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Short Term Thinking

Analysing the effect of applying VAT to school fees

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EXECUTIVE SUMMARY

- This paper reviews the proposal to apply VAT of 20% to private school fees in order to raise significant revenue;
- We build on a paper from the Institute of Fiscal Studies (IFS) which concludes that levying an effective 15% of VAT on school fees would lead to a 3-7% reduction in private school attendance and raise a net £1.3-1.5 billion;
- As the IFS noted, the evidence they drew on was “old” and “thin”. We raise several further concerns about the relevance of historical small price increases to a much larger price increase in a changed macro environment. We question the IFS’ confidence that higher migration scenarios, including up to 25% can be excluded from consideration;
- The IFS paper mentions some unintended consequences and risks; it would be prudent to consider many more, including school closures and cost-cutting; labour supply withdrawal, and human costs;

This paper focuses on 3 key areas:

1. The justification for the existing VAT exemption:

- The UK exempts VAT across the education sector, including, but not limited to universities, tutors and commercial language tuition, recognising that education is a merit good;
- Applying VAT only to part of the private sector would distort competition, favouring suppliers of near-identical services (tutoring, pastoral care, music lessons) in different settings;
- A static analysis, noting that school fees motivate marginal families’ labour supply, which can be withdrawn at any time, shows that independent schools are strongly favourable to the public finances and the broader economy.

2. The effect on the public purse:

- We used the IFS’ data inputs and assessments as a baseline for our own analysis, and explored further quantified variables;
- In a highly optimistic migration scenario of 5%, we indicate a net fiscal impact of £1.02 billion, a reduction of £0.38bn from the IFS’ estimate;
- Between 10-15% migration, we indicate that the tax would generate no net revenue;
- In a 25% migration scenario, we indicate that the tax could generate a loss to the Exchequer of £1.6 billion;
- We outline several further downside risks that apply in each scenario.

3. The impact on state schools:

- The geographical distribution of migration and school closures is impossible to predict;
- We have significant concerns about the ability of local authorities and schools to plan, adapt for and respond to unpredictable demand swings; there is a risk of children stranded without a place
- We doubt that putting private school children into the state system delivers benefit to the latter
- There may be even greater competition for preferred state schools, driving talented children from poorer backgrounds from high-performing state schools and grammar schools.

INTRODUCTION

“The problem I propose to tackle is this: a given revenue is to be raised by proportionate taxes on some or all uses of income, the taxes on different uses being possibly at different rates; how should these rates be adjusted in order that the decrement of utility may be a minimum? I propose to neglect altogether questions of distribution and considerations arising from the differences in the marginal utility of money to different people; and I shall deal only with a purely competitive system with no foreign trade. Further I shall suppose that, in Professor Pigou’s terminology, private and social net products are always equal or have been made so by State interference not included in the taxation we are considering”

- Introduction to Ramsey’s ‘Contribution to the Theory of Taxation’

We review the proposal to introduce VAT and business rates on part of the independent education sector. Advocates say these policies will (1) correct unfair tax breaks,² (2) raise £1.3-1.5bn, according to the Institute for Fiscal Studies,³ and (3) pay for improvements in state schools. The taxes are being proposed as practical revenue-raisers, rather than measures to harm independent schools. We therefore do not dwell on ideological concerns, concentrating instead on the economics of taxing education and building on the IFS submission. We consider the effect on state schools.

This paper does not explore government expenditure – whether £1.3-1.5bn (for convenience, we refer to 1.4bn) should be spent on state schools, whether spending proposals are the right priorities, or whether other measures might more effectively improve state schools. We are only concerned with the fiscal and other economic effects of applying VAT to part of the independent education sector. Regardless of wanting to spend £1.4bn, or any other plan for state schools, we should raise the money in the best, and least harmful, way. Few economists recommend hypothecated taxation. Policymakers should consider not only (1) whether this is an **effective** tax and raises revenue, which the IFS paper partially considers, but also (2) whether it is an **efficient** tax, minimising harm to the public and private sectors and (3) whether it is an **optimal** tax, compared both to other taxes and to opportunities to find the money from savings.

The IFS paper is optimistic about one of the fiscal effects, namely the cost to the state sector when children move schools. As we explore possible migration scenarios and consequential supply and demand-side effects, which raise material fiscal risks, we do not share their optimism.

We appreciate policymakers’ calls for good schools and a vibrant economy. A tax-imposed economic contraction that singles out, and risks closure of, some of the world’s leading schools is not an obvious means to those ends. The IFS paper briefly mentions unintended consequences and downside risks – but we present several more: school closures and cost reductions, upstream and downstream effects including the income effect on families that migrate to state schools, multipliers on the demand and supply-side, and human costs.

There are no free lunches here.

¹ F.P.Ramsey, ‘A Contribution to the Theory of Taxation’, The Economic Journal, Volume 37, Issue 145, March 1927, pp47-61.

² BBC News, ‘Labour drops plan to strip public schools of charitable status’, 28 September 2023, <https://www.bbc.co.uk/news/uk-politics-66942985>

³ L.Sibieta, ‘Tax, Private school fees and state school spending’, Institute for Fiscal Studies, July 2023.

PART 1 STATIC CASE: THE ARGUMENT IN PRINCIPLE

What is “fair” is subjective but can still be discussed in an economic framework. Schools should not be arbitrarily compared to consumption goods like washing machines and restaurants,⁴ which have no social benefit and no obligated state supplier. Schools should be compared to merit goods (those that deliver social benefit) and to goods where there is an obligated state supplier. In line with most of the world, the UK’s merit goods (healthcare and independent education, broadly defined) are exempt from VAT.

In Part 1 we review the VAT exemption against four theoretical criteria. The proposed selective removal detracts from **net social benefit**, harms **competition**, and poses risks to **public finances** via large tax pools in related markets. From a **distribution** perspective, to the extent it is desirable to “tax the rich by proxy” it would be simpler to “tax the rich”, with greater fiscal certainty and less distortion, and less risk to schools’ lower-paid employees. This is not a good tax.

Externalities:

A useful A-level primer tells us the mainstream view that “a private school provides an external **benefit** because the **workforce** will be more educated in the future and it **saves the cost of government education** in a publically-funded school.” [sic]⁵

Independent education is a significant investment in human capital. Human capital supports future productivity which creates returns privately (to a person and their family) and to other private individuals (customers, employers, and employees). Taxing the private sector’s willingness and ability to build human capital is not an obvious path to international competitiveness or prosperity.

Independent education helps the current public finances when the Treasury rides freely, saving the cost of state education, and the future public finances when the Treasury rides freely again on future productivity, particularly in a progressive tax system. Taxing the private sector’s willingness and ability to build human capital is not an obvious path to sound public finances.

Education provides for citizenship in terms of democratic participation (voting and debating); legitimate economic participation (avoidance and discouragement of crime); cultural participation (support for, and participation in, the various arts); and charitable participation (donations and volunteering). Taxing private investment in future citizenship is not obviously advantageous unless it is considered desirable to strengthen the state’s near-blanket monopoly on educating children.

Orthodox economists adhering to this view would strongly prescribe a subsidy, not a tax, in recognition of social benefit. School choice mechanisms with various forms of transferable funding are growing in the USA,⁶ and also observable in Sweden, Netherlands, and Chile.⁷

⁴ D.Penna, ‘Private schools should be taxed like dining out, says Rachel Reeves’, The Telegraph, 7 February 2023, <https://www.telegraph.co.uk/news/2023/02/07/private-schools-luxury-must-taxed-says-rachel-reeves/>

⁵ Economics Help, ‘Externalities - Definition’, <https://www.economicshelp.org/blog/glossary/externalities/>

⁶ EdChoice, ‘School Choice in America’, <https://www.edchoice.org/school-choice-in-america-dashboard-scia/>

⁷ A.Hudson, ‘School Voucher Systems Across the Globe Make the Case for School Choice in the U.S.’, EdChoice, 19 July, 2016.

Within the education sector, the UK does not apply VAT to:⁸

- Universities and colleges
- Vocational training
- Commercial language tuition
- Nursery schools (state or independent)
- Overnight childcare, including overnight provision at state boarding schools
- Other childcare, including holiday clubs and ancillary after-hours care provided by or located in state schools
- Tutors
- Music and drama teachers or sports coaches (as sole traders)
- Physical education
- Examinations
- School inspections
- Closely related goods and services such as accommodation, catering, transport, school trips and field trips

The UK's independent schools deliver a range of particular social benefits including partnerships, bursaries, cultural events,⁹ maintaining and providing access to historic buildings and landscapes,¹⁰ and supporting tourism.¹¹

We differ with the IFS when they indicate that “school environment and extracurricular activities” **could** be considered as standard consumption goods if “parents place a high value” on them.

- Social value depends on educational effects and the future value of human capital; parents' valuation is irrelevant, being by definition “internal” not “external” to their purchase decision.
- Outside independent schools, sports clubs, residential summer camps, sports coaching, children's theatre groups and music lessons are VAT-free even if some might view them as luxuries; state school parents use them and we recommend that the VAT exemption should be applied consistently, or not at all.
- Where some schools have invested in facilities for curricular or extra-curricular activities, they have already paid VAT on the construction costs (except on residential accommodation). The further “value-added” on the usage of the facilities would be both hard to distinguish from “education” and trivial in size compared to any single school's educational activity, let alone the whole industry – it offers no justification to tax the entirety of independent education.

We differ significantly with the IFS regarding the potential for network and information effects to be a negative externality specific to independent schools. The IFS cites two sources in discussion of the career and earnings benefits to independently-educated pupils, which they say “*mostly reflect differences in information (such as knowledge of routes to high-earning careers), access to networks or differences in family circumstances (which cannot be controlled for in empirical analysis), rather than higher skills built by private schools*” such that “*investments in private schools may come at the cost of worse outcomes for other pupils*”.

Schools and families within both sectors vary widely. Information and networking effects are of

⁸ Gov.uk, ‘Education and vocational training (VAT Notice 701/30)’, 6 February 2023, <https://www.gov.uk/guidance/vat-on-education-and-vocational-training-notice-70130>

⁹ G.Swerling, ‘Cathedral schools fear going bust under Labour plans to curb tax breaks’, Daily Telegraph, 11 January 2024

¹⁰ A.Hurst, ‘30 of the Most Beautiful Private Schools in The UK’, Independent School Parent, 12 June 2023, <https://www.independentschoolparent.com/school/beautiful-schools/>

¹¹ Winchester College, ‘Archives, Libraries, and Treasury’, <https://www.winchestercollege.org/welcome/archives-libraries-treasury>

people, not schools and do not justify taxing the independent sector: indeed, they are a feature of certain people attending certain independent schools rather than the sector as a whole; it is not clear the information and networking effects would be very different if those people were educated elsewhere. And they can be a feature of certain people attending certain state schools, in which case they are not a justification for penalising independent schools.

Most importantly, the evidence the IFS cites does not sustain their negative externality observation, instead it explicitly ascribes career success. This can be seen with statements such as “largely due to differences in educational attainment and university selection”¹² and that “much of the differences can be attributed to...higher levels of education”.¹³ Indeed, the IFS states that while “the value of private schooling is partly mediated through choice of and access to particular industry sectors”; with no further distinction between choice and access. Neither source demonstrates, or claims to demonstrate, a causative relationship specific to independent schools, nor worse outcomes for other pupils. Further, neither source considers whether social and legislative changes and university access policies in recent decades have changed the dynamics of entry into the job market, and thus whether the observed correlations of previous generations are expected to indicate outcomes for today’s pupils.

