July 1995
JULY 1995

National Economic Trends

Did Big Tax Payments and Late Tax Refunds Decrease Consumption?

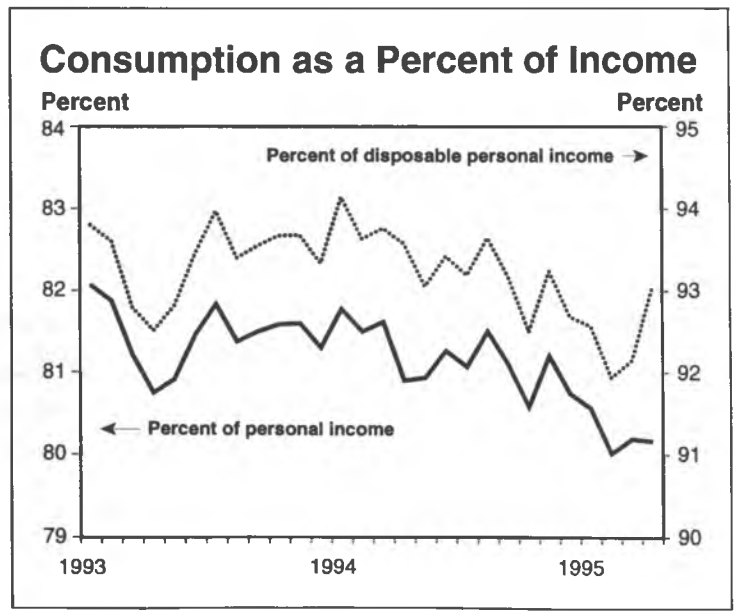
Nominal personal consumption expenditures grew 0.1 percent between March and April after growing 0.7 percent between February and March. Many analysts attributed this slowdown in consumption to a large increase in personal income tax payments and slower-than-usual tax refunds. Early this year, the IRS was slow in issuing some refund checks, partly because of a new program implemented to reduce fraudulent claims for tax refunds. According to one estimate, the dollar value of the delay reached $6 billion. At the same time, personal tax payments in April were nearly 10 percent higher than the payments made in April of last year because of lower deductions for mortgage interest paid and payments for back taxes arising from the Omnibus Reconciliation Act of 1993.

Households, faced with large tax payments and slow refunds, saw their disposable personal income fall. (Disposable personal income is personal income minus tax and non-tax payments.) Any increase in tax payments or delay in tax refunds decreases disposable personal income, but does not affect personal income. So, if households consumed less to offset their tax payments or slow refunds, the ratio of consumption to personal income would have fallen because consumption would have declined while personal income would have remained constant. In contrast, the ratio of consumption to disposable income would have remained nearly unchanged because both quantities would have fallen.

Households could have left their consumption unchanged and absorbed the higher net tax payments by reducing their savings. The ratio of consumption to personal income would then have remained constant, but the ratio of consumption to disposable personal income would have risen because the tax payments and slow refunds would have reduced their disposable personal income.

As the graph below shows, between March and April of this year (the last data plotted), consumption remained unchanged relative to personal income but rose relative to disposable personal income. This contradicts the story that higher taxes and slow tax refunds lowered consumption. It does support the hypothesis that households absorbed the tax payments and slow refunds by saving less. In fact, personal saving fell $50 billion between March and April, remarkably close to the $54 billion increase in net tax payments between the same two months.

— Peter Yoo



Views expressed do not necessarily reflect official positions of the Federal Reserve System

National Economic Trends is published monthly by the Research Division of the Federal Reserve Bank of St. Louis. For more information on data, please call (314) 444-8573. Single-copy subscriptions are available free of charge by writing Research Division, Federal Reserve Bank of St. Louis, Post Office Box 442, St. Louis, MO 63166-0442 or by calling (314) 444-8808 or (314) 444-8809. Information in this publication is also included in the Federal Reserve Economic Data (FRED) electronic bulletin board. You can access FRED with a personal computer and a modem at 314-621-1824.