Comparing Alternative Measures of Income

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Objectives of presentation

- Consider alternative BEA measures of state and local area personal income that better address user needs to estimate
  - Capacity to spend
  - Size of tax base

Presentation outline

- Compare three widely used measures of household income
  - Highlight differences in measures and uses
- Discuss alternative uses of personal income
- Describe possible alternative BEA measures that better serve these uses

Widely used household income measures

- BEA personal income
- Census Bureau money income
- IRS adjusted gross income

BEA personal income

- The most timely and comprehensive measure available of household income
- Timely: 4 months after the reference quarter
- Comprehensive: measures income received by persons from
  - production (returns to labor and capital)
  - business and government transfers
  - includes income of individuals and of non-profits serving households
  - available for states and local areas

Components of personal income

- Wages and salaries
- Employer payments for other compensation items, such as health insurance and pensions
- Proprietors income (sole and partnerships)
- Dividends, interest and rent (property income)
- Government and business transfers
  – (incl. Social Security, UI, Medicare/Medicaid, workers' compensation benefits)

State and local area personal income are widely used

- Evaluating regional consequences of alternative tax policies
- Forecasting sales tax revenue for state and local governments
- Forecasting sales for retailers
- Estimating economic impact of retirement migration
- Distributing over $170 billion of Federal funds to states
- State rankings

Census Bureau money income

- Total pre-tax cash income, excluding some lump sums and capital gains
- Uses:
  - Official poverty estimates
  - Income distribution analysis
- From Current Population Survey, Annual Social and Economic Supplement
- Alternative measures are also produced to better measure economic well-being
  - Exclude taxes
  - Include employer and govt. noncash benefits and capital gains/losses

Comparison of SPI and MI (2001)

US personal income =
$8.679 trillion

SPI includes, MI excludes
$2.240 trillion

- Property income of pension assets
- Employer contributions for pensions and insurance
- Transfer payments such as Medicare, Medicaid

MI includes, SPI excludes
$813 billion

- Retirement benefits
- Personal contributions for social insurance

SPI-derived money income = $7.252 trillion

Census US money income = $6.446 trillion

IRS adjusted gross income

- Taxable income reported on the Federal income tax return
- Includes:
  - Capital gains
  - Taxable portion of pensions, IRA distributions, social security
  - Personal contributions for social insurance
- Excludes
  - Income not reported for tax purposes

Pluses and minuses of income measures

- BEA personal income
  + timely and available in detail for states
  – may not be best measure capacity to spend or tax base
- Census money income and alternate measures
  + better measures capacity to spend
  – not as timely and subject to sampling variability for states
- IRS adjusted gross income
  + better measures tax base
  – not as timely and only those filing tax returns

Meeting BEA user needs

- State revenue and budget projections require a measure of income closer to taxable income
- Users interested in capacity to spend require a measure closer to money income
- All users need data that are timely and available for states and local areas
- Objective is to develop alternative BEA household income measures to address these user needs

Income variant 1

- Drop property income earned by
  - non-profit institutions serving households (NPISH)
- Rationales:
  - Income of these is not viewed by household as spendable
  - Income is not taxable

Income Variant 1

- Income from NPISH small
  - Less than 0.5 percent of personal income for the Nation
  - Differences could be greater at state level

Income variant 2

- Drop:
  - Employee and employers contributions for pensions
  - Investment earnings on pension accounts
- Add: pension disbursements
- Rationales:
  - Pension disbursements are taxable, contributions and earnings are not
  - Pension disbursements are available for spending
    - But: it is possible to borrow from many pension plans
  - Could evaluate regional consequences of retirement policies

Experimental estimates of income variant 2

- Estimated for 1989-97
- Results for 1997:
  - "Adjusted" personal income lower for all states except Florida--U.S. -2.2 percent
  - Florida, Arizona, Delaware, and Michigan relative gainers
  - DC, Alaska, Maryland, Virginia, and Hawaii relative losers