We also do not agree with the argument that independent school pupils unfairly dominate “top jobs”, thus are a negative externality, for two reasons.¹⁴

Like the IFS coverage of evidence that we examined above, the argument treats state schools as homogeneous, without (more reasonably) comparing top state schools to top independent schools and without considering the role of family and peer group influences that may be correlated with, but sit outside, choice of school.

Today’s senior judges and FTSE leaders attended school some decades ago. The world has changed enormously, not least with much stronger performance and greater Russell Group attendance by pupils from state schools. There is a volume of legislation and social convention supporting hiring / promotion policies today, particularly in public sector employment, that in no way resembles, and is designed to quash, an “old-school-tie” approach. The claim, in the Sutton Trust Report that “*old boys networks formed in top private schools play an important role in access to the elite*” passes without evidence nor comment on whether the future lives of today’s children bear comparison with those a generation or two before.¹⁵

Competition

Applying VAT only to part of the independent sector would distort competition, favouring suppliers of near-identical services (tutoring, pastoral care, music lessons) in different settings.

The VAT proposal would further distort competition in favour of the taxpayer-funded supplier - penalising only the part of the independent sector that the state competes against – in contravention of EU state aid law, if it still applied.

There is no competition concern across industries to VATable consumption goods such as wash-

¹² L. Macmillan et al. “Who Gets the Top Jobs? The Role of Family Background and Networks in Recent Graduates’ Access to High-Status Professions.” *Journal of Social Policy* 44, no. 3 (2015): 487–515.

¹³ Green, F., Henseke, G. and Vignoles, A. (2017), Private schooling and labour market outcomes. *Br Educ Res J*, 43: 7-28.

¹⁴ S. Weale. “Britain’s top jobs still in hands of private school elite, study finds”, *The Guardian*, 25 July 2019.

¹⁵ Sutton Trust and Social Mobility Commission, “Elitist Britain: 2019. The educational backgrounds of Britain’s leading people.”, p12.

ing machines and restaurants; if anything suppliers of consumption goods are likely to prefer a less-taxed economy with more disposable income for consumers, while strongly valuing the social benefit from education in helping to achieve a productive workforce.

Beyond the scope of this paper, the salient competition concern in education is the presence of the large state-funded supplier. Given highly variable output available “for free” it is predictable that families try hard **either** to obtain what is “free and excellent” **or** to avoid what they (rightly or wrongly) perceive as “free but unsatisfactory”. It is unclear why we should only debate the effect of niche suppliers on the dominant supplier, rather than vice-versa. It is also unclear why improvements to “free but unsatisfactory” schools are the responsibility of higher-earners paying for education from taxed income, and not also the responsibility of higher-earners who tend to obtain the best of state education.

Public finances:

A static analysis of the average per-pupil taxpayer footprint shows that the existence of the independent sector is strongly favourable to the public finances, more than justifying its tax exemptions. In the state sector, taxpayers fund state school places and fixed costs including the opportunity cost of land, and overheads. A state school place unclaimed is a saving to the taxpayer - it is not correct to talk of “unfair tax breaks” or “subsidies” without reference to taxpayer funding of the state sector.¹⁶ For both sectors, we include downstream contributions of payroll taxes and VAT on supplies. The summary chart is shown at Figure 1, with backup and sources in Appendix 2.

Figure 1 also extends the analysis to the closely related market of fee-payers’ labour supply. The need to earn school fees is a strong motivator for higher earners’ labour. It is half true to say “higher earners can afford expensive school fees”; the other half is “those wanting expensive school fees need to earn them”. Whatever mixture of hard work, talent, education, luck, and delayed gratification generates a career, the hard work can be withdrawn at any time. The Exchequer receives **upstream payroll taxes of £16k** (income tax, employee and employer National Insurance) when a 40pc marginal taxpayer earns £16.7k average fees (we use IFS data, see Appendix 3). We follow the IFS example in considering a steady state, such that the money used to pay fees out of wealth is treated as “having been taxed as income at some point”.

STATIC ANALYSIS OF PER-PUPIL TAX FOOTPRINT, STATE VS INDEPENDENT, WITH PAYROLL TAXES ASSUMING 40PC MARGINAL TAX RATE AND £16.7K SCHOOL FEES (£K)

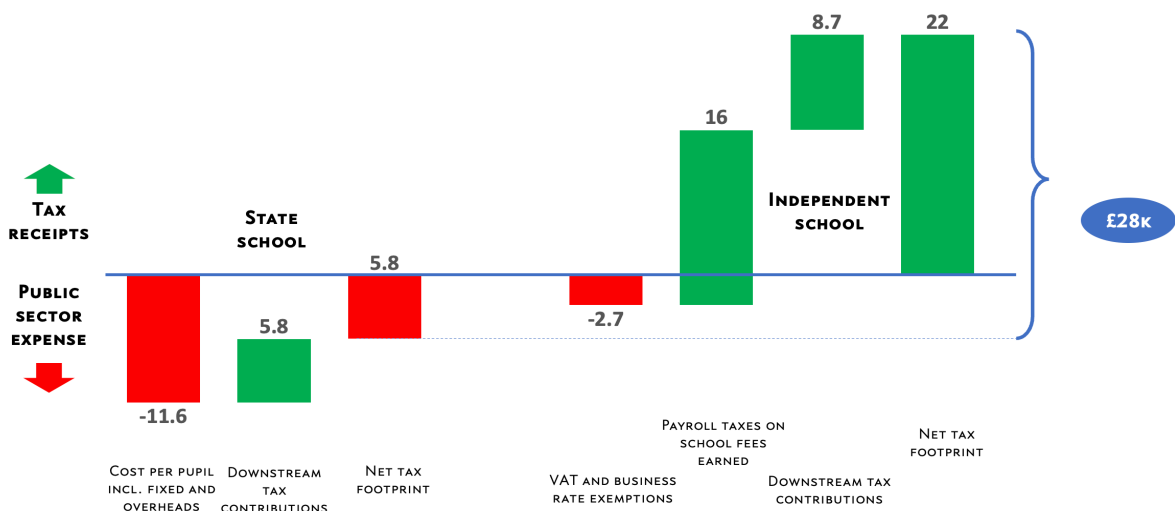


Figure 1

16 T.Ambrose, “Labour backs down from plan to strip private schools of charitable status”, The Guardian, 27 September 2023.

Every decision to earn money and pay school fees **contributes £28,000 to public finances**. To the extent the £2.7k tax exemptions are pivotal to that decision, they **generate a return for the taxpayer of 1040%**. Even if they are not pivotal (the family would nonetheless be willing and able to pay, and would nonetheless provide their taxable labour) it is not obviously “unfair”.

Two caveats apply:

- It is not our assertion that **all** independent school families **only** work to pay school fees, or that if they withdrew, they would withdraw exactly the amount of labour commensurate with fees (it could be less, or more, or they could move abroad and stop paying UK tax entirely). We propose here that “tax breaks” and what is “fair” are seen in light of overall tax payments and economic value in the education sector and in the related upstream labour market.
- Figure 1 indicates only the payroll taxes generated when fees are earned. Very high earners may, after paying the tax associated with their school fees and as part of a progressive income tax regime, still be significant contributors to the Exchequer. This part of their payroll tax contribution is not related to the choice of a certain education, however is related to our discussion of what is “fair”.

Figure 1 is generous to advocates of VAT, omitting still further fiscal and economic benefits from independent school economics. We have assumed 40pc marginal income taxes, not the 45pc or effective 60pc rate. We have not considered the economic value added by these higher-earners (such as doctors) to their customers (such as patients), employers and employees, or the various taxes raised on that value. We have not considered the multiplier on the value-added, nor taxes arising from it. We have not considered that UK independent schools may attract value-creators to the UK and thus may be associated with the entirety of their economic output, not only the part that pays the school fees. Finally Figure 1 does not feature any externalities.

It would be a reckless government that takes higher earners’ labour supply, economic value-add, and tax contributions for granted.

Distribution

Possibly the comparison to washing machines and restaurants is intended to reflect distribution rather than competition concerns – as a proxy for “taxing the rich”. If this is the outcome in mind, it would make more sense to simply “tax the rich”. The progressive taxation and benefits system are more traditional tools than targeted consumption taxes to manage distribution. It is not clear why it is “fair” to single out an independent school family to pay VAT for redistribution over an equally (or more) affluent state school family, especially given the latter may (1) buy into an excellent “catchment area” with a taxpayer-funded school place while being able to (2) buy VAT-free tutoring, take a skiing holiday, save an ISA for University, and still contribute a house deposit for each child.

If one of the criticisms of higher earners is that they “hoard wealth” and that is undesirable for distribution reasons, that criticism is difficult to aim at independent school families. According to the IFS, 71% of independent school fees cover staff costs; according to Oxford Economics, independent schools employ c.180,000 people. Independent schools put high-earners’ money into the pockets of reasonably paid teachers and often lower-paid support staff. It is difficult to see how revenue can contract without materially affecting those employees.

Case Studies: Greece and New Zealand

We note in Appendix 1 that a 23% VAT on education in Greece (in apparent contravention of EU law) caused, according to *The Economist*,¹⁷ “*general mayhem*” for exactly the reasons we outline here: migration into the overburdened state sector, school closures, job losses, tax avoidance, and a “*gap between theory and practice*”. The implementation was scrutinised in the European Parliament, where it was noted as “likely to cause financial hardship to thousands of families”.¹⁸ Any review of the effect of VAT seems incomplete without mention of the Greek experience.

Also in Appendix 1 we review New Zealand, where Goods and Sales Tax (GST) is applied to independent schools – but independent schools receive a direct subsidy that substantially offsets the GST for average fees, while also benefiting from public sector support in capital investment.

Static Case: Conclusions

Rather than ironing out an anomaly, as proponents indicate, the tax creates a new one.

We have seen that VAT applied to part of the independent sector would create a series of competitive distortions while exacerbating an existing one;

- It would make the UK an international outlier and follows an example that is not obviously encouraging;
- The overall tax contribution of independent schools, plus the upstream effects, is robustly favourable to the Treasury;
- It perversely punishes, instead of rewarding, a positive externality.

It is therefore hard to sustain the claim that the tax exemption is “unfair”.

¹⁷ *The Economist*, “*Greece reconsiders a tax on private education*”, 30 October 2015.

¹⁸ T.Zagorakis (PPE), “*Differential VAT rates for private education services in Greece*”, P-014059-15, 22 October 2015

PART 2 DYNAMIC CASE: THE ARGUMENT IN PRACTICE

Here we evaluate fiscal consequences of the VAT proposal, using the same baseline data as the IFS and likewise assuming a 15% effective rate that allows for reclaim on schools' purchases.

Migration scenarios: PED and YED

The IFS concludes it would be “reasonable and cautious to assume a net gain to the public finances of £1.3–1.5 billion over the medium and long terms”. We should indeed be reasonable and cautious.

The IFS considers that there will be a very inelastic demand response in independent schools – they anticipate that an effective 15% VAT will only generate migration of 3-7% of children. They acknowledge that the evidence they provide is “quite thin” and “relatively old” and that there is a “sparse amount of causal evidence”. Based solely on that acknowledgment, it seems incautious to model a relatively small migration at the 3-7% level, taking the elasticity estimates largely as-given. It would be reasonable and cautious to analyse a 10-15% migration level as a less optimistic scenario.

