COVID-19 Impacts on The Local Governments Sector[i]

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The COVID-19 Pandemic is expected to lead to a recession resulting from a decline in consumer spending associated with an increase in unemployment. Economic forecasts suggest that some of the hardest hit sectors include retail trade, arts, entertainment and recreation, and accommodation and food services.

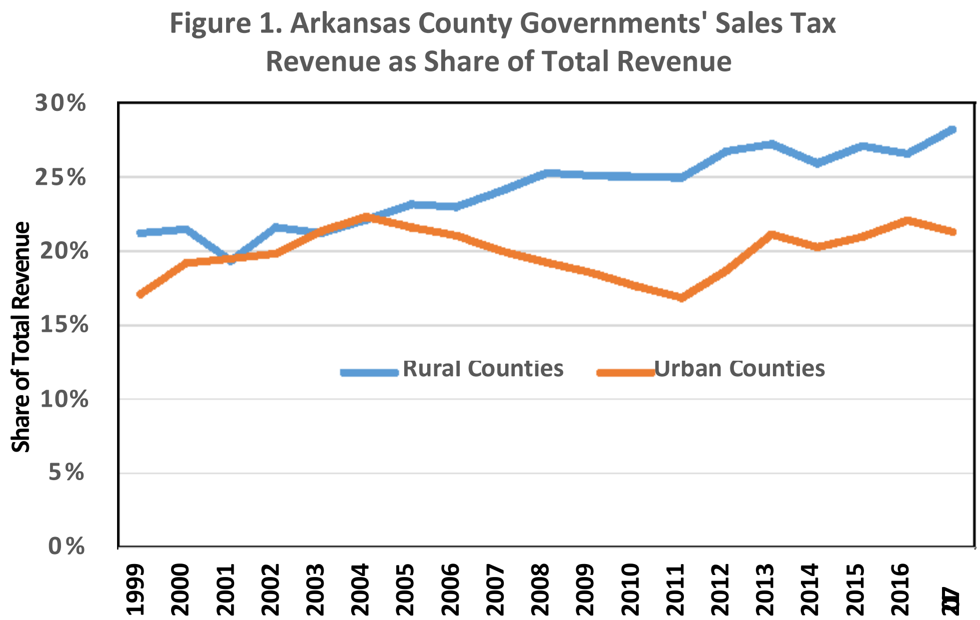
Because the retail trade and services sectors are expected to lose revenue, counties and municipalities will lose sales and use tax[3] revenue as a result of the COVID-19 pandemic. Counties will lose sales tax revenue from the statewide 0.5% sales tax for state and local roads and from their county sales tax. Municipalities will lose revenue from these two sources in addition to any municipal sales tax in their community. Also, municipalities and counties with a hamburger tax will lose revenue resulting from a decline in the travel and tourism business and a temporary restriction on dine-in restaurants.

This decline in sales tax revenue will have a substantial impact on the many counties that rely heavily on their local sales tax to generate revenue to pay for the services they provide to residents and businesses. In 2017, the local sales tax generated more revenue for county governments statewide than any other single revenue source. County governments statewide received one-fourth of their total revenue from the local sales tax in 2017. Therefore, a decline in sales tax revenue will affect their ability to provide needed infrastructure and services.

In addition to the importance of local sales tax revenue, counties and municipalities receive funding from the state, which in part is some of the revenue collected from the state general sales tax and other state use taxes. Examples of some state use taxes shared in part with counties and municipalities are the taxes on liquefied gas special fuels, motor fuel tax, motor vehicle registration and license fees, title transfer fees and others.

Rural counties are more dependent on local sales tax revenue and state revenue transfers than urban counties.[4] In 2017 rural counties received approximately 28% of their revenue from the sales tax (Figure 1) and 23% from state transfers. Conversely, urban counties obtained a larger share of their revenue from the property tax, approximately 26% in 2017. Since sales tax revenue fluctuates with the state of the economy, and since rural county governments are more dependent on sales tax revenue, the COVID-19 led recession will greatly impact the ability of rural counties to generate revenue to pay for infrastructure and services. Counties vary greatly in their reliance on the local sales tax to generate revenue, ranging from 0% in one county to 61% in another. Therefore, the short-term impact of COVID-19 will vary greatly among counties.

3 In this document the sales and use tax will be referred to as the sales tax.
4 Computed from County Legislative Audit Reports, Arkansas Legislative Audit.



Source: Computed from County Legislative Audit Reports, Arkansas Legislative Audit.

However, there are two mitigating factors that will reduce the effect of the COVID-19 led recession on local government revenue. First, as of January 1, 2020 counties and municipalities began collecting sales tax revenue from remote sellers due to legislation passed by the Arkansas Legislature in 2019. Second, the Coronavirus Aid, Relief and Economic Security (CARES) Act passed by the U.S. Congress provides some additional funding for families, unemployed workers, and state & local governments.

While these mitigating factors are expected to slow and limit the extent of the recession, they are not expected to provide enough assistance to help local governments avoid making budget cuts in 2020.

Long-Term Impacts

Long-term impacts are even harder to predict as we cannot with any accuracy predict how long the recession will last. Local governments that are required to cut their 2020 budgets may delay upgrading and maintaining their infrastructure of roads, bridges, water & sewer systems, solid waste facilities, etc. Delaying the maintenance and upgrading of infrastructure will likely increase the future cost.

Many rural counties were struggling, even before COVID-19, to generate enough revenue to provide needed infrastructure and services. Since these same counties will likely be under pressure to reduce their FY20 budgets, it will be even more difficult for them to maintain and upgrade their infrastructure and services in the future.

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[i] This article is extracted from a recent publication titled "**COVID-19 Impacts on Arkansas' Agricultural and Rural Economies**" by John Anderson, et al, University of Arkansas System, April 7, 2020.