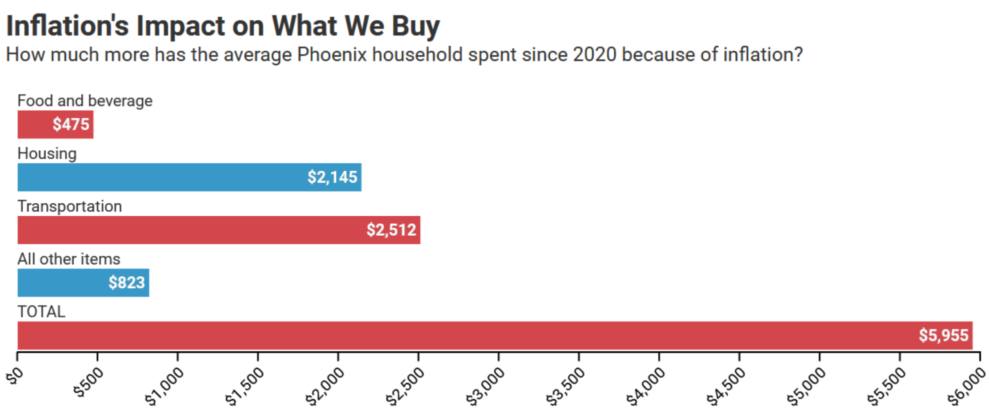
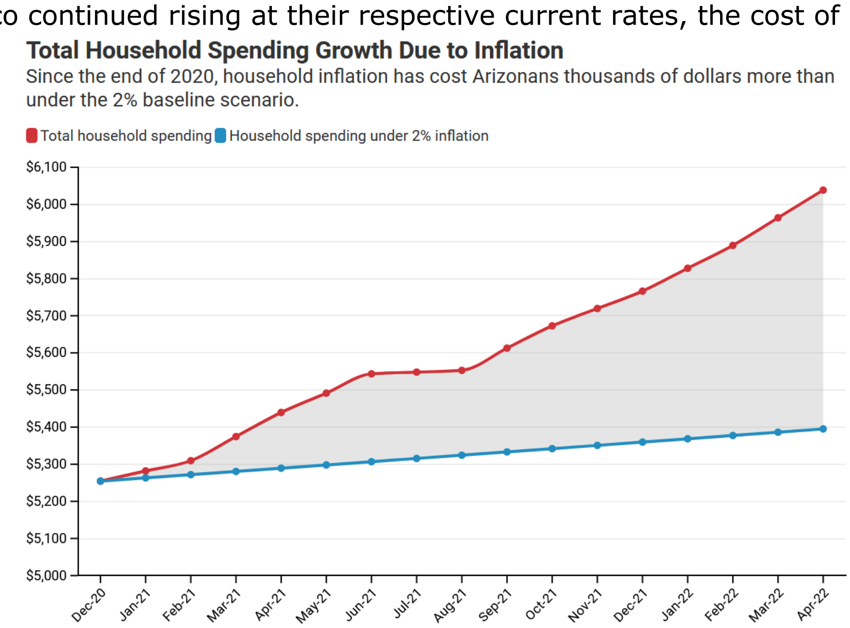
Inflation in Arizona: April 2022 Update

Consumer prices in the United States continued their record ascent in April, rising 8.3% over the last 12 months - among the highest rates in forty years. At 11.0%, price inflation in the Phoenix metropolitan area remains both well above the national average and at the highest levels ever recorded for the city. In fact, prices in the Phoenix area are rising faster than anywhere else measured by the BLS. Phoenix prices have been rising at an average rate of more than 1% per month, and at the current rate prices here will double in less than 5 years – versus 35 years at the 2% target rate. Price increases are concentrated in transportation, housing and food costs – with gasoline alone costing the average household $826 more.

