South Dakota Legislative Research Council

Issue Memorandum 95-12

COMPARISON OF TOURISM PROMOTION FUNDING BY ALL FIFTY STATES

Introduction

In South Dakota, the amount and source of funding for tourism promotion has been debated and changed by the Legislature in the last two sessions. The outcome of this action has been the removal of general funds from the Department of Tourism budget and the substitution of dedicated revenue sources. Under the new funding system, money for tourism promotion will be raised through taxes on that industry, with the hope that investing those funds in advertising will produce a cycle through which expanding industry income allows for larger budgets for the Department of Tourism.

Across the country, states have taken a variety of approaches to raising and spending public funds for tourism promotion. However, with the exception of Colorado, all states currently have a state-funded tourism office. Some states fund their departments exclusively with dedicated revenues, some use entirely general funds, and others use a combination of these two sources. In all cases of dedicated funding, the money raised comes from tourism related activities; in addition to the attempt to create a cycle of increasing funding for promotion, many states may have turned to dedicated revenue sources in order to protect tourism departments from having to compete for scarce general funds. This motivation was explicitly acknowledged by supporters of dedicated revenue sources for tourism promotion in South Dakota.

South Dakota

Tourism is the second largest industry in South Dakota, and the state provides support and promotion for this industry through the Department of Tourism. As recently as Fiscal Year 1994, the budget for the South Dakota Department of Tourism was composed almost entirely of general funds. In that year, the total amount spent was $3,786,196, of which $3,548,679 was general funds and $237,517 was raised directly from the tourism industry for cooperative advertising publications. About half of the department's budget is spent on advertising, which is intended to attract travelers to the state. The department's FY94 budget was almost static from the previous year, and many industry leaders and some legislators were interested in finding increased funding for the department's activities because of their belief that investing money in promotion would bring more visitors, thus increasing both industry profits and the state's sales tax receipts.

In FY95, the funding of the Department of Tourism changed with the creation of the tourism promotion fund. The initial source of money in this fund was the state's share of revenue from Deadwood gaming. These funds were previously deposited in the general fund, so this transfer to the tourism promotion fund reduced revenues to the general fund. The advantage of this transfer for the Department of Tourism is that future growth in Deadwood gaming revenue goes to a fund which is designated for tourism promotion spending. The FY95 budget totals $4,077,684, which is a 7.7% increase over FY94. However, when a federal flood relief grant of $300,000 is excluded, the budget actually decreased slightly. The other components of the FY95 budget are $1,653,309 in general funds, $364,375 in industry revenue and $1,760,000 from Deadwood. The original budget for FY95 was changed in a special session called to respond to the shutdown of video lottery; at that time general funds were reduced and collections from Deadwood were moved up to offset the loss. Thus, general funds dropped from nearly all of the department's budget to less than half in one fiscal year.

During the 1995 Session, the Legislature further altered the funding of the Department of Tourism. After debate throughout the session and multiple failed votes, the Legislature eventually passed, and the Governor signed, House Bill 1356. This bill imposes a tax of 1% on the gross receipts of hotels and tourist businesses, deposits the revenue in the tourism promotion fund, and appropriates $250,000 from this fund to the Mt. Rushmore National Memorial Society. With this action, the transition of the Department of Tourism to dedicated revenue was complete, and the Legislature did not appropriate any general funds to the department for FY96. The department's projected FY96 budget includes $2,077,064 from the new tourism tax, $1,445,400 from Deadwood, and $364,375 to continue the cooperative advertising effort, for a total of $3,886,839. The projected budget reflects a decrease of 4.7% from FY95; however, when the federal grant money is excluded, the budget is projected to increase by 2.9%.

Now that it will be funded from the tourism promotion fund, and thus will not be competing for general funds, the prospects for increased budgets for the Department of Tourism have improved. As an illustration, the state's share of Deadwood revenue grew 23% from FY91 to FY92, 8% from FY92 to FY93, and 14% from FY93 to FY94. Because of the acceleration of collections which causes a one-time bump in FY95, it is difficult to project growth in the current year. However, the projected average collection for fiscal years 1995 and 1996 is $1,602,700, which represents a 9% increase over FY94. It appears that the dramatic early growth in gaming revenue may be leveling off, but any increases realized will be available for funding the Department of Tourism. In addition, the passage of Senate Bill 235 could eventually lead to greater revenues for the tourism promotion fund. That legislation distributes more revenue to the state after the city of Deadwood has received $6.8 million in a year. In FY94, the city received $6.0 million, so this legislation may not have any impact for at least a couple of years.