Economists must be careful when relying on the past to predict the future. It is necessary to establish whether the circumstances have changed. If the circumstances have changed, or if there is a risk that the circumstances have changed, then we are not able to accept the past as a guide to the future, and must explore a wide range of possible outcomes. If we are to drive using the rear-view mirror, it is essential at least to confirm our expectation of a straight road.

It is not clear that the IFS considers whether the circumstances have changed. The following several concerns with the IFS' historical data suggest further downside risks i.e. higher migration:

First, the Dynarski study cited by the IFS refers to Catholic schools in the USA with sibling discounts in 2002. It is not clear how their behaviour would inform the response of British families to a general price increase in 2024.¹⁹

Second, as the Dynarski study explains, there is a “lack of exogenous variation in private school prices” and “a regression of quantity on price captures movement along both the supply curve and the demand curve”. In plainer language, it is not possible to observe the demand relationship between price and quantity, unless we can confidently distinguish or exclude shifts in underlying demand and supply:

- The IFS paper notes, despite a 20% rise in fees “only a small drop in the share of pupils attending private schools in England, from 7.1% in 2010 to 6.4% in 2022. This fall was mainly driven by a **rising pupil population** in the state-funded sector, with the number of pupils in private schools remaining around 560,000–570,000 in England over most of the 23 years” (our emphasis); thus, by calculation, a **10% rise in overall pupil demand** across both sectors;
- They do not consider whether the 10% increase in overall pupil population may have contributed to an increase in demand, and to demand for “preferred” schools specifically.
- They discount the possible effects of income growth or deteriorating state school quality in sustaining independent school headcount, concluding that “the more likely story seems to be that the relationship between private school demand and fee levels is quite weak.”

¹⁹ S. Dynarski et al, “Cheaper By the Dozen: Using Sibling Discounts at Catholic Schools to Estimate the Price Elasticity of Private School Attendance”, NBER Working Paper No. 15461, October 2009

- We are not able to accept this conclusion. In graphical terms, they are unable to prefer the left-hand side (inelastic demand and elastic supply) to the right-hand side (inelastic supply and elastic demand) in Figure 2 below. We know that demand increased (from D1 to D2); a barely-perceptible quantity shift could be a feature of a steep supply curve (S, on the right), leaving us no wiser regarding the slope or shape of the demand curve. A steep supply curve is consistent with weak incentives to expand supply (many schools being non-profit) and strong barriers to entry and expansion (land, construction, regulatory and planning approvals, long time-horizons associated with recruiting children mainly at points-of-entry).

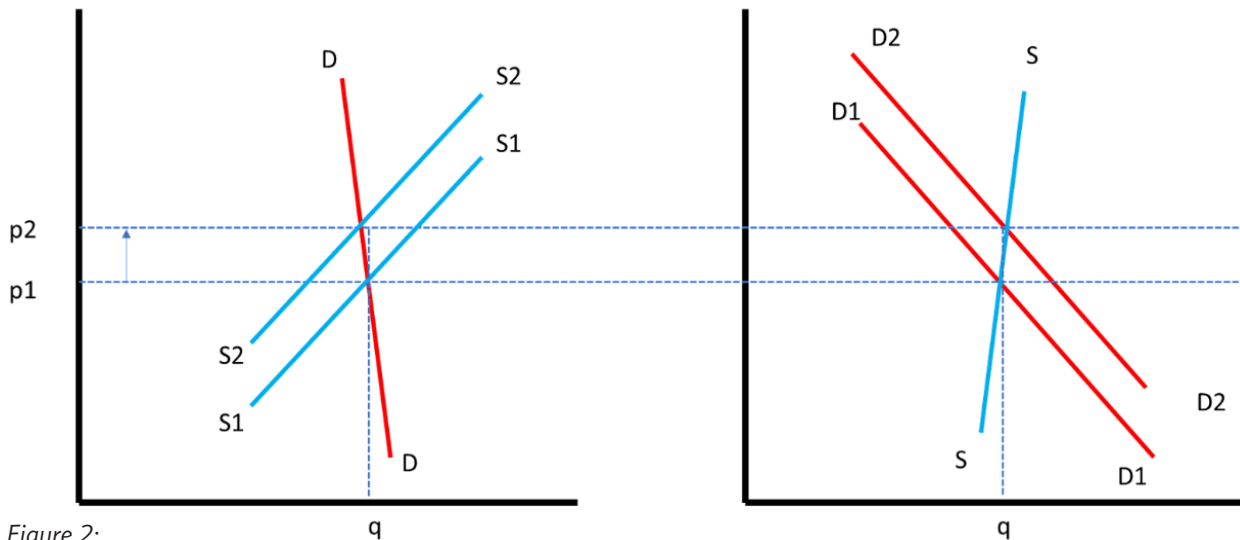


Figure 2:

Third, some goods and services, for example bread and other “fast-moving consumer goods”, have characteristics that are suitable for economists wishing to use the past to predict the future. When supermarket chains roll out a price change for bread based on a trial last month, they are dealing with the same customers, with the same income and wealth. They are replicating the same price shift at scale, on the same product with the same close substitutes, and they are working in a market with many, frequent, and recent data points. Despite working in as good a laboratory condition as economics can offer, they do not always get it right. For school fees, the laboratory is far less satisfactory. Even if the evidence presented by the IFS was robust, we cannot depend on the past to predict the future because:

- We have a different cohort of people, a different generation – even a different country.
- Today’s parents face different income and wealth constraints; the IFS is wrong to assume by omission that they are immune to higher house prices, interest rates, core inflation, fiscal drag, student debt, plus the cumulative effect of previous school fee increases. This adds up to a very large erosion of real permanent income compared to previous cohorts.

Fourth, even if we knew elasticity at or near a “point” on the demand curve, economists generally admit knowing nothing about the shape of demand further from that point. If a supermarket has trialled a 5p price increase on bread, it knows something about a single price increase. It knows nothing about several cumulative 5p price increases. Just because we have not yet reached fee-payers’ last straw, does not mean we know where it is.

- Historical evidence tells us about annual price increases mostly in the 1-4% range; this is no guide to behaviour facing a sudden 15% increase;
- The VAT-driven increase is cumulative – it must be added to previous years’ increases as well as to inflationary pressures passed on this year by the schools themselves.

Fifth, a large effective price increase due to VAT has potential to overcome relationship stickiness and status quo bias, and cannot be compared to historical smaller increases:

- A larger one-off shock brings a greater possibility of moving alongside peers. Any perceived social stigma, or psychological sense of failure, from withdrawing from school is largely obviated if several families move at once and if the move is attributable to an external shock.
- The relationship cost to children leaving school may be reduced if children are able to move with friends.
- In the event of school closure, a large number of families face an involuntary exit from their school and are immediately relieved of relationships, stigma and status quo bias; they are “nudged” into making a fresh choice in an already less favourable environment. It is not clear that the IFS have considered the role of involuntary exits.

Sixth, schools are characterised by strong relationships, high switching costs and few decision points. Most families will make a school choice once or twice in their lives, while buying bread once or twice a week. The fact that past parents stuck with independent education, or with a specific school, is a limited guide to whether the next generation of parents will form such relationships in the first place.

Seventh, a 2017 paper explores Income Elasticity of Demand (YED), which can be of much greater value than Price Elasticity of Demand (PED) in understanding the willingness and ability to pay for independent schools.²⁰ The authors note that above the 90th income percentile, $YED > 1$ – demand is highly responsive to income. The IFS’ more recent paper makes a very brief mention of the average effect of VAT on family expenditure but does not explore the distribution of real disposable income. To understand migration risks, we must understand the distribution of real disposable income. It is irrelevant that some independent school families are extremely well off; we are only interested in those at the margin of affordability.

Affordability for higher earners is not a matter for pity, or other emotions. As we explore the effects of the tax, we are interested only in those affected by the tax. We are interested in the marginal willingness and ability of parents to pay for independent schooling if VAT is imposed, and what that means for the economy and public finances. Neither do we belittle the challenges of other families by focussing our attention narrowly on those affected by the tax. We are exploring whether harming the latter is reasonably expected to help the former.

The omission of affordability considerations in today’s macroeconomy, the extrapolation of unrepresentative data to a very large future cumulative increase, and the lack of consideration of income / wealth distribution, are very serious concerns, compounded by the scarcity and age of the empirical evidence. This is a globally unprecedented change in unprecedented conditions.

There is a strong precedent to publish, consider and be guided by worst-case scenarios. Public policy regarding both Covid lockdowns and response to climate change is heavily shaped by “plausible” i.e., low probability “worst-case scenarios”. Without further exploring those contentious issues, we note that neither “more probable” let alone “best-case” scenarios receive policymakers’ or journalists’ attention. Policymakers place more-than-proportionate weight on the avoidance of severe outcomes

A reasonable and cautious approach should acknowledge that we are in uncharted waters. There is significant risk of migration larger than the 3-7% identified by the IFS. We do not share the IFS’

²⁰ F.Green, et al. “Who Chooses Private Schooling in Britain and Why?”, Centre for Learning and Life Chances in Knowledge Economies and Societies, 2017.

confidence that migration scenarios of up to 25%, as indicated by Baines Cutler, can be excluded from consideration, and encourage policymakers to account for these scenarios in their planning.²¹

We might be justified in considering only optimistic scenarios if the consequences of being wrong were materially insignificant, however that is not the case as we shall see.

Supply side impact of migration

First, we assume, per the IFS, that schools start by offsetting 20% VAT against purchases for an effective rate of 15%, then pass the full 15% onto families. Families in turn decide whether to **stick** or to **migrate** to the state sector. For convenience the IFS baseline and data inputs are at Appendix 3.

Cost to state schools

The migration impact is not the same as the average per-pupil funding outlined in Chapter 1, where we were interested in total expenditure, including land opportunity cost and overhead, on existing state school pupils. As we look at migration costs, it is debatable how much extra land and overhead might be incurred, or if those costs would remain fully fixed despite greater pupil numbers.

We differ slightly with the IFS regarding the assumptions over the SEN budget for independent school pupils. In addition to local-authority funded SEN pupils we would add: some parents of children with lower-need and/or undiagnosed examples of SEN and/or other concerns such as anxiety will have chosen independent schools, **because** they considered it a more suitable environment, although they might otherwise have chosen state schools. Finding themselves forced into the state school system, they may be newly inclined to seek a diagnosis, statement and EHCP, which will then lead to an extra cost to taxpayers; alternatively, these pupils could represent a disproportionate cost and a distraction to receiving state schools that are less well-placed to treat them on standard resourcing.

Otherwise, we see no reason to differ with the IFS' £5,900 assessment and will proceed with what is a relatively simple mapping of our migration scenarios, per the table at Appendix 4. At the 5% migration level, we see **£0.17bn** cost to the state sector (the IFS noted £100-300m). At Baines Cutler's 25% level, we see **£0.83bn**.

We reiterate that this is for per-pupil operating cost alone; there could be additional downside risk in terms of fixed costs if the state sector needs to build new classrooms, and overheads if the local authority and Department for Education is required to deliver a change programme. We shall return to the effects on the state sector in Part 3.