Alternative source data on pensions IRS Individual Master File Tax Data

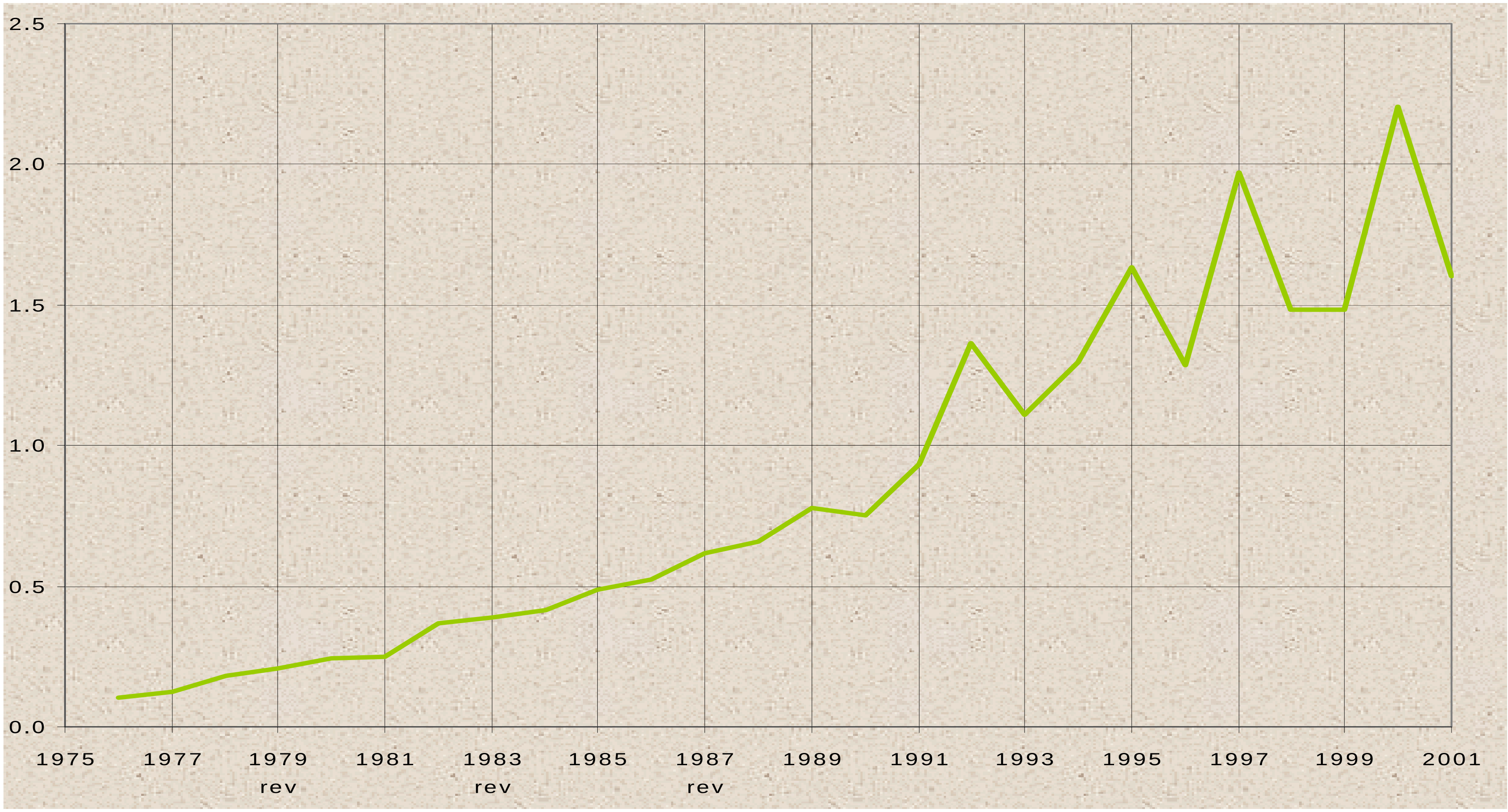
- IRS Pros
  - Tabulation of tax return information
- IRS Cons
  - Only taxable pension and annuity disbursements
  - Covers only income reported for tax purposes
  - Dependent on tax law which frequently changes

