Association of International Retail

Tax-Free Shopping and the International Visitor Sectror

Chinese Visitor Briefing

August 2023

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The Association of International Retail forecasts that the Government's decision to end tax-free shopping will result in an annual loss of three quarters of a billion pounds (£750m) of sales to Chinese visitors based on 2019 spending figures and that this most valuable element of the international visitor economy will choose to visit and shop in France, Italy and Spain rather than in Britain.

Executive Summary

1. Introduction and overview

- The Chinese are the world's highest spending travellers and have the highest potential for future growth. From 2010-2019 the number of Chinese visitors to the UK grew from 130,000 to 800,000 driving a 60% growth in visitor spending to £28.4bn in 2019.
- Shopping is the number one priority for Chinese travellers.
- The British government is seeking to establish a relationship with China which balances a robust position on security with a recognition of the economic importance of the world's second biggest economy
- This briefing looks at the impact on Chinese traveller behaviour of the government's decision to make Britain the only country in Europe not to offer tax-free shopping.
- China's extended COVID-19 lockdown in 2022 means there is little data yet on the actual impact. But all the indicators to date suggest that Chinese visitors are now much more likely to choose to visit and shop in other European destinations rather than Britain.

2. The importance of the Chinese visitor to the UK and of shopping to the Chinese visitor

- VisitBritain says shopping is the number one priority for Chines travellers
- HMRC survey of international visitors in 2020 showed that tax-free shopping is a key issue for Chinese visitors when deciding whether to visit the UK
- Chinese shoppers are very price sensitive. Data shows a price elasticity of 3.4 i.e. if price goes up by 10%, sales go down by 34%
- Chinese visitor spending is not just in London but in major cities such as Manchester and Edinburgh
- UK faces increased competition both from EU destinations all of which offer tax-free shopping but also growing number of Chinese tax-free shopping areas

3. Chinese visitor behaviour in 2023

- While most of the world started travelling again in 2022, the extended lockdown in China means that Chinese people are only just restarting.
- Practical issues such as flight capacity and visa requirements are restricting the speed of the recovery in traveller numbers.
- In the short term Britain appears to be performing well on Chinese visitor numbers and spending. But this is mainly due to the large number of Chinese students in the UK (150,000) compared to France (29,700) and Germany (40,000). We have yet to see the impact of ending tax-free shopping on Chinese tourists behaviour.
- Early traveller data confirms that Chinese travellers are still the world's highest spenders and are important for the luxury goods sectors.
- There is little data yet on Chinese visitor numbers and spending levels. But data on American and GCC travellers for 2022 and early 2023 show Britain performing badly compared to other European destinations due to no longer offering tax-free shopping.
- HM Treasury forecast that ending tax-free shopping would have little or no impact on visitor behaviour, both in choosing to visit Britain and in the amount they spend on shopping
- Choosing to visit - Two sentiment surveys show Britain is no longer a preferred destination for potential Chinese visitors.
- Level of spending - Price elasticity of 3.4 suggest that ending tax free shopping will cut Chinese spending by 68% or £680 m each year
- Combining these two predicted behaviour changes, AIR estimates that ending tax-free shopping will reduce Chinese spending on shopping in the UK by three quarters of a billion pounds each year, based on 2019 spending levels.
- That spending will be diverted from Britain to France, Spain and Italy
- Britain has cut itself off from the fastest growing and most valuable element of the international visitor sector.

1. Introduction and overview

1.1 Since 2018 the Chinese have been the world's highest spending travellers. In that year Chinese visitors spent $258 billion, nearly twice as much as the second biggest spenders (USA at $135 bn)[1]

1.2 And the potential for growth outstrips all other travel markets. While the American and GCC markets are mature with visitor numbers to the UK remaining at a stable level, the Chinese market has been growing strongly and still has a long way to go. In 2019 only 9% of Chinese citizens had a passport compared with around 40% of Americans and over 70% of Britons.

