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Florida's Sales Tax Holiday and Film Tax Credit Proposals Will Not Deliver on Exaggerated Promises

by Mark Robyn

Introduction

The last two years have brought an economic recession and steadily rising unemployment around the country, with the national numbers only recently showing signs of improvement. With the nation focused on jobs and the economy, state lawmakers are under strong pressure to do all they can to help nurse their states back to health. Many of the ideas legislators propose to help the economy are changes to the tax code which, alas, are often useless or even counterproductive, and here Florida is no exception.

Unemployment in Florida is even worse than the national average, reaching 11.8% in December 2009 with indications that it may continue to climb. With an eye on job creation and economic stimulus, Florida legislators have introduced two tax-related bills. The first would reinstate a ten-day, back-to-school sales tax holiday during the month of August.[1] The second would institute a $75 million film tax credit program.[2]

Sales tax holidays, the popular name for temporary suspensions of sales taxes on specific products, have become popular with lawmakers and voters. Lawmakers claim that sales tax holidays provide a significant tax cut for consumers and benefit the broader economy by increasing sales. Film tax credits have also become very popular with lawmakers over the last decade and are promoted for their economic and job creation benefits. Both of these proposals represent a misguided approach to tax policy and fail to deliver on their promises.

[1] HB 483, http://www.myfloridahouse.gov/Sections/Bills/billsdetail.aspx?BillId=42851
[2] HB 697, http://www.myfloridahouse.gov/Sections/Bills/billsdetail.aspx?BillId=43119

Mark Robyn is staff economist at the Tax Foundation.

Film Tax Incentives: Race to the Bottom and Exaggerated Benefits

When both tax proposals are examined in detail they fail to live up to their hype. The current situation with film tax credits is a perfect example of a "race to the bottom." In this case, states utilize taxpayer money to engage in a bidding war with each other for a limited supply of film productions. This ceaseless bidding war is driven by self-interested film production companies who ultimately reap the majority of the benefit in the form of increased returns on their investment. This process, termed "rent-seeking" by economists, consists of influencing the political process in order to secure extraordinary profits above what the market would naturally allow without providing any increased benefit to society.

It is important to note that the nation as a whole is not made better off through the rent seeking process. While jobs may appear to be "created" in a given state, they are really just shifted from one state to another, with film producers reaping the benefits. Some argue that film incentives also boost business for local establishments like restaurants and shops, but the same is true for a broad based tax cut: lowering the overall tax burden will make a state more attractive for businesses and will have positive effects for the broader economy.

Florida's current incentive program totals $10.8 million, down from $25 million a few years ago, with almost half of the incentive program's funds going to subsidize the show Burn Notice on cable's USA Network. But lawmakers say current subsidy levels are no longer enough to lure filmmakers to their state. The new proposal would create a tax credit program worth $75 million annually for production companies, nearly a seven-fold increase. But as the bidding war continues, soon this amount may not be enough either, and Florida will be forced again to redouble their efforts to lure film productions. This strategy, which amounts to corporate welfare for film producers and movie stars at the expense of the rest of Florida's taxpayers, is simply not a sustainable approach to economic development.

In addition, the economic benefits of film tax credits are greatly exaggerated. Proponents point to the economic activity and jobs created as evidence that film credits pay for themselves. But the film incentives only pay for themselves under very generous assumptions. A recent study by the Pennsylvania Legislative Budget and Finance Committee found that the state's $75 million program nets $4.5 million only when they assume that the entire industry, even those productions not receiving tax credits, would disappear if the tax credits were to end, an assumption that even they admit is not accurate.[3] Under more realistic assumptions the program loses over $40 million.[4]

Sales Tax Holidays: Temporary Tax Cuts and Timing Shifts

Sales tax holidays also fail to deliver on the hype surrounding them. Sales tax holidays are a temporary tax reduction on a specific list of products, but the actual value of the tax cut is minimal and comes with significant costs. In Florida the August holiday is billed as a back-to-school tax break and applies to clothing, footwear, books and school supplies. Consumers save a few dollars but must fight the crowds and must differentiate between exempt goods and taxable goods. Businesses see increased customer traffic during the tax-exempt period but have to pay for more workers and spend money complying with the temporary tax changes. The authors of a study

[3] See Pennsylvania Legislative Budget and Finance Committee, "Pennsylvania's Film Production Tax Credit and Industry Analysis" at http://lbfc.legis.state.pa.us/reports/2009/35.PDF

[4] For more information on film tax credits, *see Tax Foundation Special Report*, No. 173: "Movie Production Incentives: Blockbuster Support for Lackluster Policy" at http://taxfoundation.org/files/sr173.pdf

submitted to the Florida Retail Federation in support of the sales tax holiday proposal even admit, "Due to the temporary nature of this stimulus, increased labor needs are filled mostly through temporary help and overtime work for existing employees." [5] Temporary jobs obviously do not provide a long term employment boost. And overtime pay may be good for employees, but not for the businesses paying them if it doesn't translate into a net increase in sales for the year, and no serious study has proven that the holidays raise annual sales.