Alternative source data on pensions
Census Current Population Survey Data

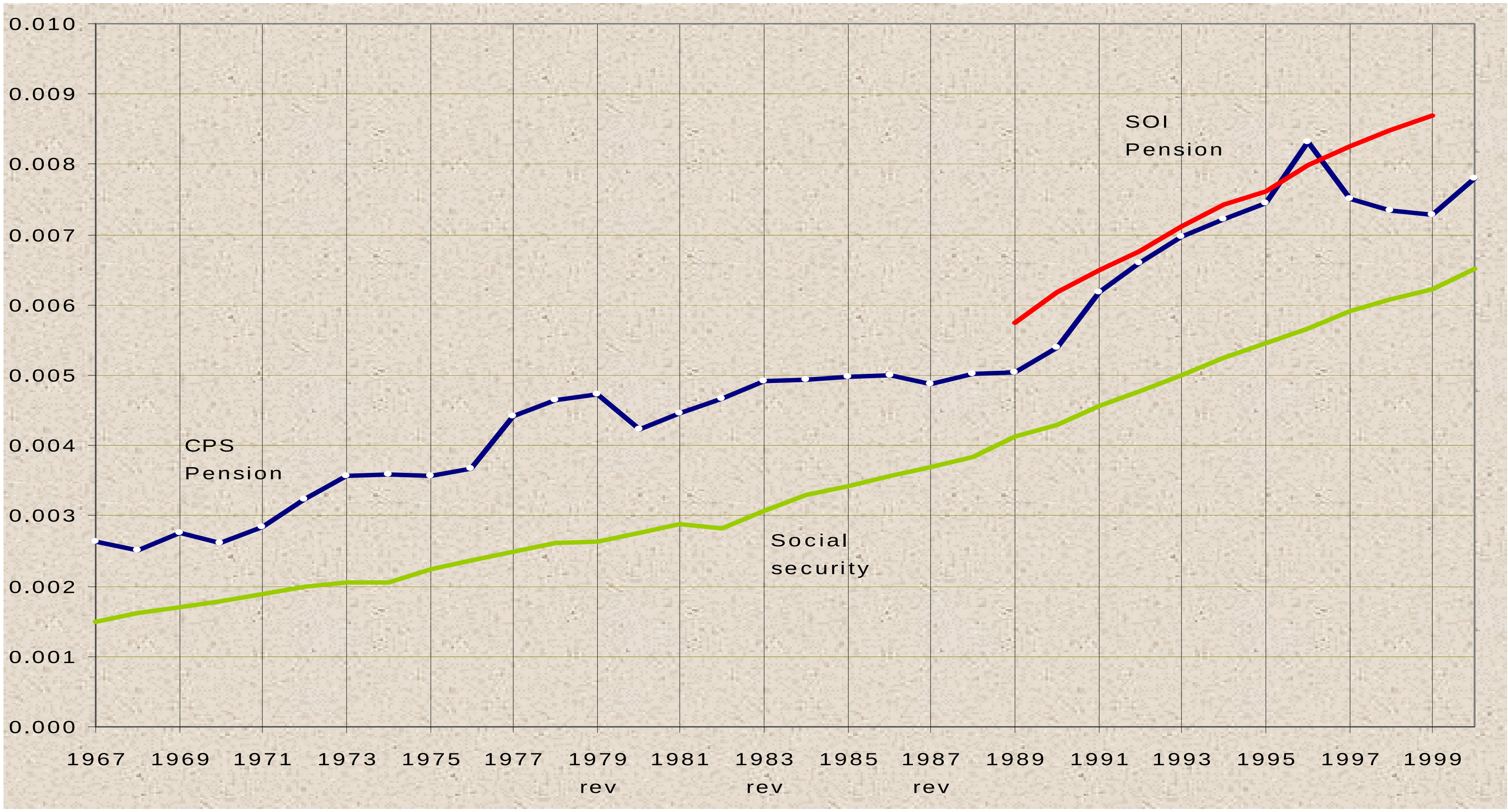
- CPS March Supplement Pros
  – Series goes back to 1977 for all states
  – More timely than IRS
- CPS Cons
  – Based on survey: sampling variability
  – Some adjustments in processing procedures and in weighting over time

