Considerations in Assessing Local Government Tax Revenues

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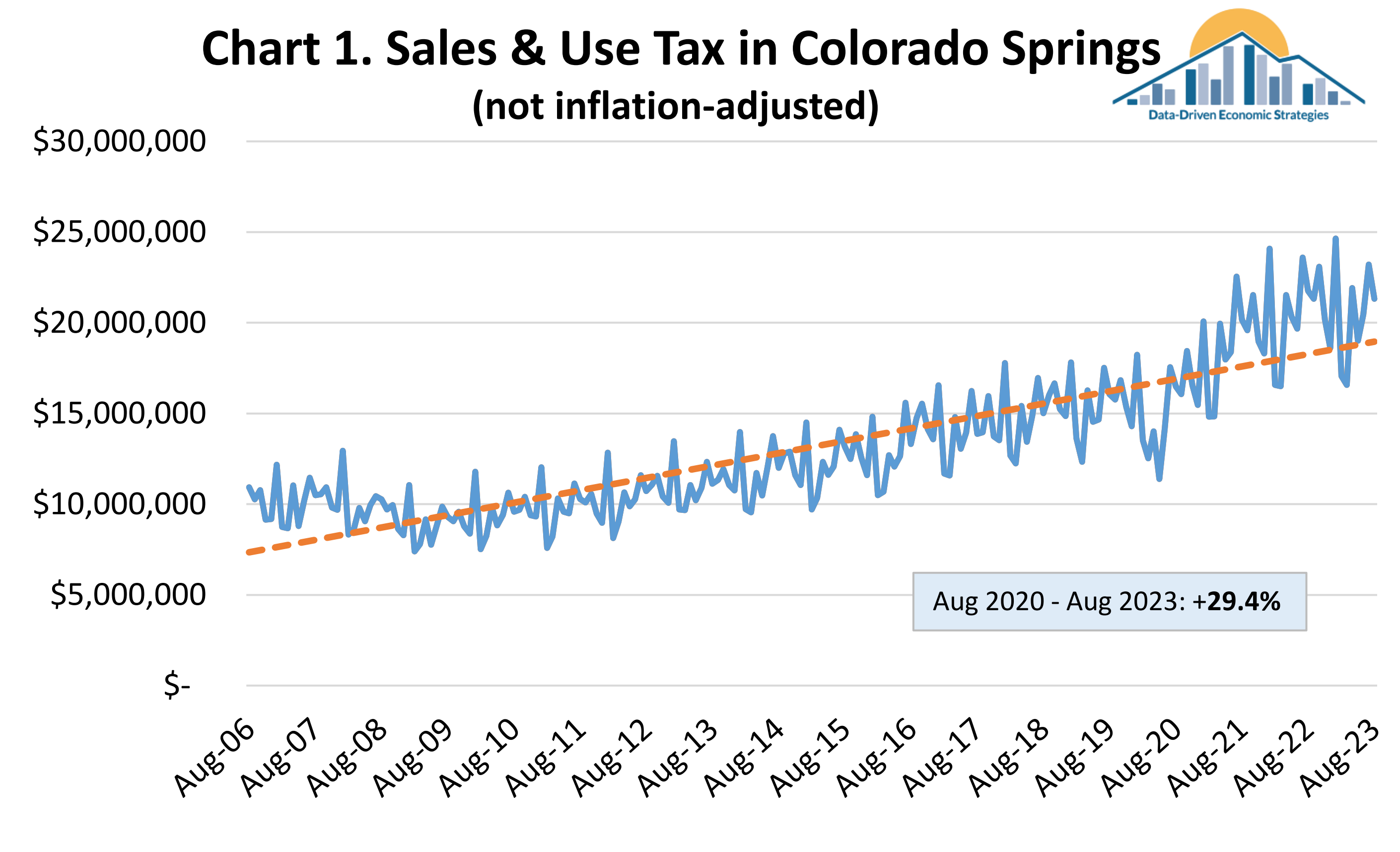
When the pandemic first hit, government was rightly concerned that tax revenues would decline significantly as consumers were hunkered down in their homes unable to go out and spend like they usually do. But we now know how that played out with an actual increase in tax revenues including for our city sales and use tax. There were three primary reasons for that.