1.3 In 2000 there were 10.5 million Chinese visitors worldwide. This grew to 149.7 million in 2018 and, before COVID-19, it was predicted to rise to 400 million by 2030.[2]

1.4 In the ten years from 2009-2019 Chinese visitor numbers to the UK grew from around 130,000 to 800,000.[3] This six-fold increase in Chinese visitor numbers was largely responsible for the growth in international visitor spending, up over 60% from £17.6bn in 2009 to £28.4bn in 2019.[4]

1.5 In 2019, the last full year before both the pandemic and the ending of tax-free shopping in the UK, the 800,000 Chinese visitors represented 5% of the 16m non-EU visitors to the UK but they accounted for 32% of all tax-free shopping spending, spending around £1bn on tax-free shopping alone.[5]

1.6 For Chinese travellers, shopping is the number one attraction and the single biggest element of their spending. When Prime Minister David Cameron asked President Xi during his 2016 State Visit to Britain what the UK could do to attract more Chinese visitors, the President replied "build more Bicester Villages."

1.7 The intervening years have seen a number of changes to the economic and political environments including the impact of the COVID-19 pandemic, concerns about the future strength of the Chinese economy, and a more robust diplomatic stance between Britain and China. The recent visit by the Foreign Secretary to China in August 2023 was the start of a move towards a more balance position in Britain's relationship with China. This looks to a robust stand on issues of security but a recognition of the importance of China in the global economy. These issues need to be taken into account when forecasting the future level of Chinese visitor numbers and spending.

1.8 But with China still leading the way in international tourism and spending and still likely to play a central role in the international visitor sectors of all European destinations, it is important to be aware of their response to the ending of tax-free shopping in the UK.

1.9 The extended lockdown in China meant that very little international travel by Chinese people took place in 2022. It is only now, in the first half of 2023, that Chinese international travel is restarting and even then, various transitional practical issue, such as the number of flights

[1] United Nations World Tourism Organisation "Global Barometer, 2018"
[2] China Outbound Tourism Research Institute
[3] Home Office visitor visa numbers issued
[4] VisitBritain "Britain's visitor economy facts" and "2019 snapshot"
[5] Global Blue tax-free spending data for the UK ,2019, by market

available and visa renewal requirements, mean that Chinese visitor numbers are still only a fraction of their 2019 levels.

1.10 This paper is meant as a guide to policy makers as Parliament debates the impact on the UK economy of ending tax-free shopping. It would seem strange to have this debate without any full consideration of the impact on the World's biggest international shopping nation.

1.11 The data is still scarce but growing. Ominously for the UK international visitor sector, these early indications point to the majority of Chinese travellers choosing to spend their money in other European destinations rather than Britain, where prices are now 20% more than in mainland Europe.

1.12 While Chinese visitors will still come for Britain's unique attractions it appears that they will not be spending on their number one priority – shopping. This suggests the worrying prospect of the Chinese travel market in Britain becoming one of high volume, low spend, while our continental neighbours enjoy high volume and high spend.

2. <u>The importance of the Chinese visitor to the UK and of shopping to the Chinese visitor</u>

2.1 We have outlined above in Section One some of the key facts and figures that demonstrate the importance of Chinese travellers to the international visitor economy and how shopping is the main attraction for them. In this section we look into these issues in more detail.

VisitBritain – Shopping is the number one attraction for Chinese visitors

2.2 In 2019, VisitBritain, the Government's tourism promotion agency reported that the Chinese market represented the biggest opportunity for growth for international visitor sector. VisitBritain's states that "going shopping is the number one activity which most Chinese visits will feature, followed by dining in restaurants, visiting parks or gardens, museums or galleries, and castles or historic houses".[6]

HMRC – Tax-free shopping attracts Chinese visitors to the UK

2.3 The VAT RES was an integral part of the UK's shopping attraction for Chinese tourists and visitors. In 2020, before the Government announced to end the tax-free shopping scheme, HMRC undertook an online survey with non-EU visitors to the UK who had used the tax-free shopping scheme. The survey was designed to understand the influence of VAT RES on tourism and tourist spending behaviour in the UK. One third of the responses were from Chinese visitors.

2.4 The HMRC survey showed that the VAT RES has a clear influence on Chinese visitors' decision to visit and spend money. It's findings showed that:

- 93% of Chinese travellers planned to shop tax-free before visiting compared with 69% of Americans
- 69% of Chinese said that shopping tax-free influenced their decision to come to the UK compared with 46% 0r Americans.
- HMRC concluded "VAT RES does play a role in attracting overseas visitors to the UK, especially for China."

[6] VisitBritain "Market and Trade Profile China" November 2019

- HMRC's survey also showed that 87% Chinese visitors spent some or all of their refund in the UK before leaving.

