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A Federally Financed Sales Tax Holiday Would Be Difficult To Implement and Would Have Limited Stimulus Effect

The full report can be viewed at http://www.cbpp.org/11-1-01sfp.htm

On November 6, the Center on Budget and Policy Priorities released an analysis of the National Retail Federation proposal that the federal government stimulate the economy by financing a temporary reduction or elimination of state sales taxes. While superficially appealing, a national sales tax holiday has a number of significant problems that would prevent it from being implemented in a timely manner and would sharply limit its effectiveness.

- A federally designed sales tax holiday would take a number of months to enact, organize, and implement. Few if any states could likely have such a program in place for the holiday buying season. Each state legislature would need to meet to enact the plan for its state, but most are not in session until January or February; some are not scheduled to meet until 2003. Special legislative sessions generally require some time to put together and carry substantial cost.

- State revenue departments would need to write regulations to adapt the holiday to their own sales tax systems and would need to educate hundreds of thousands of retailers as well as the general public about the holiday. Retailers would need to reprogram their machines and train their employees. It is not reasonable to expect that all of these steps — from federal enactment to full state implementation — could be accomplished in many places before the spring of 2002.

- Because it could not be implemented quickly, a holiday would have limited value as a stimulus. A holiday could actually worsen the recession if consumers delay making major purchases until the holiday takes effect in order to take advantage of the holiday.

- The federal reimbursement would not be distributed evenly among the states. Five states would gain no benefit because they levy no sales tax. The remaining states vary widely in both the sales tax rate and the base of goods and services on which it is levied, so the benefits would vary widely among them as well.

- Evidence from past state sales tax holidays shows that all or nearly all of the increase in sales during a holiday results from consumers accelerating or delaying purchases they planned to make anyway. In addition, since state sales taxes apply to purchases by businesses as well as consumers, only a portion of the benefits of a holiday would go to consumers.

- There are better ways to boost the economy. The federal government could provide states with fiscal relief, such as through an enhanced Medicaid match, to help states close their widening budget deficits. Otherwise, states increasingly will be forced by their balanced budget laws to increase taxes or cut state spending, either of which would weaken the economy. *A national sales tax holiday, in contrast, would provide no fiscal relief since the federal reimbursement would compensate states only for revenue foregone due to the holiday.* In addition, the federal government could encourage consumer spending through a rebate to low-income workers — who are more likely to spend the rebate than high-income individuals — and expansions of unemployment benefits.