The dedication of the new tourism tax to the tourism promotion fund could also lead to increases in the budget of the Department of Tourism. If spending on hotels and tourist attractions increases, the additional revenue would be available for additional promotional spending. This scenario would represent a beneficial cycle for the department's budget, whereby increased promtional spending leads to increased tourism which leads to more revenue from the tourism tax and Deadwood gaming which can be used for additional promotion. On the other hand, the Department of Tourism is also faced with the risk of downturns in the tourism sector, which would reduce the revenue entering the tourism promotion fund. In addition, the department's budget would suffer if the tourism tax fails to raise the projected amount of revenue. If that occurs, the Legislature could appropriate general funds to the department to offset the shortfall, but no action could be taken until it becomes evident that revenues are falling short of projections. This lag could leave the Department of Tourism with a limited budget for a year or more. In addition, after the establishment of a funding system to eliminate general funds for the Department of Tourism, a general fund appropriation to support the department would be unlikely in all but the direst of circumstances.

Another threat to expanding budgets for the Department of Tourism is the possible appropriation of funds from the tourism promotion fund for other purposes. In the last session, the Legislature appropriated $250,000 from the fund for Mt. Rushmore renovation and debated appropriating an equal amount to the state fair for similar purposes. Any appropriations for special projects reduce the amount in the fund which can be used by the department for advertising and promotions. If the revenue entering the fund grows dramatically, appropriations for special projects or transfers from the fund may be a temptation too strong for the Legislature and Governor to resist. Ultimately, the creation of the tourism promotion fund should have a positive impact on the budgets of the Department of Tourism, provided that the tourism tax and Deadwood gaming deliver the anticipated amount of revenue.

Colorado

Despite a large tourism industry, Colorado is the only state without publicly funded tourism promotion. A few years ago, Colorado had a tourism office which was receiving approximately $11 million a year in dedicated revenue from a 0.2% tax on hotels and other tourist businesses. However, a tax limitation measure passed by Colorado voters required the tourism tax to be put to a vote, because the tax included a sunset and review provision and the tax limitation measure called for a vote on any tax increases or new taxes. After the tax was defeated in the popular vote, the tourism office was closed because its source of revenue had been eliminated.

Since that time, the Colorado Legislature has passed a law to institute a "voluntary" system whereby tourist businesses can cooperatively support advertising and promotional activities. One serious impediment faced by any truly voluntary system is known as the "free rider" problem to economists. The basic problem is that the benefits of tourism advertising accrue to some extent to all tourist businesses, whether they contribute to the cost of advertising or not. For example, an advertisement of a particular attraction will bring people into a state to spend money at restaurants and hotels which may not have paid for any advertising. Thus, all tourist businesses have an incentive to not participate in funding advertising, since they can reap some benefit from expenditures made by other businesses.

The new Colorado tourism office is currently in the development stage and has just begun the process of trying to raise donations. The office's fundraising goal for the first year is $800,000. The legislation which created the office explicitly established recommended contributions of 0.1% of gross receipts for hotels and tourist businesses and 0.035% of gross receipts for restaurants. If the office were to receive full contributions from all businesses, it would have a budget of approximately $5 million. Thus, the new system will only be able to replace half of the funding of the old tax even if all businesses contribute at the recommended levels.

Because of the likelihood of "free riders," the new Colorado tourism office is unlikely to ever be able to raise $5 million through voluntary contributions. However, the legislation establishing the new office contains a provision which allows the tourism office to make the recommended contributions mandatory. Under that system, the state would have $5 million to spend on tourism promotion, although the "voluntary" nature of the system would be compromised. A system of mandatory contributions on tourist businesses would effectively function as a tax, which appears to defy the spirit of the state's tax limitation measure. However, some sort of mandatory system, whether or not it is considered a tax, may be necessary in order to raise the resources necessary to conduct extensive advertising activities.

One of the most interesting questions raised by the Colorado experience has not been fully studied. The transition from an $11 million tourism promotion budget to no budget offers an excellent opportunity to measure the value of tourism promotion to a state's tourism industry. Colorado's tourist businesses have reported losses since the demise of the tourism office, but no study has attempted to determine how much of this downturn is due to the lack of publicly funded advertisements and how much is due to other factors. Given the amount of money that all states raise for promotional purposes, it would be valuable to know the effect of a complete loss of funding for tourism promotion.

