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
- 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

Assets in Retirement Plans, 1999
Employee Benefit Research Institute

DB Plans
DC Plans
IRA's
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?