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How to Evaluate Comparisons and Rankings

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Editor's Note: Originally published in the April 2010 issue of Tax Facts, Jim Nowlan's article on evaluating tax burden studies has been updated to reflect more current data.

People are fascinated by comparisons and rankings among the states. The rankings provide context in which to evaluate public finance and performance measures.

Yet comparisons should be viewed with caution. For example, some rankings lack the full context in which they should be evaluated; other rankings include too much in a comparison, effectively comparing apples with oranges. Other rankings fail to appreciate the differing capacities of states to fulfill their financial commitments.

Below we illustrate these cautionary tales and provide readers our perspectives on the most illuminating ways to compare Illinois with other states on financial indicators.

First, compare state and local rankings together, rather than just state rankings alone.

Some analysts compare burdens for *either* the state or local levels of government. Local governments are, however, creatures of the states; residents pay taxes to both state and local governments, and costs of major governmental functions such as education and transportation are shared by the two levels of government. Thus, we find it more telling to compare combined tax burdens of state *and* local governments.

This reporting of combined tax burdens also makes sense because in Illinois the state has traditionally imposed a lighter tax burden than the typical state, while its local governments extract a heavier burden from their residents than in most states. Illinois ranked 23rd among the states in total *state* taxes as a percent of personal income in fiscal year 2012, while Illinois' ranking for *state and local* taxes was 10th (a ranking of #1 would represent the highest taxes).[1]

Illinois' personal income tax is largely a state tax. Illinois ranked 34th in state individual income tax revenue as a percentage of personal income in 2010 (before the 2011 temporary rate increases) and 16th in 2012 (after the rates were increased). On the other hand, property taxes in Illinois are largely a local tax, and we rank 11th highest in 2010 and 9th highest in 2012 terms of property taxes collected as a percentage of personal income.

Second, compare states on their respective total *taxes*, rather than on their *total revenues*.

Major state and local taxes are comparable; all states tax some combination of property, income, and sales, and generally all three. Non-tax revenues depend upon the traditions of the respective states, and are somewhat misleading if compared. For example, Illinois has a strong tradition of non-governmental hospitals, often religious in origin; in other states, governments at the regional and local levels have taken responsibility for the hospital function.

As a result, according to the US Census Bureau, in 2011 Illinois governments derived only $1.46 billion from government hospital revenues, whereas neighboring Indiana, with half Illinois' population, generated $2.74 billion from hospital revenues. A few states operate liquor stores, which generate governmental revenues; Illinois does not. Illinois has a tradition of strong, private colleges and universities, which reduces the reliance on state institutions; western states have few private colleges and large public systems.

Possibly as a result of these differences, state to state, in reliance on government to provide functions, the Federal Tax Administrators, using Census Bureau data, found total state

[1] Unless otherwise noted, the figures in this essay are from the U.S. Bureau of the Census and Bureau of Economic Analysis.

and local government revenues in Illinois in 2011 to rank 39^{th} among the states on a percentage of personal income basis. In contrast, Illinois ranks 17^{th} on the more familiar basis of total tax collections.

Third, use *percentage of personal income* or state GDP as the basis for comparison, rather than *per capita* indicators.

Illinois' personal income per capita in 2011 was 104 percent of the national average; Illinois is a little wealthier than average. Connecticut, the wealthiest state, has 136 percent of the national average in per capita income. In contrast, poor states such as Alabama and Mississippi have personal income per capita of just 82 percent and 76 percent, respectively, of the national average.

It would be unfair to compare states with such varied fiscal capacities on measures of, say, tax revenue per capita. Mississippi could have a far higher tax rate than Connecticut and still produce much less per capita than the latter state; measuring tax revenue as a percentage of personal income provides a more even comparison of tax burden.

By the way, use of these indicators tends to lower Illinois' rankings. For example, in 2011 Illinois ranked 15^{th} highest in per capita state and local tax revenue, while we were only 17th on the basis of such tax revenue as a percent of personal income.

Finally, use all rankings and comparisons with some caution.

The dollar differences between a 24^{th} and a 26^{th} ranking may be miniscule, and thus insignificant. More meaningful would be to compare a state's ranking with the top ten states and the bottom ten. This will provide a decent context for understanding tax burdens. Also look closely at the actual fiscal figures listed in the rankings. These figures provide the raw data on which the rankings are based. On some rankings, the spread of the actual figures might be quite narrow; in others, quite broad.

As a final note, it takes time for the data to become available for these evaluations, and law-changes in the 50 states during the intervening years make relying too heavily on comparison even more perilous. In Illinois rankings are in flux as a result of the significant 2011 income tax rate increases which began to roll back on January 1, 2015.