Revenue contraction in independent schools

The IFS assumes independent schools' expenditure is held constant, which is a major omission. Given they assume 3-7% pupil migration costing schools 3-7% of revenue, we expect a 3-7% reduction in expenditure. At less optimistic migration scenarios, we expect deeper cuts affecting the 180,000 people employed in the sector, with direct consequences for their tax contributions and indirect consequences for tax receipts from the downstream economy.

²¹ Baines Cutler Solutions, "Independent Schools Council, VAT on School Fees - Report", October 2018

Cutting expenditure

- **directly** affects payroll (and related tax)
- **directly** affects purchasing (and related tax, noting that VAT is likely to be reclaimed);
- **indirectly** affects the tax contributed by suppliers (payroll taxes, business rates, corporation tax, dividends, and capital gains)
- **induces** tax losses in the onward economy via a multiplier.

In rural areas a large independent school may be a very prominent customer and employer, and the multiplier impact of contraction or closure may be more significant – re-employing displaced resources is relatively hard. In prosperous locally diversified economies, there may be more opportunities for displaced resources and suppliers to find new business.

The argument has been widely presented that independent schools are able to make savings.²² Those advancing such proposals might be asked to provide greater clarity on how this would work and to account for the implications. Noting that 71% of independent school fee income goes on staff costs (as quoted in the IFS paper, Figure 4), it is unclear where significant savings are to be found other than headcount reduction or pay cuts, if the school is to survive.

Redundancy processes impose a certain one-off cost on schools needing to reduce their expenditure. In cases where a school closes abruptly and without any reserves, it is not clear how redundancy payments would be settled. We shall return to human costs later in this chapter – for now we are looking at the fiscal impact.

In compensation the state sector, which currently has teaching vacancies, might re-employ people losing their jobs in independent schools. Others may work as (VAT-free) tutors, possibly on a “grey economy” basis thus reducing their tax contributions relative to permanently-employed PAYE status.

From an operational, human, and fiscal perspective policymakers should be cautious regarding off-setting gains from state sector re-hiring. For the most prominent critics of independent schools, the greater resources in independent schools (per pupil) are problematic in themselves. Shifting pupils from well-resourced to less-resourced settings implies creating spare resources.

- Previous work by the IFS has stated “*The greatest schooling inequality by a very long distance lies in the resources gap between the private (fee-paying) and state sectors*” and indeed that this is “**the substantive issue for schools policy**” (our emphasis).²³
- The IFS devotes approximately a sixth of their paper (on the fiscal assessment of VAT) to discussion of the inequality of resources between state and independent sectors, noting the staff pupil ratio is approximately double in the latter.

As we consider independent schools’ teachers made redundant, associated with pupil migration, we can only assume limited re-hiring in the state sector. The latest data on the school workforce tells us that there are 2,300 state sector teaching vacancies.²⁴ Oxford Economics (fig 10) tells us that the independent sector employs 103,000 teachers and teaching support (extrapolating from ISC figures), so on the ISC’s scenario, 5% as their mid-point, we could expect **5,150 redundant teachers**

²² P.Wood, “Bridget Phillipson says private schools will have to make savings like everyone else in VAT fees row”, i News, 29 September 2023.

²³ F.Green, “Private schools and inequality”, Institute for Fiscal Studies Deaton Review of Inequalities, 16 August 2022.

²⁴ Gov.uk, “School workforce in England: Reporting year 2022”, 15 December 2023, <https://explore-education-statistics.service.gov.uk/find-statistics/school-workforce-in-england>

to apply for the 2,300 vacancies (this is assuming all cuts fall on headcount, not on rates of pay).²⁵

Then as we consider whether new roles are created to reflect the arrival of additional pupils, we turn to the staff-pupil ratio. Assuming equivalently attractive job, location, pay and conditions, and perfect skill matching, the state sector can hire at most one-half of redundant staff. Those assumptions are not realistic and the actual uptake, and related fiscal impact, can be expected to be considerably lower.

People and roles should not be assumed to match:

- People may not want to work elsewhere, having lost the job that suits them.
- Forcing people into less-preferred work, whatever the reason, tends not to be associated with strong productivity and performance.
- All observers agree we cannot predict where demand will be hardest-hit, and thus where school contraction/closure will be most severe. It is improbable that teacher redundancies will conveniently coincide with areas of state school demand.
- Independent schools may make redundant those teachers that they perceive to be least-efficiently employed, for example in lower-demand subjects. It is improbable that those teachers will conveniently match skill gaps in state school demand.
- Independent schools may make redundant those teachers that they perceive to be least effective. It is not clear that those teachers will conveniently be capable of delivering quality in the state school setting.

Indeed, most state schools and teaching unions emphasise the need for qualifications, which many independent schools treat as a matter of discretion. Not all redundant teachers will be eligible to work in state schools, or at least not without time and expense to re-train. And, there is a risk that lower rates of pay in state schools result in lower payroll tax revenues where teachers are re-hired. The redundancy and unemployment risks could fall upon lower-paid support staff such as maintenance workers, kitchen assistants and cleaners, and among specialist extra-curricular providers such as drama and music teachers, for which there is relatively less demand in state schools, compared to (for example) maths teachers for whom there are currently vacancies. Lower-paid staff could also be less geographically mobile, economically vulnerable, and are particularly exposed where the school is a prominent local employer.

Overall, state school hiring does not appear to be a convenient solution to the fiscal and human consequences of displacing independent school staff.

Oxford Economics report (page 22) that the total estimated direct, indirect, and induced tax contribution of all UK independent schools was **£5.1bn**.²⁶ This includes the **direct** payroll taxes of teachers and other support staff, the VAT contributed by suppliers, the **indirect** payroll and other taxes paid by suppliers, and the **induced** downstream impact of all economic activity via the multiplier. We subtract £220m which the IFS has already allowed for schools as they reclaim VAT, giving us a baseline of £4.88bn. We assume migration drives a proportionate reduction in revenue, and the revenue drives a proportionate reduction across independent schools' costs, giving us a tax revenue loss of **£0.24bn on the IFS' 3-7% scenario and £1.23bn on Baines Cutler's 25% scenario**.

That is before (on the upside) any re-hiring and re-appointment elsewhere, including filling vacancies which could partially replace the lost generation of payroll taxes. It is also (on the downside) before the state incurs any expense via the benefit system, the staff-pupil ratio effectively limits

²⁵ Oxford Economics for the Independent Schools Council, "The Impact of Independent Schools on the UK Economy", December 2022

²⁶ Ibid. p22.

re-hiring, and lower rates of pay affect tax contributions from re-hires. Again, we should say there is no evidence for such an unprecedented government induced cost-cutting exercise. We are applying judgement, as does the IFS (intentionally or otherwise) when they assume schools do not cut costs at all.

Our estimates for the supply side impact of migration appear in Appendix 4.

Supply side impact if VAT absorbed

It has been suggested that schools could absorb the VAT in full, instead of passing it on to families.²⁷ The theory is that, in this case, parents would not migrate to taxpayer-funded schools; there would be no taxpayer expense and the government would be able to book the entire VAT generated.

To absorb an effective 15% VAT charge, schools would have to reduce costs elsewhere. This is not the elegant solution it seems, reducing net tax revenue by **£0.86bn**, again in Appendix 4:

- First, VAT **within** the existing parental budget generates a smaller sum; nominal fees must fall by 13%, thus the VAT raised falls by 13%, a loss of **£0.19bn**.
- Second, schools will then have to reduce costs, which will directly hit payroll and purchases, plus their related tax contributions and consequent indirect/induced impact; a loss of **£0.67bn**.
- Third, noting that independent schools must compete against “free,” there is a risk that pupils migrate following a reduction in quality due to cost-cutting.
- Fourth, schools risk becoming unable to cover costs. Schools that close trigger a mass migration either to other schools or to the state sector. If instead fixed costs are ring-fenced, then the entire cost-cutting burden falls on payroll and purchasing, and the risk of significant quality erosion is increased.
- Fifth, it is likely that schools would look to find savings in bursary provision and partnership activity, covered in more detail later in this document. Schools can expect strong pressure from fee-payers considering that their school fees have moved onto a commercial taxation basis. Most bursary-holders should be expected to land in the state sector.

Financial impact on independent schools – changing business model

As we discussed in Chapter 1 the VAT exemption on education services is wide-ranging. There has been no indication that a proposed change to independent school VAT status would include a change the scope of the exemption other than to remove it from independent schools; meanwhile they have indicated a commitment to apply it to, for example, boarding school fees.

As the IFS says: *“Issues around tax avoidance are also highly connected with how private schooling is defined for the purposes of VAT. A wide definition would restrict the opportunities for tax avoidance, but could also end up (unintentionally) applying VAT to other forms of education and training. For example, we have assumed that VAT would not be applied to early education and childcare, or to adult education. An age-based definition (e.g. for pupils aged 5–18) would help maintain such exemptions. But there are many potentially problematic boundary cases, including: private tutoring services; breakfast and after-school clubs taking place in schools; and apprenticeships delivered by independent training providers. Such definitional issues would need to be carefully considered as part of any legislation.”*

But it is reported that its proponents intends for VAT to include everything.²⁸

²⁷ B.Riley-Smith, “Private schools won’t have to pass costs of VAT rise on to parents, says Starmer”, The Telegraph, 28 September 2023.

²⁸ P.Wood, “Labour to close private school loopholes for avoiding VAT on fees”, i News, 5 January 2024.

- “Goods and services that are closely related to education are currently exempt from VAT, such as catering, transport, school trips and boarding accommodation. However, this exemption is expected to be removed if Labour comes to power”
- “Labour will ensure schools are not able to split off boarding costs from overall boarding fees, meaning these will be eligible for the same VAT charge as tuition costs.”

We agree with the IFS that this situation is problematic, and would go further. If the government tries to discriminate by taxing similar or identical services based only on where they are provided, they can expect significant legal and implementation challenges as outlined by EDSK.²⁹

There is insufficient clarity over its proponents’ intentions to assess the ability of schools to avoid VAT by changing their business models. We can only indicate that a rapid “hasty” implementation of VAT for independent schools is prone to significant legitimate avoidance and implies downside revenue risks; a slower “deliberate” implementation that aims to close all possible loopholes implies delay, a deadweight cost to schools and HMRC, and the risk of legal challenges.

Alternatively a government could attend to the principle of fiscal neutrality, taxing similar or identical services in the same way regardless of provider. The VAT net could then be cast widely and generally, abolishing the education exemption entirely and simplifying implementation, so as to tax tutoring, state-school boarding, school trips, music lessons, sports, childcare, before/after school clubs, residential courses, college and university, vocational training etc. As we discussed in Chapter 1, current tax policy and the mainstream view is that these services offer social benefit. Such a change would be of significant interest to state-school parents; we are not aware that their expectations are currently being set.

For purposes of our analysis, we assume (like the IFS) that the VAT-base captures the entirety of independent schools’ activities; we note (like the IFS) that avoidance losses and deadweight enforcement costs are a downside risk.

Demand side impact: labour supply withdrawal and expenditure switching **Labour supply and housing spending**

The IFS paper states

- “we assume no changes in the level of private schooling, no changes in labour supply decisions and no changes in saving decisions”;
- “Indeed, if we assume constant consumer expenditure and an effective VAT rate of 15% on other goods and services, then while reduced demand for private schooling would reduce VAT from private schools, it would have zero effect on overall VAT revenues”;
- “changes in the demand for or supply of private schooling in response to higher post-tax fees are unlikely to have any meaningful effect on tax revenues”

As the IFS explores, families will consider their willingness and ability to pay independent school fees plus VAT. As we shall now consider, families may also review their workload (subject to demand from employers and customers) and how to spend their money. Labour supply and expenditure decisions could change following what is (for migrating families) a large positive income effect, receiving education “for free” and (for families that “stick”) a smaller negative income effect.