2.5 HMT, in referring to this survey, concluded that "even for the visitors that do use the VAT RES, it is hard to argue it is a significant, let along primary, determinant of their travel decision and that they would no longer visit the UK."[7] But in the survey's key conclusion that "1. VAT RES does play a role in attracting overseas visitors to the UK, especially for China and India and 2. VAT RES is a strong influence in the decision making process" this is exactly what HMRC does argue.

KPMG – Chinese shoppers are very price sensitive

2.6 The other big issue for Chinese visitor spending is sensitivity to price. KPMG has said "Chinese tourists are prolific shoppers but they are highly price sensitive. Eliminating tax and duty free shopping in the UK would be a massive own goal and would prevent the UK from capturing the significant pent up-spend of Chinese visitors"[8]

2.7 The real data suggests that the Chinese have a price elasticity of 3.4. This was shown immediately after the vote to leave the EU in June 2016 when the value of pound fell sharply. For every 1% fall in value, sales to Chinese visitors in the UK rose by 3.4%. This means that when prices go up by 20% (by adding VAT) the level of spending by Chinese shoppers is likely to drop by 68% (20% x 3.4). This would suggest that ending tax-free shopping would wipe out £680m of the £1bn Chinese people spent on tax-free shopping in 2019.

The OBR - disagrees with HMT on price elasticity

2.8 HMRC states that £500m was refunded in VAT in 2019. When announcing that it would end the VAT RES, HMT assumed that it would gain £500m VAT annually. This assumed price elasticity of 0 (i.e. that if prices rose by 20% it would have no impact on the level of sales). The OBR disagreed with this and used a price elasticity of 1.9, so reducing VAT collected by 38% or £190m, which HMT accepted.[9] However, in evidence to the Treasury Select Committee in December 2020, the OBR stated "we assumed a relatively high price elasticity response from those affected, but whether that's going to be high enough or not is something that I don't think we can be very confident in."[10] The high price elasticity of Chinese shoppers at 3.4 and the fact that in 2019 they accounted for around one third of tax-free shopping suggests that sales will be hit even further and the VAT raised by HMT will be even less.

Edinburgh and Manchester – ending tax-free shopping is a hammer blow

2.9 Outside London, Edinburgh and Manchester have established direct flights from China and growing Chinese visitor numbers and spend is a vital part of their long-term economic growth plans.

2.10 When the Government announced the ending of tax-free shopping the Edinburgh Tourism Action Group said "losing tax-free shopping will damage Edinburgh's reputation as a destination, mean fewer visits and lower spending. It will redirect Chinese visitors to visit and to spend in other destinations across Europe and put the tourism industry in Edinburgh in an even more vulnerable position for tourism recovery."

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[7] HMT Note "Mythbuster on the VAT Retail Export Scheme and tax-free airside sales" October 2020
[8] KPMG Asia
[9] OBR "Economic and Fiscal Outlook November 2020"
[10] Andy King, OBR, oral evidence to the Treasury Select Committee December 2020

2.11 Essential Edinburgh, the BID for Central Edinburgh said “tax-free shopping is fundamentally crucial for Edinburgh city centre. China remains the no.1 tourism market in terms of international tourism expenditure in 2019, with £1,937 average spend per visit in the UK and 16.33 day average length of stay. On top of the existing challenges the loss of tax-free shopping would be catastrophic for the city”

2.12 Marketing Manchester said “high-spending potential visitors to Greater Manchester are now likely to travel to other European destinations. This will have a significant negative effect on the economic impact of hotel and restaurant bookings, and visitor numbers at cultural attractions. The visitor economy of Greater Manchester, which secures over 100,000 jobs, will be dealt a hammer-blow by this decision.”

UK faces growing competition for Chinese spending

2.13 With shopping being so important to Chinese visitors and they being highly price sensitive, the decision to make Britain the only European country not to offer them tax-free shopping puts us at a serious competitive disadvantage regionally. But to this has to be added a new competitive threat.

