressure on global prices, particularly in energy markets, with many countries now recording the highest rates of inflation since the 1970s. The exceptional rise in inflation in Ireland in recent months has begun to erode real wages, with disposable incomes and living standards coming under strain. The Council recognises the pressures placed on households and enterprises by rising costs. While the Government cannot control prices in international markets, it must ensure that any policy responses to international inflation do not embed inflationary expectations into the domestic economy which would undermine our competitiveness in the longer run.'* [vi]

For the tourism sector, competitiveness is of key significance. The proposed increase in the VAT rate from 9 per cent to 13.5 per cent (increase of 50 per cent) on 1st March 2023 would further undermine the competitiveness of the tourism sector. Given the margin pressures that hospitality and tourism-related businesses are currently enduring, it does not seem feasible that the incidence of the tax increase could be absorbed into margins, and it would be passed on to the end user or the consumer. If fully passed on to the consumer, it would increase the price of accommodation and food services by around 4.1 per cent. Coming at a time when there is such upward pressure on prices, this would be negative and would undoubtedly dampen demand further in the tourism and hospitality sector.

Given the uncertainty that prevails going into 2023 and the lack of visibility, it is difficult to be very precise about the business and employment impact of an increase of 50 per cent in the VAT rate. It would further undermine the competitiveness of a sector that is currently under significant pressure and facing many challenges in 2023. Based on what we know now, a decline of 10 per cent in employment is possible in the tourism sector in 2023, which would represent a loss of around 24,000 jobs.

For Irish tourism and hospitality businesses, the key challenges are:

- Elevated energy costs.
- A softening of demand as a result of global and domestic economic weakness.
- Labour market challenges.
- The elevated level of other input costs, particularly food.
- The lack of hotel capacity due to the Ukrainian refugee crisis.
- An increase in the VAT rate from 9 per cent to 13.5 per cent.

The bottom line is that the risk of a downturn in international travel caused by a marked deterioration in the global economy is very real and could have serious implications for Ireland's tourism industry. It would threaten the viability of businesses still struggling to recover from the impact of Covid-19. Many more businesses could be forced to shut down and thousands of jobs could be lost. The real issue is that the global economic difficulties are coming on top of many business pressures emanating from dramatically higher input costs; cost of living pressures; labour shortages and rising interest rates. An increase in the VAT rate would exacerbate those pressures.

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