In the face of these income effects, it is not clear that we can assume income and expenditure re-

²⁹ EDSK, “Investigating the potential obstacles to adding VAT to independent school fees”, March 2024.

main fixed.

The value pools and taxation in play are large. From the IFS baseline, UK tax-paying independent school families pay a total of £9.41bn in school fees (average of 16.67k, 615k pupils minus 25k LEA-funded, and 25k overseas). On the same basis as we saw in Part 1, assuming a 40pc marginal tax rate, earning £9.41bn generates **£9.1bn in payroll taxes**. That is the labour supply sum at-risk.

Stick

Those that “stick” have a negative income effect of £2.5k per child per year (15% of 16.7k). The IFS assumed that they would pay the VAT entirely by substituting consumption expenditure and thus contributing less VAT on that consumption. The IFS did not note any direct or downstream impact from suppliers of consumption goods. In fact, families have further options including:

- Respond to the negative income effect by seeking to increase their income, now or later in life. Paying VAT out of labour generates payroll taxes and creates value in the broader economy; families forgo leisure. If there is no migration and all parents pay VAT and business rates out of extra income, taxed at 40% income tax plus NI, the payroll tax upside is **£1.5bn**.
- Pay the VAT by reducing permanent savings – while the IFS assumes that all savings are spent on VATable goods eventually, some savings are permanently invested in forms of physical capital such as housing, or in permanent ownership of financial capital.
- Pay the VAT by reducing current or future non-VATable expenditure, such as savings for future tuition fees.

Migrate

Those that migrate to the state sector face the mirror image. As they start receiving education “free” they experience a positive income effect worth on average £16.7k per child per year. The IFS assumed they would substitute that expenditure entirely into VATable consumption goods. Families have other options, which affect the £9bn of payroll tax they currently pay (assuming 40% marginal rate), such as:

Reduce income and choose leisure, for example to:

- provide childcare around shorter state school hours, or following the loss of boarding.
- provide or manage extra-curricular activities no longer taken at school.
- provide parental tutoring or counselling to support what is seen (rightly or wrongly) as inadequate academic or social provision.
- depending on disutility of work: enjoy more time off than was available as (for example) a dual-income, time-poor household: play chess, read books, do chores.

And...

- Spend after-tax income on tutoring or extra-curricular activities, thus not paying VAT.
- Invest money in housing, thus never paying VAT.
- Save into child ISAs for university, thus never paying VAT.
- Contributing to pensions, thus getting tax relief now and probably paying a reduced rate of tax when withdrawn.

Analysis of demand-side impact

There is minimal evidence for how families’ labour incentives will respond to the income effect of VAT on school fees and subsequent migration. However, the magnitude of the issue requires us

to explore it further on a “what-if” basis, and to make it prominent in our advice to policymakers. Every 1% of school fees not required indicates **£90m of payroll taxes at risk**. Like the IFS, we suspect that the propensity for families that “stick” to earn extra money is relatively low; however families that “migrate” are relatively more likely to withdraw labour and reduce tax contributions for the following reasons:

- Among the “stick” cohort, some are the truly rich who can relatively easily make substitutions, £2.7k per year per child being absorbed out of existing expenditure as the IFS indicates. Only those near the margin need to consider working harder.
- Withdrawing labour is relatively easy; adding additional labour is relatively difficult especially for full-time salaried employees, and depends on demand from employers and customers.
- Those who “migrate” have already shown a relatively high marginal disutility of work, such that they decided to pull their children out of school, or a relatively low valuation on consumption expenditure.
- Those that “migrate” have already shown a strong valuation on capital, and human capital specifically; it seems improbable that they will (as the IFS indicates) spend 100% of fees on consumption goods; to the extent they still earn money it seems more probable that they will spend it on tutoring, or save towards university tuition, or invest in actual capital such as housing, none of which will require them to pay VAT.
- The magnitude of the income effect for “migrate” is self-evidently disruptive and constitutes a formidable behavioural/financial “nudge” comparable to a medium-large lottery win, potentially capitalised as £340k or more (two children at £34k average fees for ten years); the magnitude for “stick” is of course 15% of that amount and less obviously transformational.
- “Migrate” disrupts school arrangements, reinforcing the financial “nudge” with an operational “nudge” to transform domestic, financial, and professional affairs.
- Some of those who “migrate” could be prompted to reconsider their desire to live and work in the UK; if they then “emigrate” the UK loses the entirety of their value-add and tax contribution.

It is possible that future cohorts may be more inclined than current parents to withhold labour. Much of the effort to secure strong earnings at age 40 takes place up-front, in your 20s and 30s. For current parents, that effort is a sunk cost. The future generation could decide not to climb the career ladder in the first place. Labour withheld by less-ambitious future cohorts, encouraged by VAT to aim for state school at the outset, will not be measurable by the ONS, but it nonetheless will represent economic value and tax revenue foregone for the future Treasury.

As we noted in Part 1, the labour supply of higher earners delivers benefits not only to themselves and the public purse, but also to customers (paying VAT), employers (paying business rates, corporation / capital gains / dividend taxes) and employees (paying income tax and NICs). We mentioned the example of doctors reducing their working hours, and the impact on patients, but we can also speak of engineers, small-business entrepreneurs, managers, lawyers, accountants, architects, scientists, and in-demand skilled manual workers. Not only is the value-add taxable, but it supports further taxable activity via the multiplier in the downstream economy.

We provide our calculations in Appendix 5. Once again, this “what-if” analysis has no empirical roots, but nor does the assumption that labour supply, income and expenditure are fixed.

Indicatively, 20% of parents who “stick” might find their VAT in full by supplying additional labour, with the remaining 80% substituting (as the IFS indicated) from VATable consumption expenditure. For those who “migrate” we indicate that 40% might switch their school fees into leisure, thus significantly reducing their payroll tax contributions (and of course not spending income on VAT-

able consumption), while 40% might spend school fees on VAT-free consumption such as tutoring or permanently save and invest in housing or ISAs, while 20% might increase VATable consumption as the IFS envisaged.

At around 3% migration, these effects roughly balance out. At 5% migration (IFS' mid-point), we see an incremental loss to the Exchequer of **£150m**. In Baines' Cutlers' 25% scenario, we see a loss of **£1.12bn**.

As we noted in Part 1, it would be reckless for a government to take risks with higher-earners' labour supply, economic value-added, and tax contributions.

Loss of social benefits from independent education

We explored in Part 1 the social benefits from education, and specifically independent education. As we concluded, education has social benefit regardless of who pays for it, reflecting social benefits via the tax system is not obviously "unfair", and there are some social benefits that are specific to independent schools.

By the same reasoning any contraction of education has a social cost, primarily arising from the reduced investment in social capital. We have observed that today's higher earners make a large per-capita value contribution in the economy, and that value accrues to taxpayers, help to develop customers, employers and employees as well as to the people themselves. If schools successfully develop a highly-productive future workforce, able to command high salaries and pay large taxes, then harming those schools is harmful for the economy and its tax base, especially where social capital has been developed at private expense.

We noted that the IFS present an overall "neutral" view of independent schools' social benefits, when they point to evidence that independent schools generate earning advantage "mainly" through network and information effects, rather than through human capital (which could be easily-measurable educational attainment, as well as leadership, critical thinking, motivation and self-discipline). We presented significant concerns about the evidence that is cited, which does not support the strong conclusions that the IFS presents.

We reiterate the mainstream view: investment in education generates human capital; human capital generates social as well as private benefit. Reducing investment in education, causing harm to institutions that deliver great education, reduces social benefit.

Some schools significantly contribute to the UK's cultural, architectural, natural and historic heritage; some provide tourist attractions at no charge; it is not clear if these social contributions would be discarded in the event of school closure, or if taxpayers would pick them up.

We also mentioned bursary and partnership provision as areas of social benefit. There is already evidence that these provisions are under threat.³⁰ In some schools these activities are funded by endowments and donations, which may be managed by separate entities. Under strong affordability pressure to attract fee-paying parents, and noting the VAT contribution for those that stay, trustees may increasingly consider that smaller bursaries for families at the margin of affordability are a worthwhile charitable cause. In other schools, bursaries and partnerships are funded by existing parents, whether via donations or out of fees. In those cases, school management may anticipate vigorous pressure, having lost tax exemptions, to stop supporting the community at all unless on a

³⁰ P.Wood, "Private schools draw up cost-cutting plans ahead of Labour fees tax", i News, 7 March 2024.

strongly commercial basis. Finally, where schools are forced to close, the local community will lose the provision of bursaries, partnerships and free/discounted facility access in entirety.

The loss of opportunity for high-potential less well-off children, and the weakening or loss of ties between independent and state sectors, are to be counted as social costs of the VAT policy.

Human costs

Economists are sometimes said to be all head, no heart, “dismal scientists”. Good economics, however, values and compares all costs and benefits, not only those that are tangible, visible and financial. We include human costs.

To quote the website Education Not Taxation:³¹

“Finally, to return to actual people. We’re asking supporters of this policy to engage with the people they’re going to affect. We’re talking about children at the end of the day, not widgets. Forcing any child out of their school is a stressful experience for everyone involved. Education is hard enough as it is, let alone adding the challenge of being thrown into a completely unknown world. You just wouldn’t do that to your child - or anyone’s child - would you?”

In addition to the numerous and large financial risks we have identified with this policy, we highlight the impact on the happiness, self-esteem and development of children currently in independent schools who undergo a government-forced move to another school which by the opinion of their parents suits them less well. The public debate has yet to feature the effect on (according to IFS estimates) 20,000 to 45,000 children and (according to Baines Cutler) 90,000-135,000 children.

Nor is consideration yet given to the deadweight financial and human cost to families if a school change is incompatible with domestic or professional arrangements, for example prompting an unnecessary house move or extended rush-hour driving or, at worst (from a fiscal perspective), contributing to a decision to withdraw labour supply.

We should also consider the human cost to teachers and support staff following school closure and contraction, whether they find alternative careers or not. A government-induced redundancy or career change is stressful even if it ends well i.e. with a reasonable alternative employment, and potentially traumatic if it does not. As we have seen, it is not reasonable to assume matching of people, motivation, skills, qualifications and locations between independent school redundancies and state school vacancies.

Dynamic Case: Conclusions

We repeat that we are in uncharted territory and much of our analysis is indicative. The IFS has, either by omission or for want of evidence, effectively zero-rated many of our assumptions; neither they nor we can draw much from empirical evidence. We encourage greater caution of the unknown and unknowable, given policymakers will be accountable for downside fiscal risks and other economic harm.

We have used the IFS’ data inputs and assessment as a baseline for our analysis. We then explored the following:

³¹ Education not Taxation, “Education Not Taxation: Parents Against School Fee VAT”, <https://educationnottaxation.org/>

Considerable uncertainty within the IFS' own evidence which we proposed should lead us to evaluate further "reasonable and cautious" migration scenarios beyond their 3-7%; additional concern about the relevance of that evidence to today's parent cohort under today's economic conditions, and the omission of any affordability / YED considerations; we encourage policymakers to take account of 15-25% scenarios as raised by Baines Cutler. The need to evaluate less optimistic scenarios is compounded by the material outcomes in those scenarios.