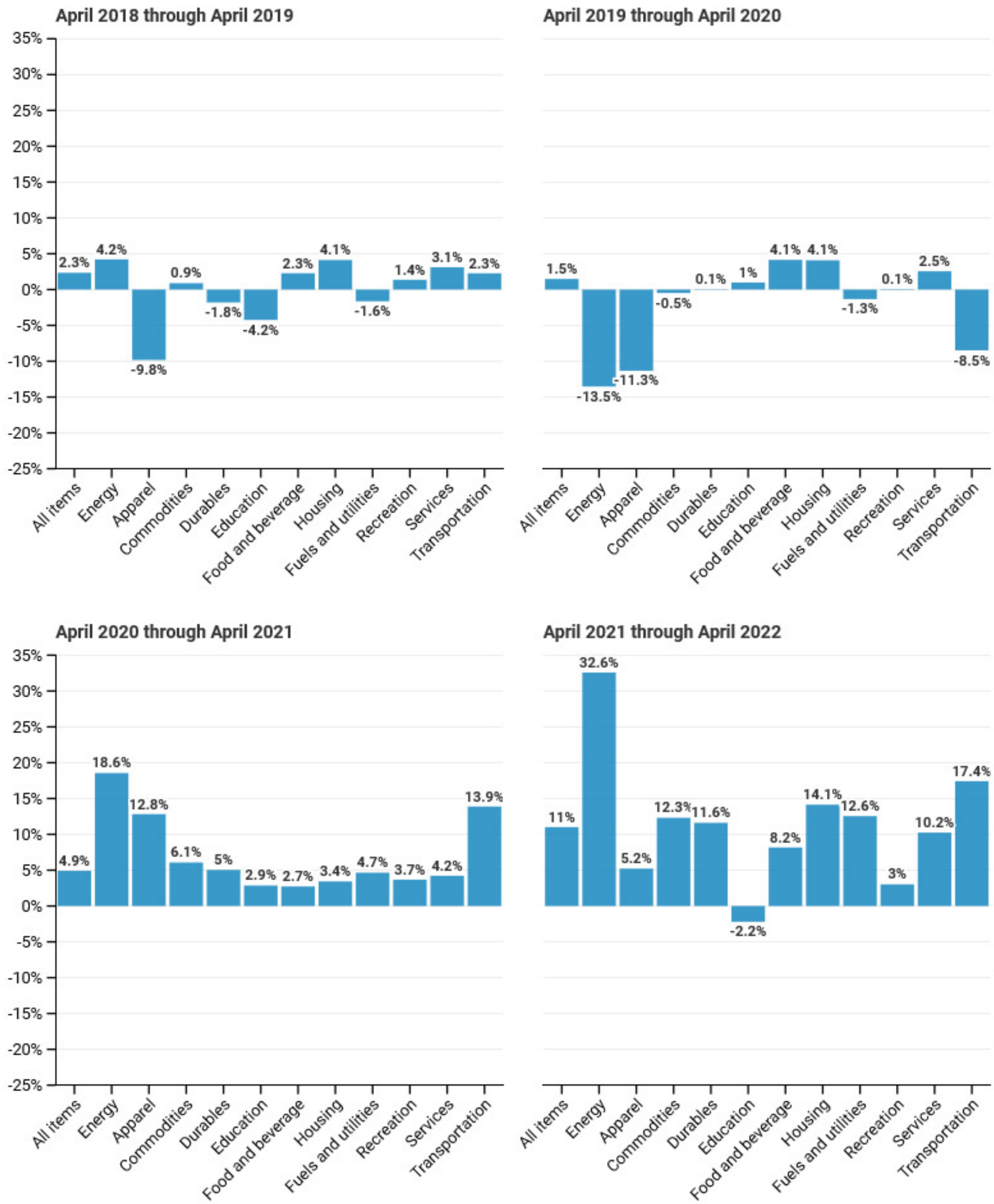
Inflation in Metro Phoenix was 2.5% between February and April and 11.0% over the Last 12 Months – April '21 through April '22 - (BLS CPI Survey)



- The typical Arizona household has spent a combined $5,955 more on food, housing, transportation, medical care, and other goods and services since the end of 2020.[i] The cost of food, housing, and gasoline accounts for nearly 60% of this.[ii]
- Inflation in metro Phoenix over the past 12 months was 2.7 points higher than the national average of 8.3%.
- Inflation remains high since spiking in the first quarter of 2021. Despite hope inflation would begin to cool, headline rates slowed only slightly from March, and core inflation accelerated. Inflation in particularly hard-hit areas like Phoenix and Atlanta reached new highs this month.
- Of the 23 urban consumer price indices tracked by the BLS, the Phoenix metro area continues to have the highest year-over-year rate of inflation.
- If prices in Phoenix and San Francisco continued rising at their respective current rates, the cost of living here would be higher than in San Francisco by 2034.[iii]
- Rents and the cost of housing in the Phoenix metro area grew by 14.8% over the past 12 months - 2.9 times the rate for the United States as a whole, according to the Bureau of Labor Statistics.[iv]
- After easing recently, national energy prices again may be rising, and US core inflation more than doubled from March to April. High inflation rates are likely to persist for many more months, and due to compounding the economic damage will only accelerate.



Source: BLS CPI-U Data



Proposed State & Local Policy Responses to Rising Inflation

In general, inflation is a national problem – the current crisis was stoked by policy responses at the Federal level to the pandemic and its associated recession. Federal policymakers, however, have been slow to react and public demand has left relatively more responsive state and local policymakers to explore various potential solutions. For example, at least 23 states have enacted or are considering gas tax holidays. Some potential policy options being considered are briefly discussed below.