Fifty State Comparisons

The table at the end of this memo includes data on budgets for tourism departments in all fifty states. The most recent available budget information covers fiscal year 1995, and the table indicates that South Dakota lags somewhat behind the average in this category. In fact, South Dakota's tourism budget is only thirty-fifth among the states. The largest budgets are in Hawaii, Illinois, and Texas, while the smallest are in Delaware and, of course, Colorado. The total budget is not a particularly useful measure, however, because of the significant variation in the size of states. Thus, the table also provides information on the amount spent per full time employee and the amount spent per state population.

The table also includes a measure of the percent change in tourism promotion budgets from FY94 to FY95. Across the country, tourism promotion budgets grew by 6.3% between those years, so states appear to believe that additional spending to promote tourism is a worthwhile investment. The South Dakota Department of Tourism budget grew by 7.6% from FY94 to FY95 despite changes forced by the temporary shutdown of the video lottery system. Througout the country, some tourism budgets changed quite drastically last year, including a 70% increase in Mississippi and a 63% decrease in Washington. As with anything controlled by politicians, spending on tourism promotion can at times be quite volatile, but the overall trend indicates growth exceeding the national rate of inflation.

The amount spent by state tourism offices per each full-time employee illustrates to some extent the relative size of the bureaucracy in each state office. For example, low-ranking states like Delaware, Georgia, and Tennessee have a budget of less than $100,000 per employee. Thus, after deducting the cost of each employee, a comparatively small portion of the state's budget remains for other activities, including the purchase of advertising, which is especially expensive in large markets. The states which spend the most money per employee are Pennsylvania, Massachusetts, and New York. However, one can not necessarily conclude that these states have the least bureaucracy, since this measure does not factor in part-time or temporary employees. South Dakota spends $226,538 for each of its 18 full-time employees, which ranks 25th in spending per employee. Thus, the state of South Dakota is about average for the entire country in terms of the size of the full-time bureacracy administering its tourism programs.

The table also includes the amount of money spent by state tourism offices compared to the state's population. This data is designed to measure the effort each state makes in funding tourism promotion. This is not an ideal measure, however, to the extent that many taxes are exported to residents of other states. For example, both Hawaii and Alaska spend far more per resident than other states. However, they do not necessarily place a higher tax burden on their population, since many of their state taxes are paid by visitors. As the table indicates, other states which spend a large amount per resident on tourism promotion are Montana, Vermont, and Wyoming.

At the other end of the scale, states which spend less than a dollar per resident include California, Washington, Indiana, Michigan, New Jersey, New York, Ohio, and Oregon. South Dakota ranks sixth in spending per resident, at $5.66 in FY95. This spending per resident is almost twice as much as the national average of $3.05. Again, this measure does not reflect an effort made entirely by South Dakota taxpayers, since the revenue comes from sources, including Deadwood Gaming and sales tax, which are partially paid by visitors. However, this level of spending does reflect that despite the limits of a small population, South Dakota invests significant resources in tourism promotion.

The table also includes the statewide hotel tax rate for all fifty states. This measure does not accurately reflect the rate charged throughout each state, because so many localities impose additional levies. The information in the table is limited to the tax imposed by each state government on hotel stays. In South Dakota, that is now 5%, including a 4% sales tax and the new 1% tourism tax. In addition, municipalities can add up to 2% of tax for their own purposes, raising the tax on some hotels in the state to 7%. South Dakota is below the national average tax of 5.41%, and, considering that many municipalities in other states have greater local taxes on hotels, the new tourism tax does not appear to have increased the tax on hotel rooms in South Dakota to a level above the national average.

In addition to strict percentage taxes on hotel rooms, some states have devised more complex taxing schemes which have not always delivered the intended results. For example, in this past year, New York repealed a 5% tax on hotel rooms exceeding $100 per night, out of concern that the effective rate on these rooms, 9%, was too high to compete for corporate customers. Unlike New York, which was attempting to simply increase state revenues, Maine recently initiated a program to enhance its tourism promotion budget without increasing its already high rate of tax on hotels (13%). In Maine, any tourist taxes collected in excess of revenue projections is to be transferred to the tourism department for spending on promotional activities. However, policymakers in Maine quickly discovered the downside of such strategies, as a downturn in the state's tourist economy rendered the returns negligible. On the other hand, this program is new, and an expanding tourist economy could eventually produce additional promotional revenue which would lead to additional promotion of Maine's tourism industry.

