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INCOME GAPS HIT RECORD LEVELS IN 2006, NEW DATA SHOW Rich-Poor Gap Tripled Between 1979 and 2006

By Arloc Sherman

New data from the Congressional Budget Office (CBO) show that in 2006, the top 1 percent of households had a larger share of the nation's after-tax income, and the middle and bottom fifths of households had smaller shares, than in any year since 1979, the first year the CBO data cover. As a result, the gaps in after-tax incomes between households in the top 1 percent and those in the middle and bottom fifths were the widest on record.

The data reveal starkly uneven income growth over recent decades. Between 1979 and 2006, real after-tax incomes rose by 256 percent — or \$863,000 — for the top 1 percent of households, compared to 21 percent — or \$9,200 — for households in the middle fifth of households and 11 percent — or \$1,600 — for households in the bottom fifth. (See Figure 1, next page.) In 2006, the average household in the top 1 percent had an income of \$1.2 million, up \$63,000 just from the prior year; this \$63,000 gain is nearly two times the *total* income of the average middle-income household.¹

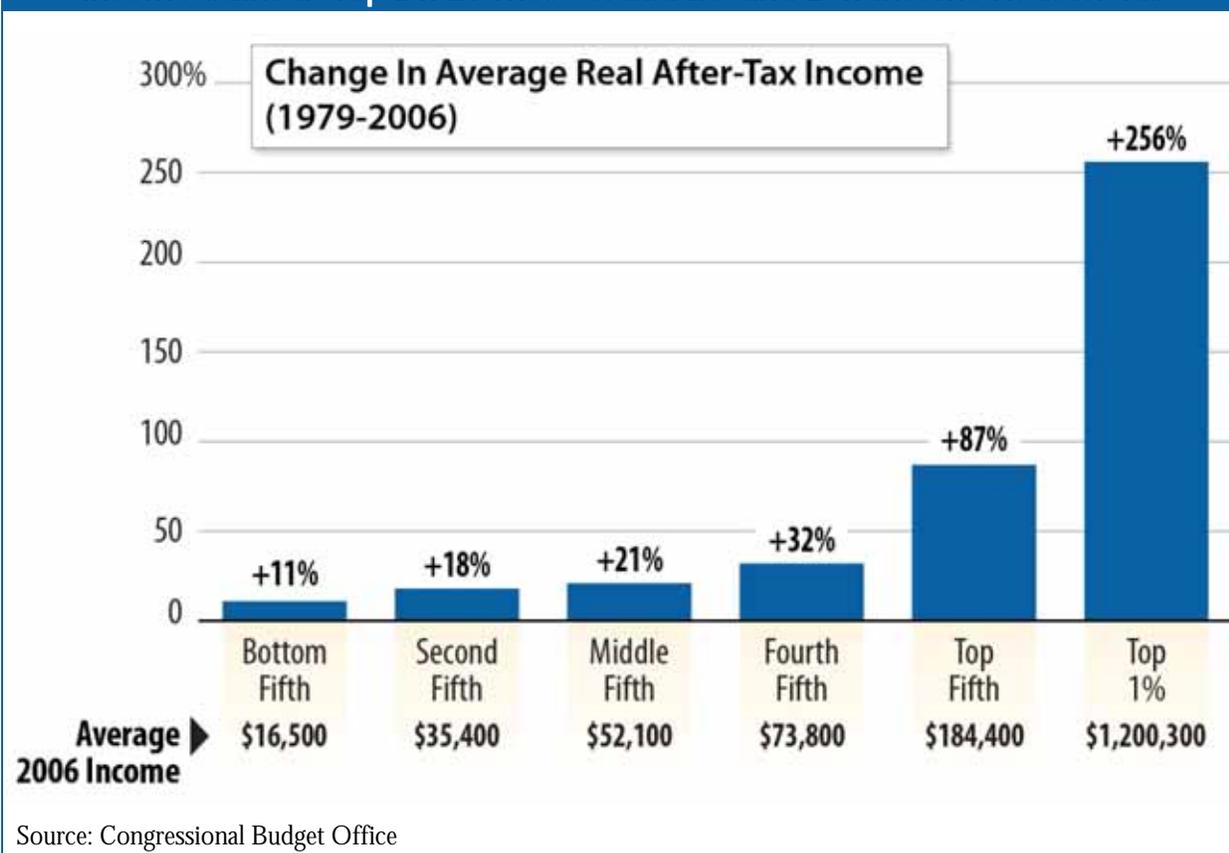
In addition, the share of national after-tax income going to the top 1 percent of households more than doubled between 1979 and 2006, rising from 7.5 percent to 16.3 percent.