Instead, serious studies of sales tax holidays show that the increased economic activity during the few days of the holiday period is due mostly to a shift in the timing of purchases. So, for example, to take advantage of the proposed back-to-school sales tax holiday in Florida, consumers will postpone purchases they would have made in July or early August, and they would speed up purchases they would have made in September or October. This shifting provides no overall economic benefit when the timeframe is expanded to more than just a few weeks.

In contrast, the politically clever study released in tandem with the tax holiday proposal completely ignores the timing-shift effect. When describing the alleged benefits, it shrewdly refers only to increases in consumption during the month when the holiday occurs. The authors spend most of the paper analyzing how the supposed increase in consumption would spread through the economy, increasing incomes, consumption and tax revenue along the way. But these indirect effects are not unique to sales tax holidays: all consumer spending has these characteristics. Without addressing the timing-shift problem the study is essentially meaningless. The champions of this idea are banking on Florida taxpayers' short memories. The August holiday was eliminated in 2007 due to budget constraints, with an implicit acknowledgement that the holiday does not pay for itself.

The authors also assume an increase in taxable purchases, and therefore tax revenue, during the holiday. It's true that many customers who shop at that time buy taxable goods, too, but the question of timing shifts still remains. If the taxable purchases would have been made anyway then there is no net increase in revenue. On the other hand, if consumers are somehow tricked by all the excitement into making taxable purchases that they would not otherwise have made, then the benefit they realize from the tax cut is reduced. And one must ask whether this tactic of giving with one hand while taking with the other is really a productive or appropriate goal for the government to be pursuing. [6]

Possible Results of Tax Cuts: Spending Cuts or Tax Increases

As is the case all too often, state legislators promoting sales tax holidays and film tax credits have failed to investigate beyond the talking points. But there is another important discussion that is often overlooked. When evaluating new tax policy proposals, in addition to adhering to principles of sound taxation, it is always important to ask what the broader budget implications will be. For the proposals in Florida there has been no discussion of how the budget will be adjusted when these measures cause tax revenue to dip. The only two options are to cut spending or raise other taxes, and a serious discussion of the two alternatives is especially important when Florida is already having trouble raising enough revenue to provide currently budgeted services. Cutting wasteful or inefficient spending is obviously beneficial, but it is still politically difficult. It would

[5] See "An Analysis of the Costs and Benefits of a Sales Tax Holiday in Florida" at http://www.frf.org/AM/files/BacktoSchoolSalesTaxHolidayReport_102009.pdf
[6] For more information on sales tax holidays, see *Tax Foundation Special Report*, No. 171: "Sales Tax Holidays: Politically Expedient but Poor Tax Policy," at http://taxfoundation.org/files/sr171.pdf

certainly be worth the effort if it were in support of a broad based tax cut. The argument is much weaker to support a targeted tax cut that has little or no broad economic benefit. This argument is almost moot, however, because Florida legislators seem willing to act without any serious discussion of explicit spending cuts.

The other option in paying for the new policies is to raise taxes to make up for the lost revenue. But again, this is rarely an explicit process. Instead, over time the tax base is narrowed as an increasing number of special tax breaks are added to the tax code. In order to raise the same amount of revenue from this shrinking tax base the tax rate must necessarily increase. And if taxes are going to be raised elsewhere to finance the original tax cut, then there is no overall net reduction in taxes, only a shift of the tax burden from one group of taxpayers to another.

The Better Option: Broad Bases and Low Rates

Sales tax holidays and film tax credits are the sort of ideas that lawmakers come up with when they try to micromanage a vast and complex economy. In the case of sales tax holidays, lawmakers are selling what sounds like a free lunch, fooling consumers into thinking they are getting a great tax break that will benefit the economy and pay for itself by increasing tax revenues. In the case of film tax incentives, lawmakers are picking winners and losers in the market, bestowing special tax breaks on favored industries while sticking the rest of the state's taxpayers with the bill. This implies they are under the impression that they know better than the market what industries are best suited for their state. Both policies are political gimmicks that provide great photo-ops and win political points, but are lacking when it comes to the fundamentals of sound tax policy.

Floridians should not settle for these political gimmicks. Instead of pandering to Hollywood or fooling parents into thinking they're getting a great deal on school supplies, Florida lawmakers should take an approach of neutrality that treats all taxpayers the same and provides a low tax rate for all. If lawmakers want to provide real valuable tax cuts they should reject these targeted and temporary tax cuts and enact lasting tax relief for all business and consumers. This "broad base, low rate" approach avoids favoring certain taxpayers at the expense of others and allows all taxpayers to enjoy the benefits of a lower tax burden, whether they are shooting films or selling flowers, buying shoes or a stroller.