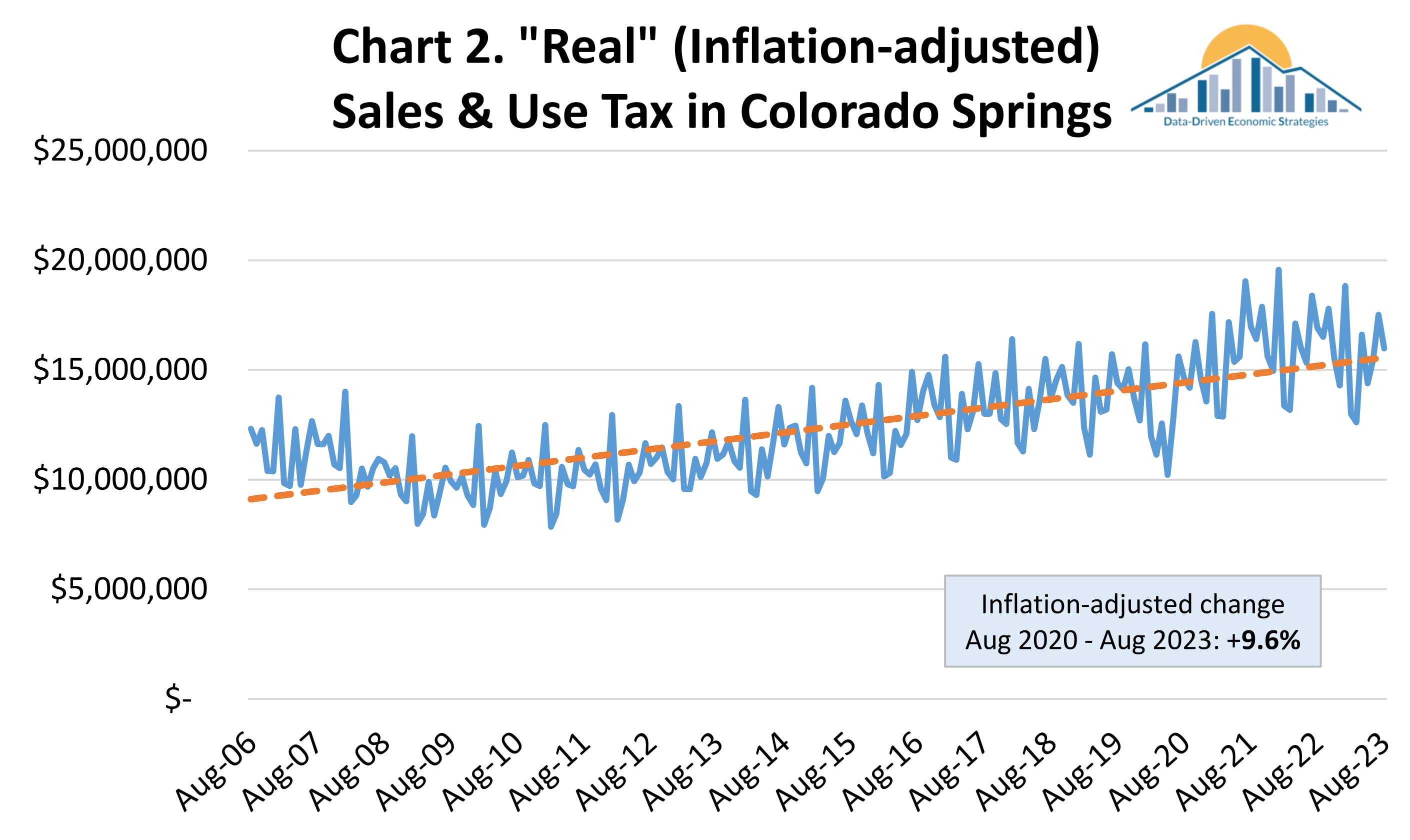
First, stimulus checks and supplemental unemployment payments enabled consumers to spend more. Second, consumers shifted to more goods, especially online goods, and taxation on those online sales was instilled precisely during the pandemic. Third, there was a boom in house buying and remodeling enabled by low interest rates and this impacts building materials, furniture, appliances, and other related categories.

As the first chart shows, with that surge in building and buying, sales and use tax notably increased during the pandemic, up 29.4% from August 2020 when the initial shock of the pandemic subsided to the most recent month data is available, August 2023. Without that pandemic disruption, however, sales and use tax today would roughly follow the trend line. In other words, revenues today would be in line with historic trends.



Sources: City of Colorado Springs; U.S. Bureau of Labor Statistics; Data-Driven Economic Strategies

As we enter the final quarter of 2023, the surge in buying and building is mostly behind us, and this does impact local sales and use tax. But it's also important to remember that sales and use tax revenues are reported in dollars such that the price increases over the past three years also influence the overall picture. When revenues are inflation-adjusted, there is still an increase in sales and use tax during the pandemic years, but it's not as dramatic as shown in the second chart (up 9.6% in the past three years). In other words, the pandemic-related volatility in sales and use tax is to be expected to some extent given the distortions of fiscal stimulus, sheltering in place, and inflation levels we have not seen in decades.



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So, what does this mean for local governments moving forward? Well, I think it will also be important to keep in mind the various macroeconomic topics I've recently covered. Student loans are resuming in a couple of weeks. There will be fewer childcare facilities with this month's termination of federal pandemic assistance to childcare centers with the net result that childcare costs will at a minimum stay expensive or become even more expensive. Also, inflation is moderating, but rather slowly. And much of inflation's persistence has to do with elevated employer costs including labor costs that are particularly volatile right now. A recent *Gazette* article I did addressed this with the latest development of a United Auto Workers strike currently impacting 13,000 union workers although the UAW has 150,000 members many of which may join the ranks in the not-too-distant future. Having lived in Ann Arbor, Michigan, I can tell you this will impact thousands more with the smaller auto industry businesses that do business with the mega automakers as well as the (economic) ripple effects to the communities at large. Yet another major consideration is the low savings rate I've also addressed previously at 3.5% now versus 9% pre-pandemic.

In sum, we should keep in mind that any declines in government tax revenues need to be both inflation-adjusted and compared to what levels would have been without pandemic stimulus. However, it's also important to look forward and there is no question that the average household has some headwinds, meaning spending and associated tax revenues are indeed likely to stagnate or decline. Prudent governments and businesses will plan accordingly.

Thank you to Rebecca Wilder for her assistance in compiling the data. Tatiana Bailey is Executive Director of the nonprofit, Data-Driven Economic Strategies (DDES). An abridged video with this information recently aired on The Economic Update with Tatiana Bailey on Fox21 and can be found on their website or at ddestrategies.org. Other articles and DDES monthly economic progress reports (EPRs) can also be found on their website.