The table also illustrates the percentage of the tourism budget in each state which is composed of non-general funds and the sources of such funds. The results in this category vary dramatically, with 12 states using almost exclusively non-general revenue and 18 states receiving only general funds. Of course, each state varies in the sources of the money deposited in its general fund, so those states which fund tourism promotion from the general fund do not necessarily use similar sources. The non-general fund sources are generally tourism related, as these states require the tourism industry to support the promotional activities which work on its behalf. In FY95, 52% of the South Dakota Department of Tourism budget was non-general funds, specifically Deadwood gaming revenue and industry participation in cooperative advertising. Thus, South Dakota already exceeds the national average of 37.92%, and, beginning in the next fiscal year, South Dakota will join those states which derive all of their tourism promotion budgets from sources other than the general fund.

As South Dakota moves to a system of tourism promotion funding which uses dedicated revenue, it is interesting to investigate whether such states spend more than others. In FY95, twenty-one states include some amount of dedicated revenue in their tourism budgets, mostly from taxes on the tourism industry, and these states spend $2.72 per capita, which is below the fifty-state average of $3.05. However, the large amounts spent by Hawaii and Alaska tend to skew the latter measure. In addition, twelve states depended completely on dedicated revenue, and those states spent $2.75 per capita. On the other hand, the eighteen states which use only general funds for tourism promotion spent $2.00 per capita. Thus, states which use dedicated revenues do spend more on average than states that depend entirely on general funds, but the difference is not great. However, a change to funding with dedicated tourism taxes does have advantages, including the ability to export a large part of the cost of tourism promotion and the possibility of increasing advertising budgets when tourism increases.

Conclusion

South Dakota has dramatically altered its method of funding tourism promotion in the past two years. In FY94, the budget for the Department of Tourism was composed almost entirely of general funds, but, in FY96, the budget will be made up almost entirely of dedicated revenues from Deadwood gaming and a new 1% tax on the tourism industry. Both of these funding sources could grow significantly in the future, which would expand the revenue in the tourism promotion fund. Because the Legislature has ultimate control over appropriations from this fund, the Department of Tourism will not necessarily see a windfall if these new revenue sources prove successful. However, the creation of the tourism promotion fund reflects an apparent intent among the Legislature that the Department of Tourism have access to its own funds rather than competing with other agencies for general funds.

Data from FY95 indicates that South Dakota spends more than most other states for tourism promotion, which is a logical investment for a state where tourism is the second largest industry. If the tourist industry continues to thrive in South Dakota, the new funding system should work well, as increasing tourist spending provides greater revenue which can be used to expand promotion and advertising. In addition, the revenue sources of the tourism promotion fund, Deadwood gaming and a tax on the tourism industry, are both exported to a significant extent, so much of the cost of tourism promotion will be borne by visitors. The advantages of the new funding method do not come without risks, however. A downturn in the tourist economy, or any other conditions which cause revenue to fall short of projections, would cause a shortfall which would force legislators to decide whether to appropriate general funds to the Department of Tourism. Ultimately, time will tell whether the tourism promotion fund will have enough money to maintain or expand advertising and promotion of the state's tourism attractions.

Comparison Of Tourism Promotion Funding In All Fifty States										
State	FY95 Budget	% Change from FY94	Full-Time Employ-ees	Budget/ Employees		Budget/ Population		State Hotel Tax Rate (%)	Non-General Revenue	
				$ per Employee	Rank	$/ Person	Rank		% of Budget	Source
AL	$6,200,000	15	60	$103,333	44	$1.47	31	4	77	Hotel Tax
AK	$8,044,500	-26	20	$402,225	9	$13.27	2	0	15	Industry Contributions
AZ	$7,398,200	37	20	$369,910	11	$1.82	27	6.5	32	Hotel Tax
AR	$9,924,184	7	67	$148,122	38	$4.05	8	6.5	68	Tourism Industry Tax
CA	$7,385,000	-3	16	$461,562	5	$0.24	48	0	0	
CO	$0	0	0	---	---	$0.00	50	3	---	
CT	$6,614,770	16	23	$287,599	20	$2.02	22	12	78	Car Rental Tax
DE	$753,300	2	9	$83,700	47	$1.07	37	8	0	
FL	$15,090,881	1	107	$141,036	40	$1.08	36	6	100	Car Rental Tax
GA	$7,872,786	7	113	$69,671	48	$1.12	35	4	0	
HI	$33,934,944	17	106	$320,140	14	$28.78	1	9	12	Industry Contributions
ID	$4,038,677	9	13	$310,667	16	$3.56	10	7	98	Hotel Tax
IL	$30,478,600	11	59	$516,586	4	$2.59	17	6	100	Hotel Tax
IN	$3,500,000	0	14	$250,000	24	$0.61	46	5	0	
IA	$3,502,766	0	8	$437,845	7	$1.24	33	4	0	
KS	$3,648,263	-5	24	$152,010	37	$1.43	32	4.25	70	Gaming Revenue and Fees
KY	$6,108,300	7	46	$132,789	42	$1.60	28	6	0	
LA	$13,438,000	9	68	$197,617	29	$3.11	16	4	100	Sales Tax
ME	$2,486,685	-25	6	$414,447	8	$2.01	23	13	28	Tourism Industry Tax
MD	$5,175,101	1	27	$191,670	31	$1.03	40	5	0	