2.14 The Chinese government has allowed and encouraged the establishment of tax-free shopping areas for Chinese shoppers within China. A duty-free market was set up in 2015 at Hainan, the largest tropical island in China. Before China reopened the border, with travel disrupted to overseas cities, Hainan became an attractive tourist destination and the only choice for most Chinese shoppers to shop tax-free offline. In 2021 Hainan offshore duty-free stores generated sales of $9.47 billion, a +84% up YoY. The results include duty-free sales of $7.94 billion, up +83% YoY.[11]

3. <u>Chinese visitor behaviour in 2023</u>

Chinese outbound tourism is just starting to recover

3.1 China’s strict lockdown policy in 2022 meant that few international tourist trips were made. Those that did take place were mainly business trips or students on overseas programmes (see sections 3.5-3.11). It is people who travel as tourists who are attracted by tax-free shopping and spend most while travelling. For other international visitor groups, such as those who travel on business, to study or visit family and friends, tax-free shopping is less important. So unlike with visitors to Europe from the USA and the GCC states there is no substantial data on the impact of ending tax-free shopping on the behaviour of Chinese tourists.

3.2 From January 2023 China reopened the boarders and removed restrictions of travel to and from other countries. Outbound tourism has been gradually recovering since the second quarter. China’s leading online travel agency, Trip.com Group, reported a surge in outbound flight bookings.

3.3 On August 10th, China’s Ministry of Culture and Tourism declared the lifting of pandemic-related constraints on group tours for multiple nations, encompassing prominent markets such as the United States, Japan, South Korea, Australia, and UK. The announcement, with immediate effect,

[11] KPMG Asia

is anticipated to have a positive impact on international travel. In 2019 group tours accounted for around 60% of all Chinese travel abroad. [12]

3.4 The scale of the recovery in Chinese visitor numbers is being affected by practical issues. Flight capacity has taken time to grow and is only now, in the third quarter, reaching 2019 levels. The extended closure of Visa Application Centres has created a backlog of requests for visitor visas, meaning long waits to book appointments. Data on Chinese tax-free shopping sales in Europe in 2023 shows that Germany and Switzerland are recovering fastest with June sales at 79% and 77% of 2019 levels respectively, compared to tax-free sales in France at 57%.[13] This is mainly due to the speed at which these countries restored flights and opened their Visa Application Centres.

Student numbers are important in this transitional phase

3.5 At this early stage in the recovery of Chinese travel to Europe, Britain has a distinct advantage over other European countries which gives a more optimistic picture than is likely when travel from China fully recovers. Unlike other European countries, Britain attracts a large number of Chinese students. Chinese students returned to Europe earlier than the tourist traveller and it is this group who make up most of the Chinese visitor numbers and spending in Europe at the moment.

3.6 Chinese students are the largest single group of overseas students in UK universities. In 2019 there were 106,000 Chinese students in the UK,[14] around one third of all overseas students. In 2023 that number has risen by 50% to 151,000. In comparison France had just 29,700 Chinese students and Germany had 40,000

3.7 Together with the quality of UK universities, the English language is one of the main reason why Chinese students chose UK universities. America also has high Chinese student numbers with 372,000 Chinese students in 2019.[15] Interestingly in 2021-22 Chinese student numbers in British universities rose by 50% on 2019 levels to stand at 151,000 whereas in the USA they fell by around 25% to 290,000.

3.8 With Chinese tourists being slow to return it is likely that in this transitional period, spending by Chinese visitors to the UK will be relatively higher than in France, Spain and Italy because that spending is by Chinese students for which tax-free shopping is not the main attraction. But when tourist do start to return, then tax-free shopping will be a major factor in them choosing where to visit and spend and we will get a true picture of the impact of ending tax free shopping.

3.9 In 2019, Chinese students accounted for 9% of Chinese visitors to the UK. In 2022 they accounted for 57% of all Chinese visitors.[16] Data for London's West End indicate that in the first half of 2023 over 80% of spending by Chinese visitors was done by students.

3.10 However, with Chinese students in the UK no longer able to shop tax-free in Britain, there is now the incentive for them to travel to EU destinations from the UK to do their shopping and reclaim their VAT.

