VAT : the temporary cut in the standard rate

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In his Pre-Budget statement to the House on 24 November 2008, the then Chancellor, Alistair Darling, announced that, given the threat to the UK economy from the global recession, the Government would introduce "a £20 billion fiscal stimulus between now and April 2010." In his view the "best and fairest approach" to delivering the major part of this stimulus was a temporary cut in the standard rate of VAT from 17½% to 15%, from 1 December 2008 to 31 December 2009, at a cost of £12.4 billion.[1] Mr Darling also announced a number of measures to raise revenue over 2010/12, including an increase in the rates of National Insurance contributions for employees, employers and the self-employed by a ½ percentage point from April 2011.[2]

At the time it was reported that the Labour Government had been planning that the standard rate would rise to 18.5% in 2010, but reversed the decision some days before the Chancellor's statement. In a debate at this time Mr Darling explained that "in the run-up to the Pre-Budget report, I considered—as any Chancellor would—a large number of options about just about every aspect of tax and spending, as the House would expect. As I had to raise money in order to ensure that our borrowing is reduced in the medium term, I concluded that the best and fairest way to do it would be to increase national insurance contributions by 0.5 per cent."[3] The 2009 Budget report noted that although it was "too early to make a full evaluation of the impact of the VAT reduction … there have been some positive early signs of the reduced VAT rate having been passed through into lower prices, providing support to consumer spending."[4] In his Pre-Budget statement on 9 December 2009, Mr Darling confirmed that "VAT will return to 17.5% on 1 January, as planned."[5]

No further changes were made to the standard rate of VAT by the Labour Government, but following the establishment of the Coalition Government after the 2010 General Election, the

1 HC Deb 24 November 2008 c492, c495
2 In his Pre-Budget statement the next year Mr Darling announced that NIC rates would rise by a full 1 percentage point – a tax increase implemented by the Coalition Government (for details see, *National Insurance contributions: changes from April 2011*, SN5550, 3 May 2011).
3 HC Deb 26 November 2008 c749
4 *Budget 2009* HC 407 April 2009 p29
5 HC Deb 9 December 2009 c360

new Chancellor, George Osborne, announced that the standard rate would be increased to 20% from 4 January 2011.[6]

This note discusses the Labour Government's decision to introduce a lower standard rate of VAT for a year, the way in which this was implemented, and the debate there was as to its impact.

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1 Introduction

The Pre-Budget statement which the then Chancellor, Alistair Darling, presented to the House of 24 November 2008 came at a time of severe economic crisis following extreme instability in the banking and financial sectors earlier in the year. At the time the *Financial Times* suggested it would be "perhaps the most important financial statement since the last downturn, in the early 1990s."[7] In his speech Mr Darling announced that, given the threat to the UK economy from the global recession, the Government would introduce "a £20 billion fiscal stimulus between now and April 2010, around 1 per cent of GDP." In his view the "best and fairest approach" to putting money into the economy immediately was a temporary cut in the standard rate of VAT:

> To prevent the recession from deepening, we … need to take action to put money into the economy immediately. I have looked at a wide range of ways in which we might achieve this. I have decided that the best and fairest approach is a measure which will help everyone, including millions of households that pay no direct tax at all, and it is to deliver a much-needed extra injection of spending into the economy right now. I therefore propose to cut VAT from 17½ to 15 per cent. until the end of next year. This reduction will come into effect next Monday, 1 December. It will continue for 13 months before returning to the present level of 17½ per cent. at the beginning of 2010, by which time we expect the recovery to be under way. This temporary reduction is equivalent to the Government giving back some £12½ billion to consumers to boost the economy. We would like retailers to pass it on as soon as they can. It will make goods and services cheaper and, by encouraging spending, will help stimulate growth ... this is possible only because I have rejected advice to take no action.[8]

The *Pre-Budget Report* (PBR) set out the case for using a cut in the standard rate of VAT as the "main lever" for this fiscal action:

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6 for details see,*VAT : the new 20% standard rate*, SN5620, 3 September 2013.

7 "Chancellor takes pains to erase last year's muddle", *Financial Times*¸ 24 November 2008

8 HC Deb 24 November 2008 c492, c495

2.40 For fiscal support to help stabilise the economy effectively it should be:

- timely – it needs to have a swift impact. This requires both that the policy change can be implemented quickly, and that it has a rapid impact on behaviour;
- temporary – to maximise its immediate impact and protect medium-term fiscal sustainability. If action is not taken to maintain sound public finances, there is a risk that higher long-term interest rates will outweigh its stimulus effect; and
- targeted – it is important that the support boosts spending, to maximise the impact on economic activity.

2.41 The Government has therefore chosen to take fiscal action that meets these criteria. A reduction in the rate of VAT has been chosen as the main lever for the fiscal action as this change can be implemented rapidly (timely), will impact immediately on the purchasing decisions of firms and individuals to boost spending (targeted) and is reversible (temporary). A temporary reduction in the rate of VAT will lower prices for households and should provide help immediately, when they need it most. It will also incentivise them to bring forward the purchase of goods, which will help support firms and the people they employ as the economy slows.[9]

It was estimated that the VAT cut would cost £3.8 billion in 2008/09, rising to £8.6 billion in 2009/10;[10] the estimate for 2009/10 was subsequently revised to £7.8 billion.[11] In an article just after the PBR, Mike Truman, editor of the technical journal *Taxation*, noted that the decision in May 2008 to increase the personal allowance by an extra £600 as compensation for the withdrawal of the 10p tax rate, would cost about £2.7 billion in 2008/09.[12] Consequently, a 'VAT giveaway' was only half the story: "with hindsight, it is clear that one of the reasons [the Chancellor] opted for giving money to everyone was that … he could see the financial storms ahead, and that a fiscal stimulus was going to be necessary by the autumn."[13]

Further details of the way the VAT cut would operate were given in a Pre-Budget notice, from which the following is taken:

> This measure will reduce the standard rate of VAT from 17.5 per cent to 15 per cent from 1 December 2008. The rate will remain at 15 per cent until 1 January 2010 when it will revert to 17.5 per cent. Zero rated supplies, such as basic foodstuffs, children's clothing and books; exempt supplies, such as education and health; and supplies subject to VAT at 5 per cent, such as domestic fuel and power are not affected by this change.
>
> Anti-forestalling legislation will be introduced in Finance Bill 2009 to ensure that businesses are not able to use artificial arrangements to reduce the VAT rate on goods or services to be provided after the VAT rate reverts to 17.5 per cent where there is no current economic activity. Genuine commercial transactions should not be affected. The Financial Secretary to the Treasury, Stephen Timms, will make a written ministerial statement to Parliament on 25 November 2008 setting out the details of the types of arrangements the legislation will be designed to capture.[14]

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9 Cm 7484 November 2008 p23

10 Cm 7484 November 2008 p194

11 HC 407 April 2009 p154

12 Cm 7484 November 2008 p194 (Table B5). For details of this change see, Treasury Committee, *Thirteenth report: Budget measures and low-income households*, 28 June 2008 HC 326 2007-08 (pp44-55).