Gas Tax Holiday

- A temporary suspension of State gasoline taxes would not substantially improve consumer welfare, and could exacerbate the short-term issues supporting high prices.
- The incidence of any excise tax is borne by both consumers and suppliers (with rare/theoretical exceptions), though the relative shares paid varies with how responsive supply and demand are to price changes.
- If consumers are particularly sensitive to price changes, and suppliers not very sensitive, then most of the incidence of a tax falls on producers (and most of the benefit of a holiday, conversely). If the reverse is true, most of the tax falls on consumers.
- In practice, economists typically believe both supply and demand for gasoline are relatively inelastic, particularly in the short run (relevant in the case of a holiday). For simplicity, we can assume the incidence of the tax is perfectly split (50/50).
- According to GasBuddy, the average price of a gallon of gasoline in Arizona is $4.64, and the state levies a $0.19 excise tax. Suspending the gas tax for 6 months might temporarily lower the price of gasoline to approximately $4.54 (a 2% reduction). For reference, one year ago the average price of gasoline was $3.08.
- A 6-month holiday could reduce state highway infrastructure revenue by approximately $377.5 million, with that surplus going to both consumers and producers. That approximately $189 million consumer surplus could stoke further demand, putting additional inflationary pressure on goods and services. Producer surplus is unlikely to support investment in supply increases, though, because it is both temporary and not a result of changing political or economic fundamentals. As a result, the price of gasoline and other goods and services could be pushed *higher* due to this holiday, and those conditions could persist after the holiday ends.
- The gasoline tax is a relatively efficient way for government to raise revenue – it is roughly equivalent to a user fee on consumers of highway infrastructure, and it is specific meaning the cost of the tax does not increase with the value of gasoline. Policymakers should focus their relief on windfall revenues from *ad valorem* taxes, like the sales tax – particularly where short-run demand is plausibly inelastic.

Rental Sales Tax Holiday

- A temporary (or permanent) suspension of Arizona's rental sales tax would have substantial benefits for consumers, and those benefits would accrue particularly to relatively lower-income consumers who are most harmed by inflation.
- In general, the short-term demand for housing is nearly perfectly inelastic – consumers need shelter, and cannot readily pursue substitutes (like moving away) in response to price changes. This means the incidence of sales taxes on rental charges will fall particularly hard on consumers.
- On the other hand, the short-run marginal supply of rental housing is probably more elastic than is obvious – owners of property other than dedicated apartments (about two-thirds of the rental stock) can readily move between rental housing, short-term vacation rentals, and owner-occupied housing, depending on relative price changes.
- Depending on where you live, nearly all cities in Arizona impose a sales tax on residential rentals, and the average rate is about 2.25%. This means assuming an average rent of $1,500/month, rental sales taxes add $405 per year to the cost of providing rental housing, not including administrative costs. In the short-term, a suspension of this tax would likely almost entirely benefit low-income renters. Longer-term, ending the tax will increase the returns to providing rental housing, which should increase the supply of rental units in the state.
- **A rental sales tax holiday or repeal could – depending on the incidence of the tax – alleviate nearly 10% of a taxed renters total inflation cost increases.**
- The rental sales tax is inherently unfair and inefficient – owner-occupied housing pays no rental tax on imputed rental income, and practically speaking could not. The tax is levied and administered entirely at the city level, and process and rate varies by jurisdiction. Revenues collected are relatively low – just $150 million statewide. Compliance costs of the tax are going to be extremely high relative to revenue collected. And unlike the specific gas tax, this sales tax is a percentage of rent charge - the tax increases with the cost of rental housing, meaning it is particularly burdensome during periods of rapid price appreciation.

[i] This figure corresponds to the data in the first graph. These are generated by distributing the consumer expenditure estimates from https://www.bls.gov/cex/tables/geographic/mean/cu-msa-west-2-year-average-2020.pdf across the individual months of 2020 and weighting them according to their corresponding CPI levels. We then assume that any price changes since January 2021 have resulted in increased costs relative to this average 2020 price level.

[ii] https://www.bls.gov/regions/mountain-plains/news-release/consumerexpenditures_denver.htm

[iii] According to nerdwallet.com, the cost of living in San Francisco is roughly double Phoenix currently. Assuming the current 11% and 5% inflation rates for Phoenix and San Francisco, respectively, persisted for 13 years, that gap would close and reverse.

[iv] For more on housing and what this means for the cost of living here, see our recently released Housing Affordability study (https://commonsenseinstituteaz.org/arizona-housing-affordability/).