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[12] https://www.reuters.com/world/asia-pacific/china-adds-more-destination-countries-outbound-group-tourism-2023-08-10/
[13] Global Blue monthly report, July 2023
[14] Universities UK International Student Recruitment Data March 2023
[15] China Daily June 3 2023
[16] VisitBritain

3.11 This temporary advantage in Chinese visitor numbers, driven by student numbers, should not give us false hope that Chinese tourists will be equally attracted to visit and shop in the UK when they start to travel in larger numbers. All the early indicators and signs are that ending tax-free shopping is likely to have result in Britain falling behind our neighbouring European destinations both in terms of the numbers who want to visit the UK and how much they spend

Chinese travellers remain the world's biggest spenders

3.12 Despite a cooling overall economy, 40% of (Chinese) people say they will spend more on travel, according to McKinsey & Co. "People want to spend the money they've saved during COVID on international travel."

3.13 With shopping being their biggest item of expenditure, already China is topping the 2023 spending table in Europe. In June 2023, in France the average tax-free shopping spend for a visitor from Hong Kong was 2,455E, for mainland China it was 1,617 E and for the United States it was 1, 569E. In Germany, the visitors from China spent an average of 1,609E per person on tax-free shopping compared to 1,249 E by the average American visitor.[17] The same report showed China going from the 10th highest spending nation in mainland Europe in July 2022 to the 2nd highest in June 2023, behind the USA mainly because of the still relatively low number of Chinese visitors.

3.14 Chinese visitors are particularly important to the UK's luxury goods sectors. Up to 2021 China has been the biggest luxury market in the world. Before the pandemic, two-thirds of Chinese consumers' personal spending on luxury goods took place outside China, and Chinese consumers accounted for about 60% of total industry growth between 2000 and 2019. [18] Thanks to strict zero-covid policy, in 2022 luxury sales in China dropped by 4% YoY, but still took account of 17% of the global luxury market, with $58.29 billion in revenue.

Early signs of Chinese tourist behaviour in Europe

3.15 With Chinese tourist spending not yet happening in Europe we have to rely on other indicators of likely Chinese behaviour when that tourist element returns to normal, probably sometime in 2024 (source). Spending on shopping by Chinese visitors in Europe (excluding the UK) for the first half of 2023 was only at between 25%[19] and 34%[20]of the 2019 level. The spending recovery is being led by Gen Z and Millennial travellers, supporting the point that Chinese spending in Europe to date is largely due to student spending before Chinese tourists return.

3.16 So with little spending data available we have to rely on forecast of what the impact of ending tax-free shopping on Chinese behaviour might be based on what we know so far about their response to price changes. In this there is consistency which suggests an even bigger fall in spending than we are already seeing with visitors from the USA and the GCC countries in 2022 and early 2023.

3.17 While the recovery in visitor numbers and spending by visitors to the UK from the USA and the GCC states has been strong due to pent-up demand, when compared with that of France, Spain

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[17] Planet Payments "Payments data and insights report" July 2023
[18] https://www.morganstanley.com/ideas/china-luxury-sector
[19] Planet Payments "Payments data and insights report" July 2023
[20] Global Blue monthly report, July 2023

and Italy, Britain is severely underperforming. The following tables illustrate the different recovery rates to 2019 spending levels.[21]

3.18 Spending by visitors from the United States in 2022 compared with 2019 levels

- In France 226% of 2019 levels
- In Spain 201% of 2019 levels
- In Italy 190% of 2019 levels
- In the UK 101% of 2019 levels

3.19 Spending by visitors from the United states in Quarter One 2023 compared with 2019 levels

- In all of EU 288% 0f 2019 levels
- In France 313% of 2019 levels
- In Spain 312% of 2019 levels
- In Italy 243% of 2019 levels
- In the UK 104% of 2019 levels

3.20 Spending by visitors from the GCC states in 2022 compared with 2019 levels

- In France 198% of 2019 levels
- In Spain 158% of 2019 levels
- In Italy 166% of 2019 levels
- In the UK 65% of 2019 levels

3.21 When ending tax-free shopping in 2020, the government forecast that there would be little impact on the behaviour of international visitors either in terms of choosing to visit Britain or in the level of spending. Three years later, the growing amount of real data is consistent in proving these forecasts to be significantly wrong, as the spending recovery tables above show. With Chinese tourist travel to Europe only just starting to recover, we need to look at two indicators of possible behaviour change. First we now have sentiment surveys which can help predict the attractiveness of the UK as a destination compared with other EU countries. And real data on the price elasticity of Chinese shoppers can help forecast the likely impact on spending levels as a result of adding a 20% tax.