Supply side variation from IFS analysis:

- Quantified impact on state school expense of less optimistic scenarios.
- Quantified impact on independent school expense and consequences for tax revenues of direct / indirect / induced economic contraction.
- Quantified impact on independent schools if they try to absorb the VAT in full.
- Unquantified impact on benefits bill if redundant resources are not re-hired.
- Unquantified cost to state sector of absorbing non-EHCP SEN children, or children with (for example) anxiety or suffering from bullying, requiring significant attention or resource.
- Unquantified cost to state sector if pupil migration drives up fixed costs or overheads.

Demand side variation from IFS analysis:

- Quantified effect of labour supply withdrawal on payroll taxes.
- Quantified switching of school fee expenditure into VAT-free categories.
- Unquantified loss of taxes on economic value-add where labour supply withdrawn.
- Unquantified multiplier risks from lost economic value-add.
- Unquantified impact on domestic and commuting "work economy".
- Unquantified emigration risk of higher-earners.
- Unquantified impact on consumption industries where (according to the IFS) expenditure is switched in favour of paying VAT.

Unquantified human cost:

- Migrating children and their families.
- Displaced teachers and support staff.
- Impact on receiving state schools, and competition for "preferred" places.

As well as the **unquantified loss of social benefit** from independent education, and the **unquantified delivery risks and deadweight losses** on implementation, enforcement and avoidance. On the upside, we have not included tax receipts on the supply side where redundant resources find new employment; we indicate caution regarding the state sector's potential to attract and hire those resources.

Our quantitative findings are summarised in the table below. The unquantified risks listed above present further downside.

- In the IFS' 3-7% scenario, for convenience we take the 5% mid-point and indicate a **net fiscal impact of £1.02bn**, a reduction of £0.38bn from the IFS' £1.4bn estimate caused mainly by including the supply-side impact on the independent sector.
- Doubting the IFS' confidence of price inelastic demand, we indicate a breakeven point **at 10-15% migration – the tax generates no net revenue.**
- In Baines Cutler's 25% migration estimate, we indicate that the tax generates a loss to the Exchequer of **£1.6bn.**

We conclude that material fiscal gains are significantly less probable than the IFS indicates, and could be strongly negative, further to which policymakers should take into account the various non-

£BN	SCENARIO, % MIGRATION	0%	5%	10%	15%	20%	25%	30%
		BASELINE	IFS MID-POINT		BAINES CUTLER			
	IFS BASELINE PRE-MIGRATION	1.58	1.58	1.58	1.58	1.58	1.58	1.58
SUPPLY SIDE IMPACT OF MIGRATION								
	COST OF STATE SCHOOL PROVISION	-	- 0.17	- 0.33	- 0.50	- 0.67	- 0.83	- 1.00
	LOSSES ON INDEPENDENT SCHOOLS' £5.1BN TAX CONTRIBUTION	-	- 0.24	- 0.49	- 0.74	- 0.98	- 1.23	- 1.48
	TOTAL	-	- 0.41	- 0.82	- 1.24	- 1.65	- 2.07	- 2.48
DEMAND SIDE IMPACT OF MIGRATION								
"STICK"	PAYROLL TAX UPLIFT MINUS VAT LOSS	0.10	0.09	0.09	0.08	0.08	0.07	0.07
"MIGRATE"	PAYROLL TAX LOST FROM 40% SUBSTITUTION OF LEISURE	-	- 0.18	- 0.36	- 0.54	- 0.72	- 0.91	- 1.09
	VAT LOST FROM 40% SUBSTITUTION TO NON-VAT EXPENDITURE	-	- 0.06	- 0.11	- 0.17	- 0.23	- 0.28	- 0.17
	TOTAL	0.10	- 0.15	- 0.39	- 0.63	- 0.87	- 1.12	- 1.19
NET FISCAL IMPACT OF POLICY		1.67	1.02	0.37	- 0.29	- 0.95	- 1.60	- 2.09

PART 3: EFFECTS ON STATE SCHOOLS

In this paper we take for granted that improving schools is desirable. We do not explore how money is spent: whether spending £1.4bn on schools is the optimal route, or whether today's policymakers will spend £1.4bn to good effect. Neither do we consider other proposals such as extending school choice or whether there is greater value in applying practices from higher-performing state schools across the sector. Our focus is the fiscal and broader economic effect of applying a selective VAT on independent education in order to raise £1.4bn.

We need to consider how the state sector can respond to migration. Baines Cutler in their report, state that *“The sheer number of pupils leaving the sector and needing to be educated by the state would also place great strains on the maintained sector, with the need to build new schools and classrooms and absorb many pupils quickly.”*

The IFS points us towards their own 2022 paper, which predicts a 700,000 fall in pupil numbers between 2023 and 2030.³² At national level, this could theoretically indicate space to accommodate pessimistic migration levels. However, in the absence of analysis by local authorities, it is not clear how vacancies are distributed or whether they are able to accommodate independent school migration.

Aggregate numbers – the flaw of averages

Economists should ask whether local authorities' track record of predicting demand and planning capacity is strong enough to indicate reliability.

For example, in *Schools Week* we read of severe capacity issues for special schools as *“surging demand and scarce places push them over capacity”*. It is noted that *“councils are forced to place more youngsters in costly independent schools – pushing their high-needs funding black hole to £1.3 billion”*. We are further told that *“The government does not collect capacity data for special schools, which instead falls to local authorities. However, many councils said they were unable to provide figures.”*³³

Discussion of capacity issues in some schools is of course politically-charged, as some will claim it is all down to underfunding, while others point to current investment in future capacity. That said, and politics aside, the starting point for many state schools today is an overcrowded classroom.³⁴ Further, *The Telegraph* has outlined a map based on Department for Education data, indicating how much of England has state schools that are heavily overcrowded or oversubscribed.³⁵

Falling numbers of pupils predicted by the IFS could be an opportunity (in aggregate) to re-establish smaller class sizes; absorbing large numbers of independent school pupils can hardly help.

Schools short of pupils?

As the IFS notes in their Annual Report on Education Spending, *“rising pupil numbers create resource challenges, mainly in terms of need for extra schools and extra staff. Falling pupil numbers cre-*

³² E.Drayton, *“Annual report on education spending in England: 2022”*, Institute for Fiscal Studies, December 2022.

³³ S.Booth, *“No place to go: Special schools' capacity crisis revealed”*, *Schools Week*, 28 April 2022.

³⁴ A.Forrest and L.Sabin, *“Soaring numbers of pupils taught in ‘supersized’ classes”*, *Independent*, 8 August 2021.

³⁵ A.Tyzack, *“Why panicked private-school parents are fighting each other for a place at the local comp”*, *The Telegraph*, 6 November 2023.

ate the reverse problem, in that some schools and staff may no longer be needed. Indeed, some schools might not be financially viable". In their VAT review, they say in regard to state schools "falling pupil numbers might not release funding in the short run, however, as costs might not fall in proportion to pupil numbers and policymakers might find it difficult to cut total spending."

These remarks could be misunderstood to imply a concern for supplier interest. As we saw in Chapter 2, the IFS has neither explored the financial viability of independent schools nor the related fiscal impact should they contract or close, nor are we aware of interest by government at any level when independent schools have historically closed due to financial stress.

Our concern is for children, families, taxpayers and society at-large, who benefit from efficiency as well as from the provision of school places. Schools in either sector with surplus capacity and stranded fixed costs should seek cost savings. If they are unviable, it may be in society's interest that they close; closure is not "good" but nor is stranded cost to taxpayers. If institutions find it difficult to expand and contract under changing supply and demand conditions, it is not clear that industry competitors should bear the consequences. If the industry in general faces a demand contraction, it is particularly unusual for economists to recommend an increase in taxation.

Policymakers should not prefer the interests of one supplier over another.

Geographic distribution

The IFS note that: "this picture is further complicated by the fact that forecast drops in state school population will not be even across the country. And they will not necessarily be occurring in precisely the areas where parents decide not to send their children to private schools".

Baines Cutler provides similar commentary: "it would also be virtually impossible to predict in advance in which towns or regions such demand would take place, the move would be a recipe for a great deal of community tension, for example in relation to school catchment areas, first-choice preferences and the National Schools Offer Date".

Several grammar schools and sixth-form colleges obtain Oxbridge results that are the envy of independent school peers. Independent school families can be expected to try hard to obtain places in these schools, as noted by a headmaster:³⁶

"Rather than benefiting state school children, Renard believes the tax could, in fact, lead to more "honey-pot" postcodes, where the rich compete to own houses in the catchment of an outstanding primary or secondary school, pricing out local families. In the state sector itself there's a two-tier system because of how admissions work and catchment areas."

Even-more intense competition for preferred state schools could simply be, in the IFS analysis, a feature of the steady-state future, however it bodes particularly ill for families migrating in 2024/5. Preferred state schools are already strongly subscribed; places (if they exist) will most likely be available at other schools. Meanwhile, intensifying competition in preferred state schools, while reducing the number of pupils in independent schools, simply tells us that we have fewer pupils attending a school of their parents' choice – a challenging starting point from which to deliver an overall improvement to the country's education.³⁷

³⁶ Ibid.

³⁷ P.Wood, "Labour private school tax set to squeeze deprived children out of grammar schools", i News, 28 January 2024.

Intensifying competition also implies the financial and academic hurdles associated with preferred taxpayer-funded schools will become even higher unless more schools become as strongly “preferred” by families. This will be of significant concern to parents on or near the edge of desirable catchment areas, or future parents hoping to move into them at the appropriate time. Unless these preferred schools expand, which does not appear to be planned, some of these families will be displaced into less-preferred options while the top schools become more exclusive.

The IFS does not consider the impact on receiving state schools if they become over-crowded, or the impact on pupils that stand to be further displaced as a result of even-greater competition for “preferred” state school places. A headmaster is quoted saying (our emphasis):³⁸

*“Of course, that means that there will be more competition for places at our schools and I would say, be likely to push some of the children from more deprived backgrounds out of the market. Most grammar schools that you’ll find around the country are full... So essentially, you’ve got the places you’ve got. So for me, I absolutely think that it would be that we would have **less [sic] children from disadvantaged backgrounds** in our schools, which would be a real shame, because we’re trying to do exactly the opposite.”*

Parents’ propensity to withdraw from independent school is not only a feature of quality and affordability of the independent school but also the (perceived) quality of the taxpayer-funded alternative, and its “fit” with the complicated domestic and professional arrangements all working-age families have spent years designing. As the IFS and Baines Cutler agree, nobody can predict these switches in advance, and therefore local authorities cannot plan for them.

It is also unclear if, or how, local authorities have planned for migration of any of the UK’s c.65,000 boarding school pupils.³⁹ Many of these are being educated away from home, however if they leave their schools and are UK-resident they are highly likely to demand a state school place nearer to home, which their home local authority may not be planning for.

A place is a place is a place...?

Local authorities’ obligation is to deliver a place. From parents’ perspective, “a place” may be unsatisfactory or impossible. Having already lost private human capital investment in children that migrate, policymakers should account for the further social and private costs of putting more children in schools that do not suit them or their families. The best state schools are already strongly-subscribed, and the probability of obtaining a place outside age entry-points should be regarded as extremely low.

