"REDUCING BOAT TAXES BACKFIRED ON OUR LOCALITIES"
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Sometimes the best-laid plans go astray, and this is what has happened as cities in Hampton Roads have reduced their boat taxes over the last decade. Individual cities reasoned that significant reductions in boat taxes (virtually to zero) would attract highly mobile boats to marinas in their cities. Well-heeled boat owners would then spend money on boat maintenance, supplies, fuel, food, drink and other items, and the cities would come out ahead because of the additional taxes they would collect that were generated by these activities.

Alas, as we report in the forthcoming State of the Region report, it hasn't turned out that way. Between 1998 and 2004, the number of boats in Hampton Roads actually declined by 1.5 percent, and the city that gained the most boats, Virginia Beach, enjoyed only a 1.4 percent increase.

Hampton, which cut its boat tax to zero, experienced a relatively small (1.5 percent) increase in its boats from 1998 to 2004. Chesapeake, Newport News, Norfolk and Portsmouth actually lost boats during this period.

We take great pleasure from our boats; more than 52,000 exist within Hampton Roads. They vary from small rowboat-sized craft up to large pleasure yachts. Until about 10 years ago, these boats were taxed in much the same fashion as automobiles or homes. Tax rates often were in the range of $1 to $2 per $100 of assessed valuation. Thus, the owner of a $100,000 boat would pay $1,000 to $2,000 in tax and the owner of a $1 million yacht would pay $10,000 to $20,000 in tax, providing the assessed valuations of their boats were equal to their market values.

A reputable Maryland study suggests that a typical sailboat owner spends about $6,800 annually on his boat, while an in-water powerboat owner spends about $5,300 annually on her craft. Let's generously assume that there is a substantial economic ripple effect associated with these expenditures and double these amounts when we compute their impact on city tax collections.

How much additional sales tax revenue will the cities actually collect? A 1 percent local sales tax attached to these expenditures by boat owners will generate about $125 per boat. But this is a losing fiscal proposition. The city of Virginia Beach, for example, lost $1.1 million annually in boat tax collections when it reduced its tax rate virtually to zero. At

$125 in additional sales taxes per boat, Virginia Beach would have had to attract 8,800 additional boats simply to break even. But it attracted fewer than 200 additional boats from 1998 to 2004.

The boat tax situation illustrates what economists label "the prisoner's dilemma" -- where a group of decision-makers compete themselves into a much less favorable position than they enjoyed before the competition started. We are familiar with this phenomenon in certain advertising situations, as when Coca-Cola and Pepsi-Cola both spend enormous amounts upon advertising -- expenditures that appear to cancel out each other. Some argue that the "cancel each other out" dynamic exists with respect to countries' military expenditures and universities' admissions activities. Economic competition usually yields favorable results, but not always.

The end result of the "prisoner's dilemma" in competitive boat tax reductions has been a visible reduction in overall taxes collected. That may be a good thing, but it wasn't the plan.

If only one city had reduced its boat tax without other jurisdictions matching that reduction, then that city might have gained boats and revenue. When nearly every city reduced its tax, no one gained and that tax burden was shifted to other taxpayers, such as those who pay sales and real estate taxes. Thus, there have been winners and losers. Perhaps this is the way of the world for all public-policy decisions. Sometimes well-intended decisions have just the opposite effect of what was anticipated.

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Abstract (Document Summary)

We take great pleasure from our boats; more than 52,000 exist within Hampton Roads. They vary from small rowboat-sized craft up to large pleasure yachts. Until about 10 years ago, these boats were taxed in much the same fashion as automobiles or homes. Tax rates often were in the range of $1 to $2 per $100 of assessed valuation. Thus, the owner of a $100,000 boat would pay $1,000 to $2,000 in tax and the owner of a $1 million yacht would pay $10,000 to $20,000 in tax, providing the assessed valuations of their boats were equal to their market values.

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