13 "Through the fog", *Taxation*, 27 November 2008

14 HM Revenue & Customs Pre-Budget Notice PBRN26, 24 November 2008

The Minister's statement on anti-forestalling is reproduced in full below:

> **The Financial Secretary to the Treasury (Mr. Stephen Timms):** The Chancellor of the Exchequer yesterday announced as part of the pre-Budget report a temporary reduction in the standard rate of VAT to 15 per cent. from 1 December 2008 to 1 January 2010 when the rate will return to 17½ per cent. This Government have taken these steps to provide further support for growth and incomes during the economic downturn. The Government's discretionary fiscal action will deliver support of around 1 per cent. of GDP to the economy in total in 2009–10.
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> However, it is also important that the Government protect the public finances from artificial avoidance seeking to exploit the change in VAT rates where there is no current economic activity. Therefore, Finance Bill 2009 will contain anti-forestalling legislation to ensure that the VAT rate changes announced are fully effective. The Government will expose the draft legislation for comment as soon as possible. Anti-forestalling legislation will apply from today to ensure that, in the circumstances set out below, supplies with a basic time of supply after a VAT rate increase takes effect will be subject to the rate of VAT in force at that time. The provisions are designed to prevent artificial forestalling while being straightforward for business to understand and operate and not affecting genuine commercial transactions. This legislation is not intended to catch the normal commercial activity of providing goods and services.
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> The anti-forestalling legislation will apply in the circumstances set out below where the supplier receives a prepayment for the goods or services or issues a VAT invoice in advance of the rate increase. It will also apply where, in advance of the rate increase, the supplier grants the customer an option or a right to obtain goods or services at a discount or free of charge after the rate increase takes effect.
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> The circumstances are that the customer cannot recover VAT in full on the supply and that:
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> - the supplier and customer are connected parties; or
> - the supplier receives a prepayment, or grants the customer an option or a right, and the prepayment, or the acquisition of the option or right, is wholly or partly funded (directly or indirectly) by the supplier; or
> - a VAT invoice is issued by the supplier showing an amount any part of which is due more than six months after the date of the invoice.
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> The basic time of supply is normally when goods are delivered or made available, or when services are performed. For continuous supplies of goods or services, with consideration payable periodically or from time to time, the basic time of supply will be the end of the period to which a payment or invoice relates (that is, a billing period).
>
> Although the anti-forestalling legislation will apply from today, any extra VAT arising from its operation will not become due until after Royal Assent of Finance Bill 2009. Until then, suppliers should continue to account for VAT as normal, applying the VAT rate at the time of the prepayment, VAT invoice issue or grant of the right or option. The operation of the legislation will be kept under review to ensure that the provisions work as intended. Any additional or alternative anti-forestalling provisions included in Finance Bill 2009 will only take effect at the earliest from the date that they are announced.[15]

[15] HC Deb 25 November 2008 cc46-7WS

2 Parliamentary process

The standard rate of VAT is set by section 2 of the *Value Added Tax Act (VATA) 1994*, as amended. Special provision exists to allow the Government to change the rate of VAT, and the rates of other indirect taxes, for a limited period of time, without immediate primary legislation, as 'economic regulators':

> There are three regulators, covering VAT, tobacco products, and other excise duties. These provide for changes to be made to indirect tax rates by Order, without need for immediate primary legislation. All three regulators are activated by Treasury Orders introduced as Statutory Instruments subject to Affirmative Resolution within 28 sitting days in the case of duty or tax increases and to the Negative Resolution procedure in the case of reductions. Rate changes made under all three regulators lapse automatically a year after their first application, unless they are continued by a further Order (although changes in such subsequent Orders must always be applied to the original rate or duty of tax) or have been consolidated by provisions in a subsequent Finance Bill.

This procedure was introduced in 1961, originally in a fairly blunt form, as it applied only to the whole range of Customs and Excise revenue duties and purchase taxes:

> In 1964, the duties were split into groups and it became possible to apply the regulator more selectively. The original legislation provided that the Economic Regulator could be used only for '… regulating the balance between demand and resources …' (hence it was known as the Economic Regulator) but this condition was removed by the *Finance Act 1980* as this was consistent with the VAT and tobacco regulators that were permanent, and not subject to any constraint about the need to balance demand and resources.

When VAT was introduced in 1973, provision was made for a separate VAT regulator:

> [The regulator] allows for a change of up to 25 per cent in the standard VAT rate (i.e. from 17½ per cent to just above 13 per cent or just below 22 per cent). However, all EU member states have agreed to apply a minimum standard VAT rate of 15 per cent. The VAT legislation also makes provision for the zero-rating and exempt schedules to be altered (either by adding new items or deleting or amending existing ones) by Order, without need for primary legislation. Again, this is subject to the constraints of EU law regarding the scope of zero-rated and exempt supplies.[16]

Up to this time, the VAT regulator had been used once in July 1974 to reduce the standard rate of VAT from 10 per cent to 8 per cent, as part of an attack on inflation and was designed to reduce prices, with acceptance of a consequential loss of revenue. The standard rate was maintained at 8% until June 1979, when it was increased to 15%.

Following the Pre-Budget statement, the Labour Government laid an Order to give effect to the new 15% standard rate.[17] As this amendment could only be effective for 12 months,

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[16] HM Treasury, *Tax/Benefit Reference Manual 2009/10*, July 2009 paras 4.51, 4.109, 4.54-.5. The EU rules on VAT rates across Member States are discussed in, *VAT : European law on VAT rates*, Library standard note SN2683, 28 August 2013.

[17] *Value Added Tax (Change of Rate) Order* SI 2008/3020. The Order was approved on 17 December 2008 (HC Deb cc 1133-1160).

legislation was included in the *Finance Act 2009* to extend the period of reduction one more month to 31 December 2009.[18]

HM Revenue & Customs published an impact assessment on this measure, which looked at a number of actions businesses would *have* to take to implement the temporary VAT cut: specifically, familiarisation, re-pricing, extra book keeping checks, extra accountancy costs, and system changes/upgrades. It estimated that total compliance costs for business would be around £300 million. The assessment went on to add:

> There could be other potential costs to businesses such as choosing how to respond to the rate changes, consulting advisors, or (if businesses have contracts inclusive of VAT) potentially renegotiating terms of contracts. However, while it is recognised that some businesses may decide to incur them in practice in light of commercial realities, since these costs arise from commercial decisions they are not analysed as part of this impact assessment.[19]

When first published this document commented – incorrectly – that "the standard rate will then return to 17.5% from 1 January 2010, and subsequently increase to 18.5% in 2011-12" (p7). Indeed, it was widely reported that the Government decided *not* to propose a VAT increase in 2011 just some days before the Pre-Budget statement.[20] At Prime Minister's Questions on 26 November the Conservative leader David Cameron asked whether the Government had had a plan "to raise VAT even further than 18.5 per cent.?" In response the then Prime Minister, Gordon Brown, simply confirmed that the Government "had considered all options, but we rejected them [as] … we chose the options that were fairest to ordinary, hard-working families."[21]

