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Using State Personal Income to Compare Taxes Across States
A MassBudget Data Droplet

Comparing tax and spending policies across states in a meaningful way across states or over time can be complicated by differences in population size, economic strength, or the changing cost of living. To account for these challenges, MassBudget often analyzes spending or taxation as a percent of a state's economy. There are many ways to measure an economy, but for these purposes we typically use the state's total personal income. For example, our Budget Browser allows for adjusting state spending by various inflation measures, including "Economic Growth," which is the term used there for adjusting by state personal income.

WHY ANALYZE SPENDING OR REVENUE AS A PERCENTAGE OF THE ECONOMY?

A state's budget or taxes represent a set of decisions about how much to pay for public goods such as education, transportation, housing, or health care. It is useful to consider a state's total resources—essentially, the size of the economy—and use that base to compare that to how much the state chooses to spend on these various priorities.

If we just looked a total dollar amounts or even per capita amounts, we would not be taking into account that different states have differing abilities to raise or spend more money. For example, two states with very different average incomes could raise the same amount of money in taxes per capita, but the less wealthy state would have to tax its residents at a much higher rate to reach this same revenue level.

WHY USE STATE PERSONAL INCOME AS A MEASURE OF THE ECONOMY?

State personal income usually mirrors a state's economy and is a good measure of a state's "ability to pay" for government services. Looking at government spending or tax revenue as a percent of a state's personal income makes sense because residents pay taxes out of various types of income, and a state's budget is largely dependent on the tax revenue the state choses to raise. Similarly, personal income is a useful measure for tracking changes over time, considering whether taxes or spending is rising or falling as a share of our overall economy

WHAT COUNTS TOWARDS "STATE PERSONAL INCOME"?

State personal income is a measure of all the income from a variety of sources received by on on behalf of residents of a state. It includes salary, wages, and benefits from work, income from owning a home or a business, interest or dividends from financial assets such as savings accounts, stocks, or bonds, and income from the government such as Social Security or cash assistance. This measure is developed by the U.S. Bureau of Economic Analysis (BEA) each year. The BEA estimates do not include income from capital gains, and they also adjust to exclude income earned in a given state by out-of-state residents.

HOW DOES MASSBUDGET MODIFY OFFICIAL MASSACHUSETTS STATE PERSONAL INCOME ESTIMATES?

MassBudget often makes two important adjustments the official state personal income estimate provided by the BEA. These adjustments were recommended in a memo from the Federal Reserve Bank of Boston, "Assessing Alternative Measures of State Income." To capture state income not included in the BEA estimates, we add in an estimate of realized capital gains income provided by the state Department of Revenue, and we make a residential adjustment to include back in the BEA estimate of earnings of residents out-of-state residents who work in Massachusetts. Since we only have these data for Massachusetts, however, do not make these adjustments when conducting 50-state comparisons.

ANOTHER NOTE OR TWO ABOUT USING STATE PERSONAL INCOME ESTIMATES

The BEA personal income measure does not include corporate profits, even though corporate profits represent an additional source of taxable income used widely to help support state government. Due to the multi-state nature of large corporations, it is difficult to allocate the proportional amount of corporate profits earned in a given state. Accordingly, MassBudget does not make an adjustment to state personal income estimates to include corporate profits.

Finally, it is very important when making comparisons over time to consider similar points in a business cycle. During periods of economic contraction or recession, the state personal income typically drops, but state spending often increases as the demand for services meeting critical needs increases. Conversely, during periods of economic recovery, government spending may not increase as rapidly as a quickly growing economy.