The Effect of Proposed Hotel Room Tax Increases in the U.S.: A Review

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Tourism - Nationally

- The U.S. tourism industry generates $590 billion per year in revenue and is responsible for 5 million in employment.
- It also yields $160 billion in tax revenues to states and localities.

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Purpose of the Research

- This analysis is based upon prior research on whether tourists are sensitive to tax hikes.
- To properly assess the outcome of the tax policy, we first develop an understanding of the elasticity of demand of tourists, then address the effects of the tax policy on tourist expenditure in general.

Price Elasticity of Demand

- The elasticity of demand is the percentage change in demand, per percentage change in price or income.
- Price elasticity of demand determines the sensitivity of demand due to a price change of a good or service.

Categories of Price Elasticity of Demand

- Demand is elastic if $|\varepsilon| > 1$
- Demand is inelastic if $|\varepsilon| < 1$
- Demand is unit elastic if $|\varepsilon| = 1$

Who bears the Tax Burden?

- Elasticity of a good determines who carries the burden of the tax
  - If it is inelastic, the burden is primarily on the buyers(tourists)
  - If it is elastic, the burden is on the suppliers(hotels)
- Based on the body of research about elasticity of demand for hotel rooms, tourism is <u>inelastic.</u>
- Thus, we expect tourists to bear more of the burden of the tax increase.

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Estimates for Price Elasticity of Demand for Hotel Rooms

Paper/Source	Elasticity Estimation
Hiemstra and Ismail (1993)	0.44
Canina and Carvell (2005)	0.13
Collins and Stephenson (2018)	0.7

Luxury and other Expensive lodgings

- Cabins and other more expensive lodging are considered as more elastic services, and they tend to be more price-sensitive than other forms of lodging (Corgel et al, 2012).
- However, any detriments of a tax hike can be countered by two factors:
  - High degrees of customer loyalty and satisfaction for lodging reduces price sensitivity (Assaf et al., 2012).
  - Those with high incomes tend to be less price-sensitive to changes in prices (Waqas-Awan, 2020). Tourists who utilize these types of lodging tend to have higher income

Relationship between the Hotel Tax Rate and Hotel Revenue

- Research indicates that there is little evidence of tax rates impacting hotel revenue.
- Additionally, directedly taxing tourism services is the most efficient form of tax collection (Gooroochurn et al., 2005).
- This disconnect was observed in Wisconsin, where tax rates and hotel revenues had an extremely weak relationship (Kashian et al, 2020)

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Tax rates and Total Tourism Spending

- There can be a decline in the total spending per tourist due to the increased tax rate (Forsyth et al., 2014).
- However, possible negative effects could be countered by directing more tax revenue into tourism (Mak 1988)
  - But the benefits of the increased spending diminishing with higher levels of spending (Deskin & Seevers, 2010).

Conclusion

- Demand for lodging is inelastic, thus tourists are less sensitive to price changes
- There is no strong relationship between tax rates and hotel revenue
- Earmarking tax revenue to the industry would help reverse any adverse effects on total tourism spending.
- **Based on the research, we can conclude that a tax hike would not harm the tourism industry of Door County.**

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