UNESCO,⁴⁰ The Universal Declaration of Human Rights,⁴¹ and the 1998 Human Rights Act all provide for parents to have a right to choose education.⁴² It is not clear that government-induced migration followed by provision of a place at local authorities’ discretion outside of application windows meets the requirement for choice.

Where a place is offered (assuming it is available) that does not meet the needs of the migrating

³⁸ A.Tyzack, “Why panicked private-school parents are fighting each other for a place at the local comp”, The Telegraph, 6 November 2023.

³⁹ J.Parkes et al. Independent Schools Council, “ISC Census and Annual Report 2023”, 19 May 2023.

⁴⁰ UNESCO, “What you need to know about the right to education”, 26 November 2020.

⁴¹ United Nations, “Universal Declaration of Human Rights”

⁴² Human Rights Act 1998

family, there are several potential costs to consider:

- Removing a child from a “great” school to a “good” school brings a social cost. Every child that lands in a less-suitable school exacerbates the social cost. At worst, we are putting more children into special-measures schools. Rightly, all major political parties wish to improve such schools; these intentions may or may not bear fruit, but either way the cost will affect the child and society in the short term.
- Parents of children migrating to schools that are perceived as less satisfactory (whether from an academic, extra-curricular, or social perspective) could be more likely to reduce their labour supply in order to fill the gaps by direct parental support. Alternatively if they maintain work and income they are more likely to divert expenditure into paying to fill those gaps with VAT-free tutoring and extra-curricular provision rather than, for example, washing machines and restaurants.
- Families’ professional and domestic arrangements are the product of years of planning; involuntary change has both a private and a social cost. If the school is less geographically satisfactory, given the substantial investment of time and money it takes to establish a home, the family may incur increased travel time at the expense of leisure and work, imposing rush hour congestion and pollution on others, or they may be forced to reevaluate their working arrangements entirely. The same applies if the receiving school is unable to replicate out-of-hours provision that is a typical feature of the extended independent school day.
- The receiving school and its community can expect additional pressure from unhappy arrivals. There is an inconsistency between the reporting of independent school families as benefitting from exclusive networking effects, as was hinted by the IFS, and the assumption that they and their children would be an asset at a receiving school that they are reluctant to attend; there is at least some risk that they distract and detract from the service offered to others.

According to the IFS, “one could imagine” benefits to the state system when independent school pupils enter, particularly if such pupils have high ability. We see no evidence for this. It is likewise inconsistent to argue that the famous sharp elbows of fee-paying parents will ensure that “standards would rise, sharpish”.⁴³

- “Sharp-elbowed” individualistic behaviour could translate itself to private tutoring or family coaching rather than wholehearted support for state education.
- While some state schools are excellent, there is little evidence that the contribution and engagement of affluent families are instrumental in raising the standards of other schools; it is unclear how independent school arrivals would drive generally high standards in ways that wealthy state school families do not.
- Top-performing state schools already have high ability children, such that new arrivals bring limited marginal impact - other than to displace other children. In a school challenged with behaviour issues, the new arrival may suffer significant harm (relative to their existing setting) while it is unclear how their mere presence helps anyone else.

Effects on state schools: conclusions

As with the migration and fiscal impact we explored in Chapter 2, we are in the world of the unknown. Our assessments of migration are hugely uncertain.

In this chapter, despite reportedly favourable aggregate indicators, we have significant concerns about the ability of local authorities and schools to plan for, adapt and respond to unpredictable demand swings. All commentators agree that the geographical distribution of migration and school

⁴³ C. Maume, “Never mind sharp-elbow parenting, David Laws. True equality of opportunity would mean the abolition of private education”, Independent, 27 February 2014.

closures is impossible to predict. Parents will have similar concerns. Even if a place is available, that is not to say it will be satisfactory in quality, or manageable in terms of proximity / travel time / domestic and personal arrangements. Children, families and future employers will bear the cost of unsatisfactory or unmanageable provision.

Money aside, parents on all sides may reasonably be concerned about the impact of new arrivals on the state school system. Nobody knows exactly which families, which schools, which local authorities risk being disrupted. Even the IFS' optimistic estimates suggest some tens of thousands of pupils will be looking for places in the state sector, leaving their independent school and expecting a taxpayer-funded place at short notice.

CONCLUSION: A SUB-OPTIMAL WAY TO RAISE £1.4BN

Hypothecated taxes are politically convenient but seldom economically optimal.

For the purpose of this paper, we have assumed the desirability of spending £1.4bn a year on state education. We want to raise revenue in the optimal way i.e., minimising economic harm in the private sector, and optimising for social benefit.

Wishing to raise money, few economists would instinctively recommend (1) a new tax offering (2) highly uncertain net revenue potential (3) on a positive externality, that (4) distorts competition and (5) disrupts the education of (in the IFS' optimistic scenario) some tens of thousands of children, (6) shifting their demand onto a state-obligated supplier; that (7) poses hard-to-quantify risks to the labour supply, value creation and taxes of higher earners, and that (8) requires new legislation, presenting many avoidance opportunities and enforcement challenges and (9) has only one international precedent, said to have caused "general mayhem".

This is not a good tax.

If the Exchequer needs money, a conventional approach would be to tax a negative externality. £1.4bn equates to a 3% increase on existing alcohol expenditure, including duty and VAT, of £47bn. Alternatively, if the tax is considered to be a proxy for "taxing the rich", it would be simpler, less harmful and more effective to "tax the rich", operating within much smaller margins of extremely well-researched tax levers with existing collection and enforcement mechanisms. £1.4bn is 0.32% of the UK's £440bn income tax and NIC bill and could be targeted to suit distribution objectives, including contributions from affluent families tending to fund the best of state education, if that is indeed the aim.

Taxes such as these offer more certain revenue, fewer distortions and fewer avoidance opportunities. Both have the advantage of being well understood by the Treasury and use existing HMRC mechanisms, and are very broadly-based.

This tax runs the significant risk of being **ineffective** at raising revenue. It could raise no net revenue at a migration rate between 10-15 per cent, not much more than the IFS 3-7%. At the 25% migration rate identified by Baines Cutler, it **could generate a loss of £1.6bn**. Given the numerous fiscal and other economic harms we noted in Parts 1 and 2, it is remarkably **inefficient**. For these reasons it is not hard to identify more attractive sources of revenue, and the tax cannot be considered **optimal**.

APPENDIX 1: INTERNATIONAL CASE STUDIES

Greece

The experience of Greece's 23% VAT on independent education is described by *The Economist*: *Greece reconsiders a tax on private education*:¹

- “The left wing government aimed a new tax at the rich. It hit the poor instead”
- “The measure, dreamed up by the governing Syriza party as an alternative to raising tax on beef, featured in their manifesto as a blow against plutocracy. It looked like a double win that would simultaneously please creditors and demonstrate the government's commitment to helping the underprivileged. Unsurprisingly, it did neither.”

An MEP submitted a question to the European Commission regarding the policy (our emphasis, below).²

“The decision of the Greek Government to impose three-tier VAT rates to a maximum of 13% [sic] for private education services is likely to cause **financial hardship to thousands of families**, and is already prompting a storm of protest in this sector. Under the government decision, the following levels of VAT will be charged:

- nurseries and kindergartens; zero;
- tuition centres, vocational training establishments, language schools, dance schools and conservatories: a reduced rate of 6%;
- private schools: 13% [sic]

Given that the Commission has not called on Greece to amend its legislation regarding VAT rates for private education services: is it aware of this Greek Government decision and were proper consultations held before its promulgation? **Does the imposition of differential VAT rates for what are essentially similar private education services infringe EU legislation?**

Can it give any information regarding VAT rates for private education services in other EU Member States?

What financial benefits does it consider are likely to accrue from VAT adjustments affecting private education, accompanied by a **reduction in the number of pupils** attending private schools in Greece and hence the **number of posts in this sector?**

The challenge by the European Commission is noted,³ stating that it was against EU law to apply VAT to education services provided elsewhere by the state:

¹ *The Economist*, “*Greece reconsiders a tax on private education*”, 30 October 2015.

² T.Zagorakis (PPE), “*Differential VAT rates for private education services in Greece*”, P-014059-15, 22 October 2015

³ R.Asquith, “*EU tells Greece to cut VAT on private schools*”, *Avalara*, 29 August 2015.

- The European Commission has warned Greece that last month's rise in VAT to 23% on fee-paying private schools was in breach of the EU VAT Directive.
- "Under the EU VAT Directive, education service fees for tuition also provided by state schooling should not be charged with the standard VAT rate."

A Greek writer notes that the options available to education establishments facing 23% VAT were "to increase their retail prices by 23% (which will lead to a great loss of students, meaning reduced revenues) or to absorb part or the total of the 23% tax (which will also lead to a great loss of revenues).⁴ This is actually a dilemma of how do you prefer to die."

In another account,⁵ the challenges of implementation, with the then governing Syriza party insistent on rolling out the tax, are described as "a mix of incompetence and political obsession". The first consequent private school closure is described,⁶ noting that "The imposition of the VAT was the straw that broke the camel's back".

The outcomes noted by *The Economist* are:

- "Some of the country's reasonably priced private schools were forced to close, leaving staff jobless. Elsewhere, fees rose."
- "Those whose parents were unable to pay higher fees moved into the already overwhelmed state system. At the beginning of term in September, Greek schools were short of some 12,000 teachers, according to the ministry of education. Some predict the shortfall will soon exceed 20,000."
- In the new climate, "lay-offs are inevitable, but so is tax avoidance,"
- "The general mayhem caused by the tax is forcing the government to reconsider."
- "As in so many areas of Greek life, the dispute has highlighted a gap between theory and practice"

The government is reported to be scrapping the idea of taxing private tuition and imposing higher road taxes instead.

New Zealand

New Zealand charges 15% GST on independent school fees but pays a subsidy of around NZ\$2,000 which roughly offsets GST for lower- to mid-priced independent schools.⁷

Consistent with our observations in Chapter 1, the article indicates an **1800% return on the \$48m subsidy**, including the GST generation.

- The NZ government spends **£47.8m a year** subsidising independent schools (offset by GST) for the <4% of pupils attending them
- If pupils switched, or were switched, to state schools, **it would cost taxpayers \$174m in teaching costs alone**, plus the cost to maintain and modernise buildings
- Independent schools **raise \$64m in tax revenue**
- Analysis indicated that independent schools contributed **\$697m to GDP**

⁴ T.Totskias, "Value Added Tax in education: live your myth in Greece!", LinkedIn, 2 September 2015, <https://www.linkedin.com/pulse/value-added-tax-education-live-your-myth-greece-thenos-totsikas-pmp/>

⁵ P.Chrysopoulos, "Greek Government in Total Confusion Over VAT on Private Education", Greek Reporter, 26 October 2015.

⁶ P.Chrysopoulos, "First Private School to Close in Greece After Imposition of 23% Value Added Tax", Greek Reporter, 1 September 2015.

⁷ L.Walters, "Govt can't afford to stop funding private schools – yet", newsroom, 13 September 2020.

