

MEMORANDUM

To: Debbie Johnson

From: Elliott Pollack
Jim Rounds
Danny Court

Date: 2/22/2010

Re: Findings Regarding Impacts of Tourism Funding Reduction

This memo represents the economic and fiscal impact findings pertaining to a reported redirection of \$14.0 million in funding that otherwise would be used on tourism related marketing and administration (only a limited portion of the total budget is protected from fund transfers and is dedicated for specific uses). We have no vested interest in the findings nor are we being compensated based on performance. This is a straightforward fact finding analysis.

Synopsis: Dozens of economic studies were reviewed related to how tourism marketing impacts actual tourism activity. Studies were reviewed that address: 1) how tourism spending, specifically in Arizona, impacts job creation and State General Fund tax collections, 2) how INCREASES in tourism marketing in other states led to an increase in overall market share within the industry, 3) how DECREASES in tourism spending within one such state resulted in an overall extended decrease in market share and significant economic losses, and 4) the basic corporate marketing of products and consumer behavior.

To summarize, it is our opinion that the proposed reduction in Arizona Office of Tourism marketing monies will result in a decline in tax collections well in excess of the amount of redirected funds. Using the most conservative advertising return-on-investment figure that is available (this example is discussed more extensively later in the memo), the proposed funding reduction will result in an annual General Fund revenue loss of at least \$26.7 million. This figure backs out administration monies and is significantly more conservative than other studies that were reviewed. It is anticipated that at least half of this value will be realized in FY2011 and the full amount will be realized in FY2012. The actual revenue losses could potentially be many times this amount.

This is not a matter of choosing tourism funding over a social program. The proposed redirection of funds will very simply result in a loss of General Fund tax collections in excess of the redirected monies. Alternatively, the full restoration of funding will similarly result in a net gain in tax revenue.

The following points separately highlight our findings.

- It is expensive to recover market share once losses occur and the recovery can take multiple years. A number of studies exist that identify the difficulty of recovering market share of a particular product or service when marketing of the product or service is temporarily suspended. One study identifies that when company expenditures on advertising are maintained through a recession, market share later increases at triple the rate of those companies that cut their advertising budget. Advertising on tourism is no different. It can take several years of above-trend spending just to return to previous market share levels. As Colorado experienced, within two years of eliminating its tourism funding, the state fell from 1st in the nation for summer resort travel to 17th. See below for more on Colorado.

This implies that **the planned reduction in tourism funding could negatively impact State tourism activity for multiple years.** This is of additional concern since the State may miss the opportunity to capture any pent up demand for travel within the U.S. that has been building during the past recession and that will be of significant value during the next two to three years of economic recovery.

- The Tourism industry does not require incentives to operate. However, this important base industry still represents a significant portion of the State's economy and does require efficient advertising from a centralized State marketing entity. Reviewed materials identify that every state in the country has a tourism budget for direct marketing use. Rhode Island had the smallest budget at \$1.4 million as of FY2008 while Hawaii posted the largest at \$85.1 million. The State of Colorado temporarily eliminated its tourism budget only to later realize significant fiscal and economic losses, and has since fully restored the budget (see below for case study conclusions). The Colorado tourism budget stood at \$22.7 million as of FY2008 after being fully restored, approximately equal to Arizona for that year. Arizona's budget has since been reduced though, beginning in FY2009.
- In 1993, Colorado became the only state to eliminate its tourism marketing funding and realized massive economic and fiscal losses as a result. Before that, the state had a \$12.0 million promotion budget. The following quote by a Colorado lawmaker in 1993 is very similar to what we heard in Arizona this year:

"It's not that we are against tourism. But the Rocky Mountains were there long before the Colorado Tourism Board, and they (will) be there long afterwards. Surely the tourists will keep on coming."

After the elimination of the marketing budget, Colorado experienced a loss of domestic market share by 30% within two years, which reportedly equated to a loss of over \$1.4 billion in annual tourism spending. Eventually, annual lost spending was estimated to have increased to over \$2.0 billion.

In 2000, the Colorado legislature reinstated funding to the Colorado Tourism Office with a \$5.0 million budget. Research performed to estimate the effectiveness of the state's tourism campaigns over the next few years resulted in a return on investment ratio of over 12-1, or \$12 in tax revenue for every \$1 spent in advertising. In 2006, a bill increasing the tourism promotion budget to \$19.0 million was passed. By 2007, annual travel to Colorado rebounded to an all-time high, with 28.0 million visitors spending \$9.8 billion.

The conclusion from the Colorado analysis was that marketing the state in the form of advertisements was a net revenue generator to the state, and by a large margin. It was also clear that the state could not assume that travelers would be attracted to the state at the high levels that were expected, especially during the summer vacation months, without adequate marketing efforts. There is no reason to believe that Arizona will be any different.

- Dozens of studies exist that closely tie positive changes in state tourism budgets with positive changes in tourism activity, and vice versa. These studies cover multiple years and different points in the business cycle. To adjust for fluctuations in overall economic activity, market share is typically used as the primary indicator of local industry health. Those states that have realized significant expansion in overall market share also enhanced their state's tourism budget.