Raw CPS Pensions—Nevada

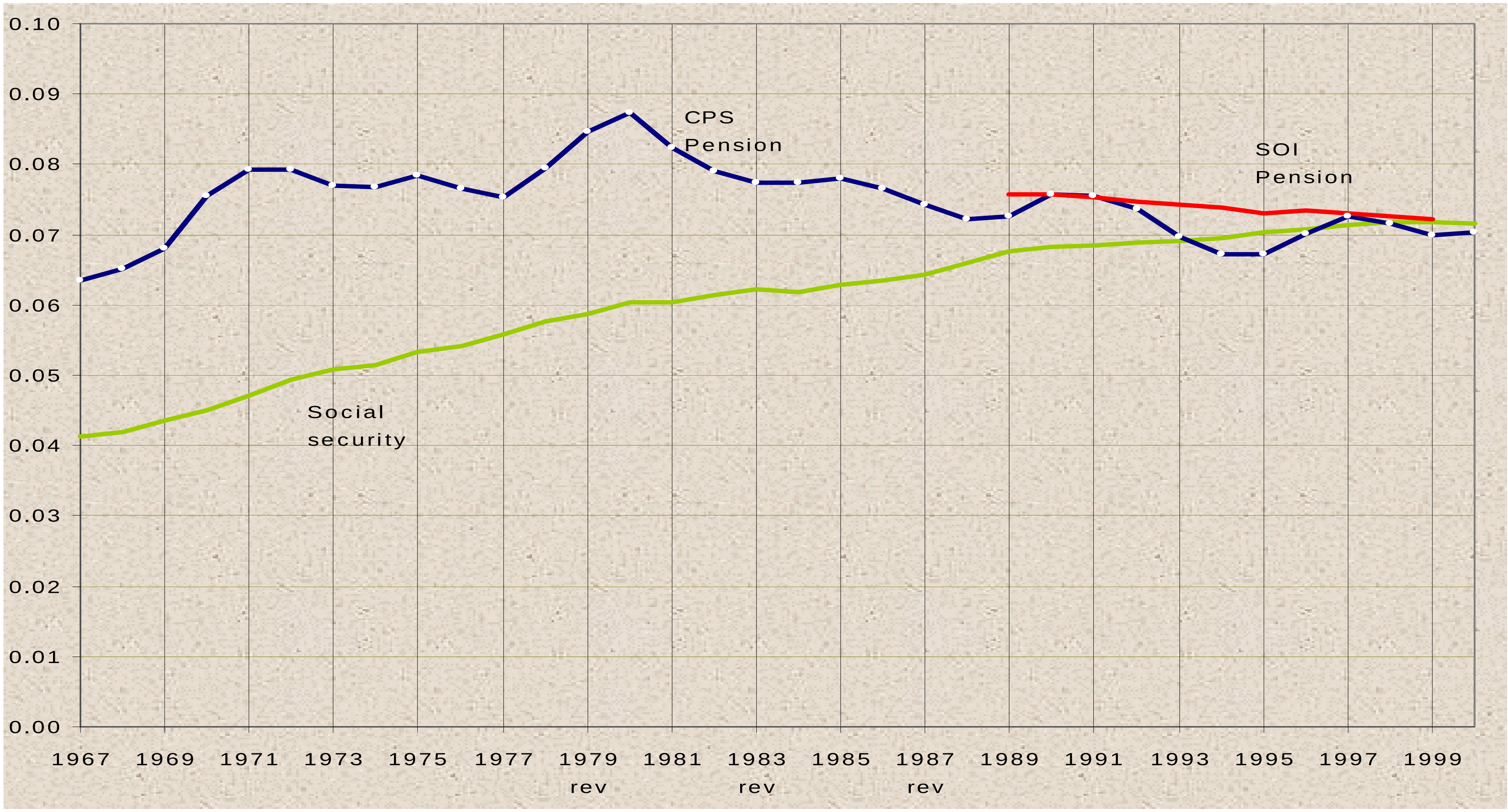
(billion dollars)