3 Debate over the impact of the lower rate

At this time HMRC issued detailed guidance on the practical application of the temporary 15% rate; this included a series of FAQs for consumers, which address the question of whether retailers would have to change their prices, and pass the VAT cut onto customers:

> **Q3 Do retailers have to change their prices (and so pass on the VAT reduction to their customers)?**
> The Government is making this VAT rate change as part of a broader package of measures to give the economy a boost. Passing on the VAT reduction through reduced prices will stimulate consumer spending, and mean that both businesses and consumers benefit from the change. The Government is looking to businesses to pass on the benefit to consumers, and has encouraged them to do so. Ultimately, however, decisions on prices, charged by businesses and paid by consumers, are for businesses rather than the Government.[22]

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[18] Section 9 & schedule 3 of the *Finance Act 2009* provide for this change, as well as the anti-forestalling measures mentioned above. This provision was published in draft prior to the 2009 Budget (HC Deb 31 March 2009 c48WS). See also, HM Revenue & Customs Budget note BN72, 22 April 2009.

[19] *Explanatory memorandum to … SI 2008/3020*, November 2008 p8

[20] for example, "VAT rise to 18.5% scrapped at last minute", *Financial Times*, 26 November 2008; "VAT rise 'dropped just days ago' ", *BBC News online*, 26 November 2008

[21] HC Deb 26 November 2008 c716

[22] HM Revenue & Customs, *Change in vat rate – top Q&As for consumers*, November 2008

The initial reaction of retailers was that larger retailers would pass on the VAT reduction quickly, though smaller stores might not bother. Sir Stuart Rose, chief executive of Marks & Spenser, was quoted as saying, “are retailers minded to pass it on? Absolutely. Is there a logistic nightmare? Yes. Will we get there by Monday? Probably.”[23] In an interview with the BBC a few weeks later Sir Stuart suggested that the VAT cut had “not made a material difference to our sales.”[24] In February the *Sunday Times* reported that some retailers had reversed the price cuts they had made when the VAT cut was first introduced.[25]

There was considerable speculation before the Chancellor’s statement that the Government would announce a cut in VAT,[26] though the *Financial Times* reported diverging views on whether this was the best way to deliver a fiscal boost:

> On the merits of VAT, economists are divided. Respected figures reject as bogus the notion that VAT is the most effective tool for a stimulus because it applies only to money that is spent. They point out that if prices fall following a VAT cut, families can choose either to consume the same basket of goods and services, saving the difference, or to spend more. As such it is little different from a rise in income. Robert Chote, the director of the Institute for Fiscal Studies, nonetheless says: "As temporary tax measures go, at least they've picked a reasonably good one."
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> Others are concerned that VAT is particularly ill-suited to addressing a credit crunch because its stimulus effect relies on people being able to borrow to spend now rather than later - and that is exactly what banks are preventing households from doing. Ray Barrell, of the National Institute of Economic and Social Research, says a £15bn cut in VAT would work more slowly than an income tax rebate "because [the latter] reduces people's need to borrow".[27]

Following Mr Darling’s statement, and the introduction of the 15% rate, politicians, academics and commentators continued to have quite different views as to its effectiveness.

When the Chancellor first announced the new lower rate, the then shadow Chancellor George Osborne argued, “borrowing money for a temporary cut when prices are already falling, and telling people that their taxes will go up to pay for it, is not much of a stimulus.”[28] Speaking for the Liberal Democrats, Vincent Cable said, “The Chancellor has based his plans essentially on a temporary small cut in value added tax … What I fail to see is how the economy receives a major stimulus from, for example, a £5 cut in the price of a £220 imported flat-screen television or a 50p cut in a £25 restaurant bill. Surely it would be much more sensible to put money directly in the pockets of low-paid workers by cutting their income tax.”[29] Similar criticisms were made when the legislation to cut the rate of VAT was debated in the House; for example, Dr Cable said:

> The policy [of a temporary VAT cut] … assumes … that we expect a recovery in 13 months from now … [However] as we approach the end of next year, most people will have to look forward to an increase in VAT that may be greater than a return to 17.5

[23] “Shops warn of struggle to deliver cut in time” & “Small stores unlikely to pass on reduction to customers”, *Financial Times*, 26 November 2008
[24] Robert Peston (BBC Business Editor) blog, “Rose on pay and VAT”, 7 January 2009
[25] “Shops quietly take back the cut in VAT”, *Sunday Times*, 22 February 2009
[26] For example, “Brown to cut VAT as winter recession bites”, *Sunday Times*, 23 November 2008
[27] “A return to prudence will be some feat”, *Financial Times*, 24 November 2008
[28] HC Deb 24 November 2008 c505
[29] HC Deb 24 November 2008 c508

> per cent.—to reopen the whole issue of what the Government really intended—as well as an increase in income tax, although it is called national insurance. Most rational consumers will calculate that they face a reduction in real income and adjust their budgets and spending patterns accordingly.[30]

Following his Pre-Budget statement, Mr Darling emphasised the importance of taking immediate action; in response to a question from David Heath – suggesting that a targeted cut in income tax would be preferable – he noted that "income tax personal allowances take time to be fully implemented; a cut in VAT can be implemented much more quickly."[31] A similar point was made by Ruth Kelly in the emergency debate on the PBR on 26 November: "the beauty of the VAT reduction is that unlike direct income tax cuts it can be implemented virtually straight away and can clearly be seen to be temporary."[32]

Speaking in this debate, Kenneth Clarke also supported the use of a temporary VAT cut:

> All possible approaches have upsides and downsides, but VAT reductions have a bigger impact on big ticket items such as cars, furniture and carpets, particularly when we approach the magic period in which the temporary VAT reduction is about to go up again. I have no doubt that had the Chancellor been allowed to print the figure that the Treasury wanted to print, to try to make the future more credible—it was going to put VAT up to 20 per cent. by the time we got to 2012—that would have given an even bigger stimulus to spending.[33]

During this particular debate, Mr Darling took the opportunity to underline the fact that "the Government's policy is and remains that VAT will fall to 15 per cent. at the beginning of next week. It will then rise to 17.5 per cent."[34]

In February 2009 the Labour Government reiterated the case for the VAT cut in a paper prepared for the G20 summit in April:

> A temporary reduction in the rate of VAT is an effective mechanism for injecting money into the economy because it can be implemented rapidly, and so is timely; it will impact immediately by increasing the incomes of both consumers, giving more help to those with a higher propensity to consume, and businesses, and so is targeted; and it is reversible and thus temporary. A temporary reduction in the rate of VAT will lower prices for households and should provide help immediately and it will support firms and the people that they employ.[35]

The then Governor of the Bank of England, Mervyn King, gave evidence to the Treasury Select Committee the day after the Pre-Budget statement, and was asked by Graham Brady when he would expect to see whether the stimulus package was starting "to have the kind of effect that was hoped for":

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[30] HC Deb 17 December 2008 c1133. Both Members made similar points in the debate on the Queen's Speech focusing on the economy on 15 December: HC Deb 15 December 2008 c837, 840 (Mr Osborne); *op.cit.* c860 (Dr Cable).