Researchers also found that

- *“Private schools also cater to a range of needs not currently met in the state system, and provide families with choice. And with scholarships and government funding, those who are not classified as the country’s top earners can access a different type of education for their children.*
- *For instance, Summit Point has developed a curriculum tailored to dyslexic learners so they can learn key numeric and literacy skills faster. And Ambury Park Centre provides horse riding therapy for children with physical, emotional, psychological and intellectual disabilities.*
- *There are also schools that cater to students who come from disadvantaged backgrounds, such as Dilworth. Or those recovering from traumatic experiences or addictions, such as Odyssey House School.*
- *The NZIER report says with very little government funding, independent schools develop different learning techniques, which the Government can then adopt and roll out when independent schools have ironed out the kinks. It could be seen as low-cost R&D”*
- *Independent schools also provide competition for state and state-integrated schools. This competition adds impetus for the state school network to improve*

APPENDIX 2: BACKUP TO TAX BREAK CHART

STATIC TAX FOOTPRINT COMPARISON			
INPUTS		PUPILS, M	SOURCE
NATIONAL PUPIL HEADCOUNT (A)		9.07	GOV.UK STATISTICS
VAT-ELIGIBLE INDEPENDENT SCHOOL HEADCOUNT (B)		0.59	IFS, TABLE 1 AND SECTION 5
MAINTAINED HEADCOUNT (A-B); INCLUDES LEA-FUNDED PLACES IN INDEPENDENT		8.48	
STATE SECTOR, TAXPAYER FUNDING	COMMENTARY	PER-PUPIL, £K	SOURCE
PER-PUPIL STATE FUNDING (REVENUE FUNDING)	ON A PER-PUPIL BASIS THE TOTAL FUNDING ALLOCATED TO SCHOOLS FOR 5-16 YEAR OLD PUPILS, IN CASH TERMS, IN 2023-24 WAS £7,460	- 7.46	GOV.UK STATISTICS
PER-PUPIL STATE FUNDING (BUILDING PLUS LAND)	PAGE 28: TOTAL CAPITAL-RELATED TAXPAYER SAVINGS FOR ISC SCHOOL PUPILS THEREFORE AMOUNTED TO £952 MILLION PER ANNUM, OR £2,069 FOR EACH ISC SCHOOL PUPIL NOT TAKING UP THEIR STATE SCHOOL PLACE.	- 2.07	OXFORD ECONOMICS
NON-SCHOOL OVERHEAD (EXCLUDING PRE-PRIMARY AND POST-SECONDARY EDUCATION)	PAGE 29 2021: £18.1BN CONSISTING OF £6.7BN NON-SCHOOL SPENDING; £5.7BN R&D; £2.3BN STRATEGY, POLICY, OVERSIGHT AND INFORMATION; £3.4BN STUDENT SUPPORT: TRANSPORT, LODGING, MEDICAL	- 2.13	OXFORD ECONOMICS
TOTAL TAXPAYER FUNDING		- 11.66	
DOWNSTREAM TAX CONTRIBUTION	BY ASSUMPTION, 50% OF INCOME	- 5.83	
NET STATE SCHOOL TAX FOOTPRINT		- 5.83	
INDEPENDENT SCHOOLS, VALUE OF TAX EXEMPTIONS			
	ALL PUPILS (£M)	PER PUPIL (£K)	
PROSPECTIVE VAT GENERATION	- 1,438.20	- 2.44	IFS, NO MIGRATION
PROSPECTIVE BUSINESS RATES	- 140.00	- 0.24	IFS, NO MIGRATION
TOTAL	- 1,578.20	- 2.68	
GROSS INCOME FOR £16.7K FEES @ 40PC TAX+2%NIC		28.74	
INCOME TAX 40%		11.49	
EMPLOYEE NIC 2%		0.57	
EMPLOYER NIC 13.8%		3.97	
TOTAL PAYROLL TAX		16.03	
INDEPENDENT SCHOOLS' DOWNSTREAM TAX	5,100	8.65	OXFORD ECONOMICS
NET INDEPENDENT SCHOOL TAX FOOTPRINT		22.01	
RETURN ON TAX EXEMPTION		-1040%	

APPENDIX 3: IFS BASELINE AND DATA INPUTS

DATA INPUTS			SOURCE: IFS
INDEPENDENT SCHOOL PUPILS A	614,449		TABLE 1
PUPILS VAT-ELIGIBLE B	589,449	MINUS 25K LEA-FUNDED	SECTION 5
AVERAGE FEES C	16.67	£K, ANNUALLY	TABLE 1
TOTAL FEES D	10,241	£M	TABLE 1
VAT-ABLE FEES ON 590K PUPILS E	9,824	£M	BY CALCULATION
VAT-ABLE FEES ON 565K PUPILS	9,408	MINUS 25K OVERSEAS	
BASELINING IFS CALCULATIONS			
£M	IFS (PUBLISHED)	IFS (CORRECTED)	TABLE 2
VAT@20% ON TOTAL FEES (20%*D)	2000	2048	
LESS VAT PAID ON INPUTS	-340	-340	
NET YIELD ON DAY SCHOOL FEES	1700	1708	
PLUS VAT ON BOARDING	170	170	
MINUS EXEMPTION FOR SPECIAL PROVISION	-220	-220	
NET YIELD AFTER EXEMPTIONS	1700	1658	
LESS REDUCED VAT (OTHER G&S)	-220	-220	
TOTAL FOR VAT	1480	1438	
BUSINESS RATE REVENUE	140	140	
TOTAL	1600	1578	

APPENDIX 4: SUPPLY SIDE IMPACT OF MIGRATION

£bn	SCENARIO, % MIGRATION	0%	5%	10%	15%	20%	25%	30%
		Baseline	IFS				Baines Cutler	
COST OF STATE SCHOOL PROVISION								
	# PUPILS MIGRATING	0.00	28,222	56,445	84,667	112,890	141,112	169,335
	COST TO STATE SECTOR	0.00	0.17	0.33	0.50	0.67	0.83	1.00
LOSSES FROM INDEPENDENT SCHOOLS TAXATION (BEFORE ANY REHIRING OR REEMPLOYMENT)								
	BASELINE TAX CONTRIBUTION	5.10	5.10	5.10	5.10	5.10	5.10	5.10
	VAT RECLAIM ON PURCHASES	0.22	0.21	0.20	0.19	0.18	0.17	0.15
	NET TAX CONTRIBUTION BASELINE	4.88	4.89	4.90	4.91	4.92	4.94	4.95
	TOTAL LOSS OF TAX CONTRIBUTIONS	-	0.24	0.49	0.74	0.98	1.23	1.48
LOSSES IF VAT ABSORBED IN FULL BY INDEPENDENT SCHOOLS, NO MIGRATION								
	REDUCED FEE TO PARENTS £k	14.49						
	EFFECTIVE REDUCTION ON REVENUE	13.0%						
	DOWNSTREAM TAX IMPACT (£bn)	0.67						
	REDUCED VAT RECEIPTS (£bn)	0.19						
	IMPACT ON NET TAX CONTRIBUTION (£bn)	0.86						

APPENDIX 5: DEMAND SIDE IMPACT OF MIGRATION

£bn	SCENARIO, % MIGRATION	0%		5%	10%	15%	20%	25%	30%
		BASILINE	IFS					BAINES CUTLER	
STICK	TOTAL FEES PAID	9.41	8.94	8.47	8.00	7.53	7.06	6.59	
	VAT REQUIRED @15% EFFECTIVE	1.41	1.34	1.27	1.20	1.13	1.06	0.99	
	ASSUMED PROPENSITY TO EARN VAT FROM LABOUR INCOME UP	20%							
	PRE-TAX INCOME UPLIFT	0.49	0.46	0.44	0.41	0.39	0.36	0.34	
	40% INCOME TAX	0.19	0.18	0.18	0.17	0.16	0.15	0.14	
	2% EMPLOYEE NIC	0.01	0.01	0.01	0.01	0.01	0.01	0.01	
	13.8% EMPLOYER NIC	0.07	0.06	0.06	0.06	0.05	0.05	0.05	
	TOTAL PAYROLL TAX UPLIFT	0.27	0.26	0.24	0.23	0.22	0.20	0.19	
	ADJUSTED VAT LOSS (FROM IFS 220M)	-0.18	-0.17	-0.16	-0.15	-0.14	-0.13	-0.12	
	TOTAL TAX UPLIFT TO BASELINE	0.10	0.09	0.09	0.08	0.08	0.07	0.07	
MIGRATE	TOTAL FEES RELEASED	-	0.47	0.94	1.41	1.88	2.35	2.82	
	ASSUMED % OF RELEASED FEES TAKEN AS LEISURE	40%							
	AFTER-TAX INCOME CONVERTED TO LEISURE	-	0.19	0.38	0.56	0.75	0.94	1.13	
	PRE-TAX INCOME CONVERTED TO LEISURE	0.00	0.32	0.65	0.97	1.30	1.62	1.95	
	40% INCOME TAX	0.00	0.13	0.26	0.39	0.52	0.65	0.78	
	2% EMPLOYEE NIC	0.00	0.01	0.01	0.02	0.03	0.03	0.04	
	13.8% EMPLOYER NIC	0.00	0.04	0.09	0.13	0.18	0.22	0.27	
	TOTAL PAYROLL TAX LOST TO BASELINE	0.00	0.18	0.36	0.54	0.72	0.91	1.09	
	ASSUMED % OF RELEASED FEES CONVERTED TO NON-VAT EXPENDITURE AND NIL VAT ON % TAKEN AS LEISURE	40%							
	SUM OF VAT LOST ON RELEASED FEES	80%							
NON-VATABLE EXPENDITURE	-	0.38	0.75	1.13	1.51	1.88	1.13		
VAT LOST AT EFFECTIVE 15% RATE	-	0.06	0.11	0.17	0.23	0.28	0.17		
TOTAL TAX LOST TO BASELINE	-	0.24	0.47	0.71	0.95	1.19	1.26		
NET IMPACT (STICK + MIGRATE) TO BASELINE		0.10	- 0.15	- 0.39	- 0.63	- 0.87	- 1.12	- 1.19	

APPENDIX 6: SUMMARY OF FISCAL SCENARIOS

£BN	SCENARIO, % MIGRATION	0%	5%	10%	15%	20%	25%	30%
		BASELINE	IFS MID-POINT		BAINES CUTLER			
IFS BASELINE PRE-MIGRATION		1.58	1.58	1.58	1.58	1.58	1.58	1.58
SUPPLY SIDE IMPACT OF MIGRATION								
	COST OF STATE SCHOOL PROVISION	-	- 0.17	- 0.33	- 0.50	- 0.67	- 0.83	- 1.00
	LOSSES ON INDEPENDENT SCHOOLS ¹ £5.1BN TAX CONTRIBUTION	-	- 0.24	- 0.49	- 0.74	- 0.98	- 1.23	- 1.48
	TOTAL	-	- 0.41	- 0.82	- 1.24	- 1.65	- 2.07	- 2.48
DEMAND SIDE IMPACT OF MIGRATION								
"STICK"	PAYROLL TAX UPLIFT MINUS VAT LOSS	0.10	0.09	0.09	0.08	0.08	0.07	0.07
"MIGRATE"	PAYROLL TAX LOST FROM 40% SUBSTITUTION OF LEISURE	-	- 0.18	- 0.36	- 0.54	- 0.72	- 0.91	- 1.09
	VAT LOST FROM 40% SUBSTITUTION TO NON-VAT EXPENDITURE	-	- 0.06	- 0.11	- 0.17	- 0.23	- 0.28	- 0.17
	TOTAL	0.10	- 0.15	- 0.39	- 0.63	- 0.87	- 1.12	- 1.19
NET FISCAL IMPACT OF POLICY		1.67	1.02	0.37	- 0.29	- 0.95	- 1.60	- 2.09