Pension Disbursement Share of Nation—Nevada



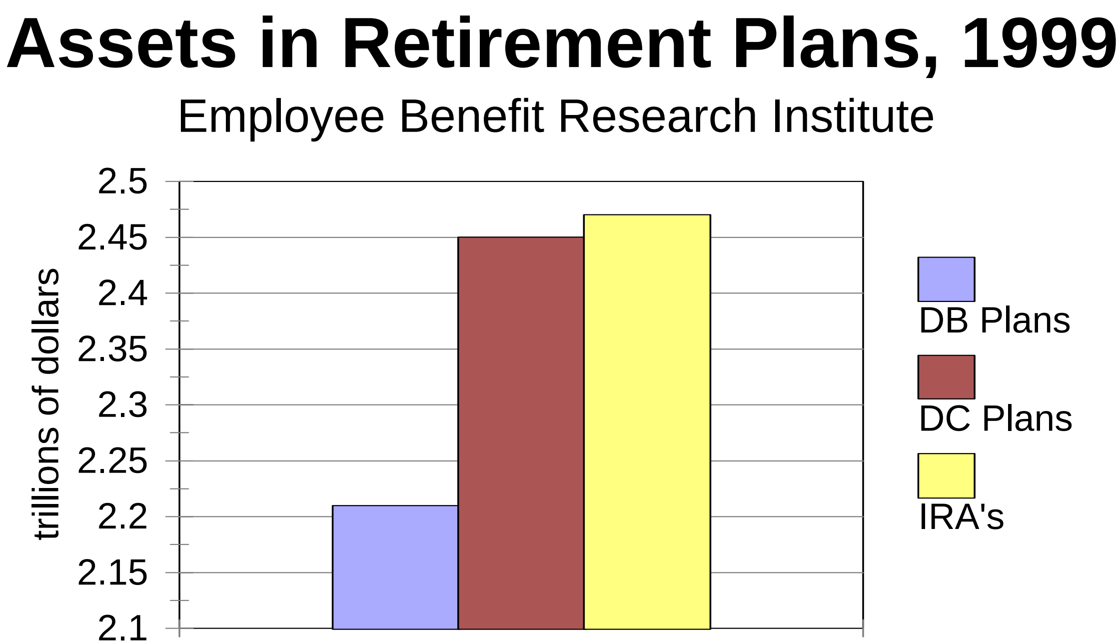
Pension Disbursement Share of Nation—Florida



Income variant 3

- Income variant 2 plus other retirement income
- Include income from other tax-preferred retirement plans
  - Individual Retirement Account (IRA) Distributions
  - Deferred compensation to government and nonprofit employees (Section 457 pension plans)
- Rationales are similar to treatment of pensions
  - IRA distributions are available for spending
  - Continued shift in pension plans to defined contribution makes NIPA pension distribution less relevant to State users

IRA Assets Are Substantial



Experimental Estimates of Income Variant 3

- IRA distributions add about 20% to pension distributions in 1997
- Regional distribution of IRAs differs from pension distributions
  - For pension distributions, government states have highest per capita receipts
  - For IRA distributions, high per capita income states have highest per capita receipts

Income variant 4

- Income variant 3 plus realized capital gains/losses
- Rationales
  - Capital gains are taxable (but what about losses?)
  - Capital gains are available to spend
    - But: consumers may spend more by saving less even if capital gains are not realized
- An even more expansive definition might include unrealized capital gains

Summary

- Not one definition that can serve all purposes
- Should BEA pursue generating alternative income estimates along lines discussed in the paper?
  - How well will these alternative measures address user needs?