[31] HC Deb 24 November 2008 c519

[32] HC Deb 26 November 2008 c767

[33] HC Deb 26 November 2008 c772

[34] HC Deb 26 November 2008 c750

[35] HM Government, *The road to the London Summit: The plan for recovery*, 18 February 2009 p59

> **Mr King:** I think well into next year. As Charlie Bean[36] said, obviously one of the likely impacts of the temporary reduction in VAT is that during the second half of next year there will be a lot of advertisements saying: "Buy now before VAT goes up in January 2010". So precisely when this expenditure-switching will occur is not entirely easy to judge. However, of course, the real problem is to know what the counterfactual is … what would have happened had you not done it. That, simply, we do not know; we do not know how quickly spending would have tailed off, how orders would have declined. That is why in these circumstances almost any policy measure is really about trying to balance risks …
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> **Mr Brady:** Can I ask you and, perhaps, any of your colleagues to comment on the particular decision to reduce VAT on a temporary basis rather than some of the other things that might have been done? Does that impact more obviously on inflation in the medium term as opposed to demand, or is it principally a demand stimulus?
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> **Mr King:** I think, as Professor Bean said, the idea behind it, at least in the textbooks, is that you can try to switch expenditure from one period to another. That has pluses in that you may be able to move expenditure to a period when otherwise you would expect demand to be rather weaker; it has minuses in that if you get the timing wrong and demand turns out to be weak just after you put the rate back up, then it may be switching expenditure at the wrong time. These are risks that need to be taken. There are enormous challenges for policy. Mr Fallon rightly pointed to the challenge posed by the overall scale of borrowing, and there is no doubt this is a major challenge, but we have to try and balance the risks. We are going to have a long, hard path back to fiscal sustainability because the debt has been increased not just by a downturn in the economy but, also, by the need to recapitalise the banks and provide so much lending to the banking system. This is a problem facing all Western governments - indeed, governments around the world.
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> **Mr Brady:** Many people, after yesterday, are saying that a 2.5% cut in VAT is not going to make much difference; if you walk down the High Street you will see shops making cuts of 20%, 30% or more in prices. Would it not have been more effective, perhaps, to reduce National Insurance?
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> **Mr King:** I do not think so. If you want to have the impact on expenditure switching, then actually doing it through VAT is probably more likely to be effective.[37]

A similar point was made by Professor Colin Talbot, Professor of Public Policy and Management, Manchester Business School, in evidence to the Committee on 4 December:

> There is a real danger that the VAT cut could have the completely opposite effect of what is intended and that is to discourage people from purchasing in the short term. Certainly if I were buying a new car at the moment I would wait under the end of the VAT cut period and buy it then, on the grounds that prices are likely to have fallen by that time.[38]

Robert Chote, then director of the Institute for Fiscal Studies (IFS), also gave evidence on this occasion. Asked about a possible alternative to the VAT cut, he said, "prior to the rush of leaks, I would have expected a larger proportion of the stimulus to come in the form of a permanent increase in the generosity of benefits and tax credits for relatively less well-off

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[36] Mr Charles Bean, Deputy Governor of the Bank of England (Monetary Policy) – who also gave evidence at this session.

[37] *November 2008 inflation report: oral evidence*, 25 November 2008 HC 1210-i 2007-08 Qs 24, 26-7

[38] *Second report: Pre-Budget Report 2008*, 28 January 2009 HC 27 2008-09 Q22 Ev 5

families on the grounds that they are relatively likely to spend a higher proportion of it and you would take it away from other richer households in the future”:

> **Mr Brady:** Some of us have struggled to see any really good reason why the decision to go with the VAT cut was taken instead of that. Can you see a good reason?
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> **Mr Chote:** There is a political issue which is that the alternative strategy gives to one group of people and takes it away from others, so you have a problem that the people you take it away from are angry and the people you give it to may be less than wholly grateful. The other issue is that the attraction of VAT is that it is not just giving income to people, it is a change in the price of buying today relative to buying tomorrow so therefore it is the argument that it shifts people's spending forward. Those are the two reasons I presume the decision was taken.[39]

The Committee took evidence from Treasury officials on 9 December, and Graham Brady raised Professor Talbot’s point about the VAT cut – that its impact was likely to “bring forward expenditure decisions at the end of next year.” Mr Dave Ramsden, Managing Director, Macroeconomics and Fiscal Policy, responded as follows:

> I was interested in Mr Talbot's remarks because when you are thinking about a measure like VAT, there are two very important aspects to the temporary VAT cut. One is the income effect, which leads to an increase in consumers' real purchasing power throughout the 13-month duration of the VAT cut, and you could see that type of income effect being analogous to what you would get from other types of tax cuts. Of course, because we can do VAT straight away, we get it for the whole 13 months rather than having to wait, as with some measures, until next year. The second thing, which is I think what the Governor meant, if you like, that first aspect will mean that it is cheaper to buy goods; your purchasing power is stronger throughout the whole period of the VAT reduction, and you see that already in the shops, whichever shop you go to. Nearly all of them that I have seen are passing on the VAT reduction, and we assumed that they would pass on the majority of it over time.
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> Secondly though - and this is what I think the Governor was talking about - you get a relative price effect, and that is why we chose VAT over other measures, because it makes the price of consumption cheaper now relative to the future. In the way that we have assessed the VAT reduction, we have assumed that that relative price effect will be particularly strong actually at the beginning of the recovery, i.e. in the second half of next year, and that was the experience in Germany. Before their VAT went up at the beginning of 2007 there was a bunching of consumption because the relative price effect was stronger then but the income effect, the first effect, will apply throughout, so you get these two effects.[40]

For its part the Committee noted that “the overall effect of the fiscal stimulus remains uncertain” although “in the view of the majority of commentators, the Treasury’s analysis of its impact is an optimistic one.”[41]

There has been a similar division of opinion among commentators and in the national press as to whether the temporary cut in VAT will work. At the IFS presentation on the PBR, Robert Chope, noted, “on balance the risk of acting may be less than the risk of refusing to. However, it certainly underlines the need to be serious about getting the public finances back

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[39] HC 27 2008-09 Qs24-5 Ev 5
[40] HC 27 2008-09 Q185 Ev 32-33
[41] HC 27 2008-09 para 12

into good shape once the stimulus has passed."[42] His colleague, Stewart Adam, noted that consumers still might decide to save the benefit of this VAT cut, simply by buying the same amount at a lower price and pocketing the difference. One reason for doing this would be the prospect of future tax rises after 2009, though, in turn, this raised a number of further issues: the degree to which people would be far-sighted, especially as "big future tax rises [were] not a prominent feature of yesterday's announcement"; the fact that future tax rises might hit different people, and that future public spending cuts could "force people to spend more of their own money instead." In addition, those on low incomes at the moment – especially the young – would often prefer to spend now and pay later, and this VAT cut was, in effect, "a loan" from the Government, who would "tax them (or others) later to pay for it."[43]