MA	$14,042,184	-6	23	$610,529	3	$2.32	19	5.7	100	Hotel Tax
State	FY95 Budget	% Change from FY94	Full-Time Employ-ees	Budget/ Employees		Budget/ Population		State Hotel Tax Rate (%)	Non-General Revenue	
				$ per Employee	Rank	$/ Person	Rank		% of Budget	Source
MI	$9,041,300	0	27	$334,863	13	$0.95	42	4	0	
MN	$8,406,555	-6	57	$147,483	39	$1.84	26	6.5	19	Highway Funds and Industry Contributions
MS	$12,296,845	70	75	$163,958	35	$4.61	7	6	0	
MO	$8,191,473	36	37	$221,391	27	$1.55	39	4.23	0	
MT	$5,706,002	4	21	$271,714	21	$6.67	5	4	100	Hotel Tax and Industry Contributions
NE	$1,680,385	0	10	$168,038	34	$1.04	38	6	100	Hotel Tax
NV	$5,906,517	13	34	$173,721	33	$4.05	8	1	100	Hotel Tax
NH	$2,729,300	2	6	$454,883	6	$2.40	18	8	0	
NJ	$5,965,000	1	15	$397,666	10	$0.75	45	6	0	
NM	$5,380,000	-1	17	$316,471	15	$3.25	14	5	17	Highway Funds
NY	$15,397,000	28	25	$615,880	2	$0.85	43	4	4	Industry Contributions
NC	$7,143,474	-4	35	$204,099	28	$1.01	41	4	7	Industry Contributions
ND	$2,229,403	7	10	$222,940	26	$3.49	12	5	0	
OH	$6,289,025	4	18	$349,390	12	$0.57	47	5	5	Industry Contributions
OK	$6,511,782	6	53	$122,864	43	$2.00	24	4.6	38	Tourism Industry Tax
OR	$2,600,000	0	9	$288,889	19	$0.84	44	0	100	Lottery
PA	$12,559,404	-5	8	$1,569,925	1	$1.04	38	6	0	

State	FY95 Budget	% Change from FY94	Full-Time Employ-ees	Budget/ Employees		Budget/ Population		State Hotel Tax Rate (%)	Non-General Revenue	
				$ per Employee	Rank	$/ Person	Rank		% of Budget	Source
RI	$3,523,500	4	13	$271,038	22	$3.53	11	12	80	Hotel Tax and Industry contributions
SC	$11,742,101	-2	73	$160,851	36	$3.20	15	7	100	Tourism Industry Tax
SD	$4,077,684	8	18	$226,538	25	$5.66	6	5	52	Gaming Revenue and Industry Contributions
TN	$10,213,100	10	161	$63,435	49	$1.97	25	5.5	0	
TX	$20,838,702	11	110	$189,443	32	$1.13	34	6	100	Hotel Tax and Highway Funds
UT	$4,028,364	4	13	$309,874	17	$2.11	20	4.88	0	
VT	$4,831,125	27	52	$92,906	46	$8.33	3	8	25	Highway Funds
VA	$10,440,204	2	54	$193,337	30	$1.59	29	3.5	8	Industry Contributions
WA	$1,272,105	-63	13	$97,854	45	$0.24	48	6.5	25	Highway Funds
WV	$6,280,028	56	45	$139,556	41	$3.45	13	6	100	Lottery
WI	$10,365,000	11	34	$304,853	18	$2.04	21	5	0	
WY	$3,869,534	18	15	$257,969	23	$8.13	4	3	0	
AVG	$7,983,041	6.3	37.74	$211,527	------	$3.05	-----	5.41	37.92	--------

This issue memorandum was written by Jeff Bostic, Fiscal Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.