Sentiment surveys

3.22 Surveys of Chinese sentiment are consistent is showing that Britain has fallen significantly as a destination that Chinese tourists wish to visit.

3.23 In early 2022, Global Blue conducted a survey of around 10,000 people China travellers who had shopped tax-free in Europe in the years up to the end of 2019. 92% of responses say they have plans to travel to Europe over the next 12 months However, while in 2019 Britain was second only to France in popularity it is now the least favoured destination among large European countries The survey showed that 77% planned to travel to France, 68% Italy, 64% Germany and 59% Spain. But only 43% planned to visit the UK.

3.24 The fall in popularity of Britain as a destination for Chinese tourists is reflected in the European Travel Commission's Long Haul Travel barometer which explores the travel preferences of

[21] Global Blue presentation to Parliament on impact of ending tax-free shopping February 2023

Chinese travellers. Comparing the results for 2023 with 2019, France remains the top destination at 56%, down just 3% on its 2019 score of 59%. However, Britain falls from 29% in 2019 to just 18% in 2023.

3.25 So, contrary to the Treasury forecasts, it is clear that far fewer Chinese travellers are now choosing Britain as a destination. The only significant difference between 2019 and 2023 that can account for this fall is that Britain has ended tax-free shopping. Some may suggest that the changing diplomatic situation could be a cause but this is unlikely given the 50% increase in Chinese student enrolments in the UK in the same period.

The high price elasticity of Chinese shoppers

3.26 The extent that adding a 20% tax on goods bought in the UK will have an impact on the level of spending by Chinese travellers who do still chose to visit the UK can be forecast by applying their level of price elasticity to the amount they spent on tax-free shopping in 2019. This again strongly suggests that the Treasury's forecast on little or no behaviour change is likely to be shown to be wrong, as it already has for visitors from the USA and GCC states.

3.27 For decades, retailers and tax-refund agencies track annual levels of tax-free spending against exchange rates. All the data shows that Chinese travellers have the highest price elasticity i.e. they are very sensitive to price changes and change their spending behaviour accordingly. This was most starkly seen in 2016 immediately after the Brexit referendum result was known. The sharp fall in the value of the pound was immediately matched by an increase in spending by Chinese visitors in the UK as goods became cheaper for them.

3.28 HM Treasury's forecast assumed a price elasticity for all international visitors of 0. Their forecast was that the sales of previously tax-free goods would remain at the same level even after 20% tax was added. HM Treasury's November 2020 Budget forecast was for a VAT income of £500m annually, the same amount that was refunded in 2019. The OBR disputed this and used a price elasticity of 1.9 instead. This meant that a 20% price increase would lead to a 38% fall in sales (1.9 x 20%). The OBR reduced the forecast VAT income by £190m to £310m which HMT accepted.

3.29 But in evidence to the Treasury Select Committee in December 2020 a representative from the OBR said of its 1.9 price elasticity estimation "whether that's going to be high enough or not is something that I don't think we can be very confident in." The OBR was right to have little confidence in the 1.9 estimate, particularly in relation to Chinese visitors. The real evidence, collected over many years, shows that the price elasticity for Chinese international shoppers is 3.4. This means that a 20% price increase will lead to a 68% fall in sales.

3.30 HMRC estimates that £3bn was spent on tax-free shopping in 2019.[22] Tax-refund data shows that Chinese visitors were responsible for almost one third of that amount at 32%. This means that in 2019 Chinese visitors spent £1bn on tax-free shopping in the UK.

3.31 With a price elasticity of 3.4, this suggests that a 20% price increase will lead to a 68% fall in sales. This means that ending tax-free shopping is likely to lead to a loss of £680m in retail sales in the UK based on 2019 spending levels.

3.32 Taken together it is likely that fewer Chinese travellers will chose to visit the UK and those that do will spend 68% less than previously. This means that AIR forecasts a loss of sales to Chinese

[22] HMT Note "Technical Note" on the VAT Retail Export Scheme and tax-free airside sales" September 2020

visitors of around £750m, or three-quarters of a billion of sales each year to Chinese visitors alone as a direct result of ending tax free shopping.

3.33 Those sales will still take place with spending diverted from British shops to shops in France, Spain and Italy. Not only will we immediately hand over £750m of British sales to France, Spain and Italy but we will also give our European competitors the most valuable and fastest growing element of international visitor market for the future.