The IFS published a more detailed analysis of this issue in their *Green Budget* in January 2009, arguing that the VAT cut is "a better policy than many commentators suggest. It is critical to bear in mind that the proper comparison is not between consumer spending now and last year but between spending now and what it would have been now in the absence of the tax cut."[44] Unsurprisingly the Labour Government welcomed this conclusion.[45] That said, the authors went on to recommend that the UK should abolish most of the existing zero & reduced VAT rates on supplies such as food, children's clothing and domestic fuel and power – a highly contentious proposal that none of the major political parties have shown any interest in taking up.[46]

Writing in the *Guardian* just after the PBR, economics editor Larry Elliott commented, "Will the public respond? Jonathan Loynes at Capital Economics notes that Marks & Spencer and Debenhams were forced to cut prices by 20%-25% last week to drum up business, so it is questionable whether a 2.5-point cut in VAT - even assuming it is passed on by retailers - is going to make that much of a difference."[47] Similarly, an editorial in the *Financial Times* argued that "the decision to provide a fiscal stimulus was the right one [and] it is still difficult to do this effectively … the impact of [the VAT cut] will be lost in the price cuts that retailers are introducing anyway."[48]

The *Times* reported "serious doubt" that retailers would pass on price cuts from "the cost and effort of changing price tags and adjusting IT systems". In addition "retailers [will] be reluctant to move merchandise from psychologically important price points such as £9.99."[49] Writing in the *Times* Anatole Kaletsky noted that "most serious economists admit that there is simply no way of telling what may happen next year. Unfortunately for the Chancellor, he does not have the luxury of simply saying: 'I don't know'."[50]

42 Institute for Fiscal Studies, *Pre-Budget Report 2008: Robert Chote's opening remarks*, 25 November 2008
43 Stuart Adam, *Indirect and business taxes*, IFS November 2008
44 "Chapter 10: Value Added Tax", *IFS Green Budget*, January 2009 p212
45 For example, the Financial Secretary, Stephen Timms, in an Opposition Day debate at this time (HC Deb 2 February 2009 c609).
46 "Broadening the VAT base by extending the standard rate to most goods and services would remove many of the distortions to consumption decisions caused by the current system and would raise significant revenue even after *more than compensating* poorer households on average" (*IFS Green Budget*, January 2009 p194).
47 "Just like the 70s - without a 3-day week", *Guardian*, 25 November 2008; see also, "VAT cut was 'not a good idea', says IMF economist", *Guardian*, 24 December 2008.
48 "Editorial: Extraordinary optimism for extraordinary times", *Financial Times*, 25 November 2008
49 "'When M&S is slashing prices by 20% to get customers in, VAT cut is insignificant'", *Times*, 25 November 2008
50 "Darling's step into the unknown", *Times*, 25 November 2008

4 Budget 2009

In his Budget speech on 22 April Alistair Darling did not discuss the VAT reduction in detail, simply noting, "in the pre-Budget report, I announced a range of measures to help the country through the recession, putting £20 billion back into the economy. That help is coming through now, from an income tax cut, and a VAT reduction that will continue until December."[51] The Budget report discussed the evidence that the VAT cut was having an impact on consumer behaviour:

> It is too early to make a full evaluation of the impact of the VAT reduction. But there have been some positive early signs of the reduced VAT rate having been passed through into lower prices, providing support to consumer spending. According to the Bank of England's February 2009 Inflation Report: "prospects for consumer spending in the near term have been boosted by the temporary reduction in VAT". This view is supported by stronger retail sales growth in December, January and February than many commentators had predicted, and significantly stronger than the equivalent point in the recession of the early 1990s. The VAT reduction will, in particular, provide support towards the end of the year when its imminent reversal should provide an incentive for consumers to bring forward spending.[52]

The Centre for Economics & Business Research also published analysis at this time suggesting that the VAT cut had boosted retail sales.[53] The IFS published three papers on the possible economic impact of this measure in its April 2009 issue of *Fiscal Studies*;[54] in one of these, the author noted that, even if the stimulus was as effective as the Government hoped, there remained the question of what would happen when it was removed:

> Increased uncertainty and credit problems among consumers will moderate the impact on durable buying and reduce the impact relative to the impact in a milder downturn.[55] Nonetheless, the VAT cut has the potential to be a very successful short-run stimulus. This stimulus will, however, be short-lived, lasting only for the duration of the VAT cut. There will also be an offsetting adjustment once the full VAT rate is restored. Timing the VAT rise to occur after economic growth returns is likely to be critical. But any uncertainty about the timing of the rise will dampen the intertemporal effect. One can only hope the recession itself, perhaps as a result of the stimulus package, will be relatively short-lived and economic growth will appear well before the end of 2009, when the VAT cut is due to be reversed.[56]

In their 2009 Budget submission, the Institute for Chartered Accountants also raised this issue, from the perspective of businesses altering their prices:

> Changing the VAT rate back to 17.5% from 1 January 2010 is a highly inconvenient time for businesses, particularly retailers. The ICAEW is also concerned that … the start date for the proposed changes to the VAT place of supply rules for services will also come into affect in January 2010, thus businesses will need to deal with a major

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51 HC Deb 22 April 2009 c238

52 *Budget 2009* HC 407 April 2009 p29

53 "Study says VAT cut has helped retailers", *Financial Times*, 13 April 2009

54 IFS press notice, *Fiscal Studies symposium on the economics of VAT cuts*, 17 April 2009

55 Note that increased uncertainty and debt would very likely reduce the impact of other stimulus policies.

56 Richard Blundell, "Assessing the Temporary VAT Cut Policy in the UK", *Fiscal Studies*, vol.30 no.1, April 2009 pp 36-7

> change in the VAT system and a change in rate at the same time.[57] The ICAEW appreciates that the date of a change will always be inconvenient, but in view of the above problems we suggest that (assuming that the date of supply of services change remains January 2010) the date that the VAT is increased to 17.5% is put back to 1 April 2010, i.e. to the beginning of the VAT year.[58]

However, in the Budget the Government confirmed that the VAT cut would not be extended; in addition, the rules regarding the VAT regulator would be amended:

> The 2008 Pre-Budget Report announced a temporary reduction in the standard rate of VAT to 15 per cent for a 13 month period from 1 December 2008 to 31 December 2009. The reduction was implemented by secondary legislation effective for 12 months. Legislation will be introduced in Finance Bill 2009 for the 15 per cent rate to apply during December 2009 and for the rate to revert to 17.5 per cent on 1 January 2010. The measure also provides for minor amendments to the powers contained in the VAT Act 1994 (VATA) to implement a temporary change to the standard rate and for related changes to the Agricultural Holdings Act 1986 …
>
> Section 2 of VATA specifies the standard rate of VAT to be charged on the supply of goods or services, the acquisition of goods from another EU Member State or the importation of goods from outside the EU Member States. The standard rate was reduced to 15 per cent by the VAT (Change of Rate Order) 2008 with effect from 1 December 2008 to 30 November 2009. The Order will now cease to be in force on 1 January 2010 when the rate will return to 17.5 per cent.
>
> Section 2 also provides powers for the standard rate to be varied by secondary legislation for a period of 12 months. The measure amends section 2 to make clear that an order adjusting the standard rate of VAT can be made for a period of less than 12 months and that any order introduced under the section may be revoked. Section 97 of VATA prescribes the Parliamentary procedures that govern the order making powers contained in the Act. A new subsection, (4A) will be introduced, making it explicit that an order implementing a temporary reduction in the standard rate may be revoked using the negative resolution procedure.[59]

At this time the Government published its response to the Treasury Committee's report on the 2008 PBR. In response to the Committee's concerns about the administrative burden placed on firms – in particular, from the short notice the Government gave of the VAT cut – the Government said the following:

> When deciding to temporarily reduce the standard rate of VAT the Government recognised that the changes would impose a compliance burden on businesses and that smaller businesses may suffer more cost relative to larger businesses. However it was important to make the change quickly to maximise the economic and commercial benefits. We take seriously the concerns expresses by small firms and understand that it is important for businesses to have sufficient notice to implement a change. The Chancellor set out at the time of the PBR last November that the standard rate will revert to 17.5 % on 1 January 2010. Businesses therefore have adequate time to prepare for the change.[60]

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57 [For details of this measure see, HM Revenue & Customs Budget Notes BN74&75, 22 April 2009.]
58 ICAEW Tax Faculty, *2009 Budget Submission TAXREP 14/09*, March 2009 p8
59 HM Revenue & Customs Budget note BN71, 22 April 2009
60 *Third special report*, 1 May 2009 HC 431 2008-09 p7

After the Budget the Committee held several evidence sessions, and at the first of these Graham Brady asked witnesses about the impact of the VAT cut:

> **Q11 Mr Brady:** Is there any evidence in your view that the temporary VAT cut has worked?
> **Mr Martin Weale, National Institute of Economic and Social Research**: Could I say there that, as always, it depends what you mean by "worked". One of the intentions of it was that it would encourage people to buy in anticipation of future price rises. Inevitably, if that effect is there, it will be observed at the end of this year rather than at the moment, so a lot of the effects that I am sure the Treasury were hoping for we would not expect to see yet and that indeed might question whether a reduction was a sensible thing to do if we wanted the stimulus now. Beyond that I do not think you would expect it to have a large effect and my guess is that even with the benefit of hindsight we will not be able to see whether it has actually worked or not. In that sense I think it was probably a mistake in that it was quite a big thing to do, but not so large as to have a clear and visible impact in the data and, as we have seen, it has been swamped by continuing macroeconomic decline.
>
> **Q12 Mr Brady:** Does anybody take a different view?
> **Mr Robert Chote, Institute for Fiscal Studies:** I would be inclined to think that it was probably a more sensible policy to be going in with, but I think the difficulty is discerning what would have happened to the path of consumer spending in the absence of it, and so the idea that one can demonstrably say that this has succeeded or failed on the basis of the evidence we have at the moment seems to me implausible and I am sure PhD students will be failing to resolve this question in 20 years' time.

Mr Brady went on to ask about the impact of the return to VAT at 17.5% in January 2010:

> **Q13 Mr Brady:** What is going to happen at the end of the period? There is the possibility that it might stimulate demand leading up to the end once the rate goes back up again. What is the effect of that?
>
> **Mr Chote:** One of the objectives of the policy would be to try to bring forward spending in anticipation of the increases Martin was mentioning, which would imply that consumer spending will be softer than it otherwise would be the other side of the return to the previous level. Of course, if we end up having VAT rising to different rates as time moves on, then the story could get more complicated yet.
>
> **Mr John Whiting, PriceWaterhouseCoopers:** If I could add a word from a general business point of view, one side effect is undoubtedly, particularly for small and medium sized businesses, that a number have simply absorbed the cut to offset other cuts that they were making. So, moving aside from the economic impact, it has certainly given a lot of businesses a bit more flexibility as to what to do. It has helped some, and, of course, it has also given them a headache in managing the sheer logistics of the changes, as has been well documented.[61]

The Committee published its report on 6 May, and in this, noted that it remained "too early to judge" whether the fiscal stimulus – "and in particular the VAT reduction – has been successful". The Committee had also asked witnesses on whether the Government should have introduced a *second* stimulus in Budget 2009. In evidence to the Committee the Chancellor acknowledged arguments in favour of such a move, but suggested that he

[61] Treasury Committee, *Eighth report: Budget 2009*, 6 May 2009 HC 438-II 2008-09 Ev2

needed to "to balance what you do by way of stimulus with the fact that at the end of the day it has got to be paid for." On this point the Committee made the following comments:

> There has been much discussion of whether a subsequent fiscal stimulus, separate from the stimulus provided by the automatic stabilisers was necessary, but ultimately the Government decided against introducing a further large-scale fiscal stimulus at the time of the 2009 Budget. No doubt the debate around the need for a further fiscal boost to the UK economy will continue, particularly if growth in the economy fails to pick up. Any discussion of additional stimulus must take into account both the implications for the public finances of such a boost and the credibility of the Government's plans to bring the budget back into balance.[62]

Several Members raised this issue during the second reading debate on the Finance Bill on 6 May – in particular, the case for amending the date at which the lower 15% rate would be withdraw (31 December 2009). Speaking for the Conservatives, Philip Hammond said:

> We genuinely cannot understand why the Government have not listened to the universal view of retailers that, regardless of the merits or otherwise of the VAT reduction, changing it back at midnight on 31 December, in the middle of a public holiday and in the middle of the busiest sales period of the year, would be a disastrous mistake. The change could be made on 1 December or 31 January. Of course there will be fiscal implications arising from either of those dates, but have the Government not taken on board the simple practical point that retailers cannot manage the change in the middle of a public holiday, in the middle of the busiest sales period of the year?[63]

At a later stage of the debate Philip Dunne suggested that the Government "engage with the retail industry to come up with a sensible compromise – a cut-off date that will not engage retailers, at one of the busiest times of the year, in a great deal of extra work for no particular benefit to them."[64]

Speaking for the Liberal Democrats, Jeremy Browne noted the significant resource implications of extending the 15% VAT rate: "currently, the cost of the VAT reduction to 15 per cent. is about £1 billion a month, so were we to defer by only three days … the approximate additional cost would be £100 million. Of course, with new year sales, it might be even higher." The cost implications were also touched on by Ministers, as well as the strong desire on the part of retailers to know well beforehand when the VAT rate was going to revert to 17½%; at the opening of the debate, the then Chief Secretary Yvette Cooper argued that "extending the VAT reduction until, say, the end of January to move it outside the sales period would have cost substantially more. We made a judgment … about what time would be right, bearing in mind the scale and timing of the fiscal stimulus.[65]