According to one source, for every 0.1 point loss in market share, Arizona will lose an estimated 13,000 jobs, \$780.0 million in Statewide spending, and \$60 million in State tax collections. Our firm did not independently confirm these statistics, but the scale is consistent with multiple reports on the subject. For perspective, the Arizona tourism market share was 2.69% in 2005, but fell to 2.37% as of 2008. The loss of market share through 2008 appears to be mostly due to increased tourism advertising by competing states such as California. California doubled its tourism advertising budget in FY2008 and realized an immediate increase in its market share, from 11.09% to 11.27% in the first year of the campaign. The local budget cuts that occurred in Arizona for FY2009 and FY2010, and are proposed for FY2011, will most likely impact Arizona market share statistics beginning later this year.

- There is some disagreement on the extent that advertising spending produces net benefits to states, but the benefits are always positive. Most of the out-of-state studies reference a return on investment ratio of greater than 7-1. This means that the state receives tax collections in the amount of \$7 *or more* for every \$1 spent on tourism advertising. However, the agency-wide analyses (i.e. includes all tourism advertising spending by a particular state) may include some coincident tourism activity that is independent of the advertising, and may also include tourism activity that was the result of multiple years of advertising promotion. The use of specially designed surveys partly corrects for this to some extent. But,

it is nearly impossible to fully correlate current advertising with current visitor activity.

We approached these studies with skepticism due to the large multiplier effects. Again, it is always difficult to fully separate out coincident impacts versus induced impacts. Therefore, it is not probable that the positive return on tourism advertising is indeed as much as 10-1, or even 8-1. **However, the ratio only needs to be 1 to 1 for the positive revenues that policymakers are associating with the redirection of funds to be completely offset by lost tax collections.**

- This review uses a very conservative return on investment value that is based on one particular advertising campaign in Michigan. The most conservative (and reputable) estimate of ad effectiveness relates to a fairly new campaign used by the State of Michigan known as the Pure Michigan advertising campaign. Beginning in 2006, funding for the campaign was only sufficient enough for regional advertising (Chicago, Milwaukee, Indianapolis, Cleveland, Cincinnati, Dayton, Columbus, St. Louis, and Southern Ontario). The campaign continued to run in regional markets through 2008.

The effectiveness of Michigan tourism advertising was analyzed over the period from 2004 through 2008, recognizing that the impact of advertising cannot be contained within a one year span. Thus the combined ad campaigns of “Great Lakes, Great Times” and “Pure Michigan” produced an annual average of \$2.86 in tax revenue for every \$1 in advertising (this is the figure used in the synopsis calculation). In 2009, the campaign received one-time monies to expand the advertising to a national audience. The outcome was a 5.34-1 effectiveness ratio on a regional level and a 2.23-1 effectiveness ratio for the rest of the nation based on advertising and visitor spending that occurred in 2009. The combined regional and national effectiveness ratio was \$3.36 for every \$1 in advertising.

It appears that equity has been building in the ad campaign over the course of a few years as the return on investment has grown over time. As noted in many studies, tourism advertising must first create awareness followed by motivating people to visit. This can take multiple years. This supports the argument that a reduction of advertising monies may have a lasting impact.

- Regarding statistics for Arizona, according to one source, as of 2008, the Arizona tourism industry was responsible for 6.9% of all State and local tax collections, equal to approximately \$1.4 billion. Our firm did not independently confirm these statistics. The industry employs 167,000 direct tourism workers. While the employment multiplier effect in tourism is less than in other higher value added industries, the same report identifies that the indirect and induced employment combined with direct employment sums to a total of 310,000 jobs. This represents over 10% of all jobs within Arizona and approximately equals the total number of jobs lost during the past recession. This is consistent with our firm’s previous estimate that the tourism industry makes up about 10% of the Arizona

economy. The dynamic employment figures (i.e. the multiplier effects) were independently modeled by our firm and appear to be accurate.

- The State is in desperate need of new jobs. Similarly, the State also needs to maintain the jobs that are currently here. Work completed by our firm this past year for the Speaker of the House of Representatives identified how hard it is to generate new jobs and maintain current ones. Efforts to create jobs must always begin with an area's current economic strengths. Tourism is one of those strengths. **As noted above, the tourism industry does not need strategic incentives to function properly. However, the industry indeed needs a respectable advertising budget to maintain market share.** If our firm had earlier learned that the Legislature was seriously considering a redirection of \$14.0 million from the tourism advertising budget, this action would have been criticized in our published jobs recovery report.
- Finally, as previously noted, this is not an issue of choosing between funding for tourism versus supporting disadvantaged children or funding for the State's health stricken elderly population. Based on our review, we conclude that the funding redirection proposal simply WILL NOT result in positive revenue for the State for use on balancing its budget in FY2011 and FY2012. **In fact, the policy action will very likely result in a significant net loss for the State during this time period.**

Regardless of cause, the fact is that Arizona has lost market share in U.S. tourism during the last few years and further losses are expected under current policy considerations. While the tourism industry does not produce the highest value added employment opportunities, minimal changes in market share can result in significant levels of job creation (or loss). **This is one area of public policy where government action could produce an immediate and positive (or negative) economic result. Policymakers need to tread very carefully on this matter.**

If reviewers of this document have any questions, they can feel free to contact our office. Please ask for Jim Rounds, Senior Vice President.