Provision to extend the 15% standard rate until 31 December 2008 was made by s9 of the *Finance Act 2009*.[66] This was debated at the Committee stage of the Finance Bill on 12 May. Speaking for the Liberal Democrats, Jeremy Browne, argued that "the most problematical aspect of the VAT cut ... is that it did not have the effect of giving people additional confidence: the mental sense that they had additional money in their pockets." Speaking for

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62 *Eighth report: Budget 2009*, 6 May 2009 HC 438-I 2008-09 para 20-1
63 HC Deb 22 April 2009 c199
64 HC Deb 22 April 2009 c270
65 HC Deb 22 April 2009 c181
66 As noted above, provision for the cut to last 12 months had already been made by Order (SI 2008/3020): the Act extended the VAT cut by one more month.

the Conservatives, David Gauke said that "in the current circumstances, the benefits from a discretionary fiscal stimulus such as a VAT cut are outweighed by the dangers that it poses to the public finances and the burden it places on future taxpayers."[67] Mr Gauke went on to suggest that it would be better that the standard rate returned to 17.5% on 1 December, as initially provided for.

On this occasion, the Liberal Democrats put down an amendment to require the Government to publish an assessment of the VAT cut by April 2010; in response, the Financial Secretary, Stephen Timms, confirmed that he *had* commissioned research on this question:

> I can tell the House that on 6 March, with my agreement, HMRC commissioned a study from an independent research organisation, ORC International, whose report will be published, as always with externally commissioned research. The research will look carefully at the compliance costs burden imposed by the change and compare them with the estimates in the public impact assessment. It will also gather data about the commercial effects and the decisions that businesses took in the light of the VAT reduction, including looking next spring at the effects of the rate going back up again to 17.5 per cent. ... To assess the impact of the VAT cut, we will need data from the consumer trends survey, breaking down consumption between zero-rated and VAT-able goods. Data for the first quarter of 2010 will be available in July 2010, so the timing will be a little later than [the Liberal Democrat] amendment proposes.

Mr Timms went on to reject the case for the standard rate to return to 17.5% from 1 December, and announced special provisions for pubs and clubs which would be open on New Year's Eve:

> To those who suggest that it would be a good idea if the change took place on 1 December, I emphasise that that date is immediately before the busiest retailing weekend of the year. It would be a much worse date on which to make the change—that was clear from our discussions with the British Retail Consortium. There is not much support for that.
>
> I want specifically to tackle one point, which was raised in today's debate and on Second Reading. Indeed, I was surprised that an amendment had not been tabled about the difficulty for the many businesses that will remain open beyond midnight on 31 December in coping with two different VAT rates in a single trading day. Her Majesty's Revenue and Customs will allow a few hours' grace for businesses such as pubs and clubs, which will serve customers over midnight on 31 December, to enable them to charge the same 15 per cent. for a session that goes beyond midnight into the early hours of 1 January.[68]

Subsequently HM Revenue & Customs published details of this concession: in brief, businesses open across midnight, such as pubs and clubs, would be entitled to charge VAT at 15% until they closed, or until 6am on 1 January 2009, whichever was earlier.[69]

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[67] HC Deb 12 May 2009 c748, c752

[68] HC Deb 12 May 2009 cc770-1, c773

[69] HM Treasury press notice, *15% VAT rate extended for New Year's Eve traders*, 5 November 2009. For more details see, HM Revenue & Customs Brief 68/09, 5 November 2009.

5 Subsequent discussion of the temporary 15% rate

Despite calls from business groups in the summer of 2009, the Government showed no signs of reconsidering the end date for the 15% rate.[70] Its position was set out in a written answer on 21 July:

> **Jo Swinson:** To ask the Chancellor of the Exchequer what assessment he has made of the merits of postponing the reversion of the rate of value added tax to 17.5 per cent. until after the January 2010 sales period.
>
> **Mr. Timms:** The Government recognise that changing the rate at this time will be challenging for some businesses and have considered the representations businesses have made very carefully. The decision to reconfirm the 1 January reversion date that was announced last November has not been taken lightly. We have had to balance the needs of the economy as a whole against the challenges for businesses. Deferring the change by a month, as some have suggested, would have cost a further £800 million. By confirming the date for the end of the rate change in Finance Bill, businesses have a long lead time over which to plan for the change. HMRC will continue to talk to businesses with a view to identifying satisfactory arrangements for any particularly awkward cases.[71]

In August 2009 the consultancy PricewaterhouseCoopers published a survey which indicated that consumers believed that the VAT cut had made little or no impact on their spending. Of the 2,000 individuals polled, "88% ... said that the VAT change had not caused them to increase their spending on goods and services over the last few months and that the VAT change was insignificant compared to other factors such as reduction in income or uncertainty about the economic situation."[72] At the time it seemed likely that even if few consumers were thinking of the VAT cut during the summer months, the Christmas sales, and the imminent return of the 17.5% rate, might reverse this pattern. In November the BBC Working Lunch programme published a survey which found 23% of the 1,000 people polled saying the VAT cut had meant they had spent money they would not otherwise have done, and 27% saying they would bring forward their spending before VAT returned to 17.5%.[73] In its inflation report published that month the Bank of England noted that retailers might delay increasing prices, extending the impact of the 15% rate into 2010:

> VAT is likely to raise CPI inflation in the coming months, but there is uncertainty about the magnitude and timing of this effect. The number of companies that base their prices on the lower level of VAT is likely to have changed since December 2008. For example, some retailers may have cut prices only for a short period, possibly because they wanted to revert to preferred pricing points. There is also uncertainty about when companies that continue to base prices on the lower VAT rate will choose to pass through the VAT reversal. Some companies may raise prices prior to January, while others may delay until after the New Year sales. That decision is likely to be influenced by developments in demand at that time.[74]

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70 "VAT cut must be extended, say business leaders" & "Darling says VAT must rise", *Daily Telegraph*, 24 & 27 July 2009

71 HC Deb 21 July 2009 c1357W

72 PricewaterhouseCoopers press notice, *VAT reduction has had very little impact on consumer spending so far says PricewaterhouseCoopers LLP research*, 26 August 2009

73 "Shoppers give muted VAT response", *BBC News online*, 20 November 2009

74 Bank of England, *Inflation Report*, November 2009 p33

At this time several commentators suggested that in the longer term, it was most likely that the standard rate of VAT would rise *above* 17.5%. In October the professional services group KPMG published a survey of indirect taxes across the world, which found that "an urgent need for more revenue is pushing many governments into active moves to increase the tax take from indirect taxes."[75] The survey found that the average VAT rate across the EU was now 19.8%, while the UK's 15% rate was the joint lowest in Europe. As the *Financial Times* reported, "VAT is likely to be a strong contender for tax rises, whichever party wins the election."[76] In a paper on the UK's fiscal position, the IFS noted that changes to the VAT system were a simple way to substantially increase Exchequer revenues:

> If a government wished to raise revenue quickly and simply, it would likely change the rates or allowances for some of the taxes that already raise large sums, rather than creating new taxes or dramatically increasing the role of existing small taxes. By way of illustration, increasing i) the standard rate of VAT, ii) the basic rate of income tax or iii) the main rates of National Insurance Contributions for employees and the self-employed by 1p would each raise roughly £4½ billion or 0.3% of national income in 2011–12. Increasing the higher 40p income tax rate by 1p would raise roughly £1.4 billion. Freezing the income tax personal allowance in cash terms in 2011–12, 2012–13 and 2013–14 would raise roughly £3.7 billion if retail price inflation evolves as the Treasury has assumed in its Budget 2009 forecasts.
>
> If the government wanted to raise significant sums in additional tax revenue (accepting the public unhappiness that is likely to result) then ideally it would take the opportunity to do so in a way that improves the structure of the tax system. For example, economists have long pointed to the inefficiencies inherent in the VAT system. The Government could raise additional revenues and improve the efficiency of the tax system by abolishing the VAT zero-rating of certain goods. Though some vulnerable groups would be likely to be made worse off by this policy in isolation, it could be accompanied by an offsetting increase in other support directed at these groups. Depending on the exact design of the policies, such a course of action could still raise additional revenues whilst, on average, not making vulnerable groups any worse off.
>
> For example the main rate of VAT could be extended to children's clothing with child benefit rates being increased by the average amount that low income families spend on children's clothes. On average this would ensure that low income families with children were no worse off but would raise revenue as higher income families with children, on average, would be worse off (since they typically spend more than low income families with children on new children's clothes). In addition to raising revenue such a reform would simplify the tax system (as it would no longer need to specify and police what counted as children's clothes) and would remove the current incentive to buy new children's clothes rather than other goods that are currently subject to a higher rate of VAT.[77]

In his Pre-Budget statement on 9 December, Mr Darling did not announce any major changes in VAT:

> This time last year, we recognised the exceptional trading difficulties that businesses here were facing. In the past, inaction by Government to support firms led to

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75 KPMG press notice, *Recession hastening move to indirect taxation*, 20 October 2009

76 "Further VAT rises likely as Europe sets the pace", *Financial Times*, 20 October 2009. see also, "High street fears VAT could rise to 20%", *Guardian*, 16 November 2009.

77 Robert Chote et al., *Britain's fiscal squeeze: the choices ahead*, IFS Briefing Note BN87, September 2009 pp38-9

> widespread-and avoidable-business failure. I was determined that we did not repeat that mistake. So in an unprecedented move, I cut VAT to 15 per cent. for a year, to put more than £11 billion into the pockets of consumers and retailers. That countered the impact on businesses of the global credit squeeze and the collapse in consumer demand when it was needed most. I can confirm that VAT will return to 17.5 per cent. on 1 January, as planned. I have no other changes in VAT to announce.[78]

The *Pre-Budget Report* gave a short explanation for the withdrawal of the 15% rate, and reiterated the special arrangements drawn up for pubs, clubs and other traders affected by the timing of this change:

> [The fiscal stimulus announced in the 2008 PBR] was time limited to increase its impact during the downturn and support sustainable public finances over the medium term. The VAT reduction was designed to be temporary, and will expire on 31 December 2009. This reversal is an important part of the effectiveness of VAT as an instrument for fiscal stimulus, as it encourages consumers to bring forward spending at the end of 2009 ...
>
> The Government is working to minimise the associated administrative costs for businesses. The Government has given certainty about the end of the temporary reduction with a long lead-time from the announcement at the 2008 Pre-Budget Report. HMRC has also set out the arrangements for a period of grace for those businesses trading across midnight. The Department for Business, Innovation and Skills (BIS) is amending the rules enforced by trading standards on pricing to give retailers more time to display any changes to prices.[79]

Subsequent events – the outcome of the 2010 General Election, the length and depth of the economic recession, with the impact that this has had on the public finances – have meant that there has been relatively little discussion of this policy in recent years. In their Green Budget published in February 2010, the IFS considered the evidence for the impact of the 15% rate, suggesting that it "was likely to have been an effective stimulus" though, on those grounds, "we believe that the return of VAT to 17.5% will in turn have a negative impact on the growth of purchases … and on spending."[80] Subsequently HMRC published research it had commissioned on the compliance burden and commercial impact of the temporary VAT cut. Of the businesses surveyed, almost four in five had passed on the VAT cut to their customers, although a majority took the view that it had had little impact:

> Although the majority passed on the rate reduction, most businesses felt that it had no impact on either their customers (55%) or their organisation (63%). Only relatively small proportions were either positive about its impact (on customers, 24%; on the organisation, 16%) or negative about its impact (on customers, 4%; on the organisation 9%). However, perhaps, as a reflection of the fact that large businesses tended to spend proportionately more time on activity related to the rate change, they were notably more negative about the impact (customers, 28%; organisation, 35%) than micro (customers, 4%; organisation, 9%), small (customers, 3%; organisation, 8%), and medium companies (customers, 1%; organisation, 8%).[81]

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78 HC Deb 9 December 2009 c360

79 Cm 7747 December 2009 paras 2.68, 4.12

80 *Green Budget 2010*, February 2010 p65

81 HMRC, *HMRC Compliance Costs and Commercial Impact of December 2008 VAT Rate Change – Research report no.103*, October 2010 p3

Finally, on the political dimension to the Government's approach, in summer 2010, after the Coalition Government's announcement of the new 20% rate, Alistair Darling acknowledged that the year before, he had been over-ruled on raising VAT, as he had wished, by the Prime Minister.[82] Peter Mandelson had made this observation in his memoirs, published shortly after the 2010 election.[83] In turn Mr Darling reflected on the politics of increasing VAT in his memoirs published in 2011:

> The real problem [to obtaining the Prime Minister's agreement to increasing VAT] so far as I could discern it, was that to some of the Prime Minister's closest advisers VAT had a special political significance.
>
> From 1992, Gordon had masterminded a highly successful campaign against John Major's Conservative government, largely based on their attempt to put the full rate of VAT on gas and electricity. The weekly taunts of the 'twenty-two Tory tax rises' imposed after Black Wednesday, when the Tories had earlier promised not to increase taxes, was highly effective. Alliteration required there always to be twenty-two tax rises. When they came up with another tax rise, we would drop a corresponding one off the list to make sure there were only twenty-two. I think it was because of this that Gordon had come to the view that for us to put up VAT, even in a completely different world, would be lethal.
>
> He dispatched one of his pollsters to test the water. As was to happen subsequently when he was asked to test something Gordon did not like, this particular pollster declared the policy to be deeply unpopular. That wasn't surprising. I have yet to come across a tax that is popular with the person who pays it. The only taxes that are popular are those perceived to be paid by someone else.[84]

82 "Darling: Coalition cuts a 'hell of a risk'", *BBC online: Andrew Marr show transcript*, 25 July 2010
83 Peter Mandelson, *The Third Man: life at the heart of New Labour*, 2010 pp497-8.
84 Alistair Darling, *Back from the brink*, 2011 p184