Taken together with prior research, the new data suggest greater income concentration at the top than at any time since 1929.² The data precede the current recession, which is likely to reduce the income of the wealthiest Americans substantially, given the decline in the stock market, and thereby shrink somewhat the income gap between rich and poor households. But there was a similar development when the dot.com bubble burst a few years ago — income at the top of the income scale fell sharply — and it turned out to be just a speed bump. Incomes at the top more than made up the lost ground from 2004 to 2006.

¹ The record income gain among households in the top 1 percent is \$184,000, in 2005. Figures throughout this paper were adjusted by CBO for inflation and are presented in 2006 dollars.

² Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1913-1998," *Quarterly Journal of Economics*, 118, 2003. Piketty and Saez's tables have been updated through 2006 at <http://emlab.berkeley.edu/users/saez/>. The Piketty and Saez data are discussed further in Chye-Ching Huang and Chad Stone, "Average Income in 2006 up \$60,000 for Top 1 Percent of Households, Just \$430 for Bottom 90 Percent," Center on Budget and Policy Priorities, revised October 22, 2008, <http://www.cbpp.org/3-27-08tax2.pdf>.

**FIGURE 1:
Income Gains at Top Dwarf Those of Middle- and Low-Income Households**



Changes in Inequality Since 1979

The gap in income between the wealthiest Americans and all others has grown strikingly in recent decades, the CBO data show. In 1979, when the data begin, the average after-tax incomes of the top 1 percent of households were 7.9 times higher than those of the middle fifth of households. By 1989 they were 13.5 times higher.

Top incomes continued climbing in the 1990s, to 20.6 times higher than the middle fifth of households in 2000 and 21.3 times higher in 2005. By 2006, top incomes were 23.0 times higher than those of the middle fifth — nearly tripling the income gap between the top 1 percent and those in the middle since 1979.

The gap between the top 1 percent and the *poorest* fifth of Americans widened even more dramatically over this same period. In 1979, the incomes of the top 1 percent were 22.6 times higher than those of the bottom fifth. Top incomes continued climbing to 63.1 times higher in 2000 and 72.7 times higher by 2006 — more than tripling the rich-poor gap in 27 years.

The CBO data also show that between 1979 and 2006:

Table 1: Average After-Tax Income by Income Group, 1979-2006 (in 2006 dollars)				
Income Category	1979	2006	Percent Change 1979-2006	Dollar Change 1979-2006
Lowest fifth	\$14,900	\$16,500	11%	\$1,600
Second fifth	\$30,100	\$35,400	18%	\$5,300
Middle fifth	\$42,900	\$52,100	21%	\$9,200
Fourth fifth	\$56,100	\$73,800	32%	\$17,700
Top fifth	\$98,900	\$184,400	87%	\$85,500
Top 1 Percent	\$337,100	\$1,200,300	256%	\$863,200

Source: Congressional Budget Office, *Effective Federal Tax Rates: 1979-2006*, April 2009.

- The average after-tax income of the top 1 percent of the population more than tripled, from \$337,000 to over \$1.2 million. As noted, this represented an increase of \$863,000, or 256 percent.
- By contrast, the average after-tax income of the middle fifth of the population rose from \$42,900 in 1979 to \$52,100 in 2006 — a relatively modest gain of \$9,200 or 21 percent over a 27-year period.
- The average after-tax income of the poorest fifth of the population rose only from \$14,900 to \$16,500, an increase of \$1,600 or 11 percent.³

Trend of Rising Inequality Continued in 2006

The new data CBO released for 2006 show that income inequality widened significantly over the previous year. After-tax incomes rose by more than twice the rate among the top 1 percent of households than among any other income group. (See Table 2.)

As a result, the share of the nation's overall after-tax income going to the top 1 percent rose from 15.6 percent in 2005 to 16.3 percent in 2006. This income amounts to approximately \$61 billion in additional income for the top 1 percent.

Table 2: Change in Real Average After-Tax Income, 2005 to 2006 (in 2006 dollars)		
Income Category	Dollar Change	Percent Change
Lowest fifth	\$600	+3.8%
Second fifth	\$400	+1.1%
Middle fifth	\$300	+0.6%
Fourth fifth	\$1,000	+1.4%
Top fifth	\$63,300	+3.5%
Top 1 Percent	\$95,700	+8.7%

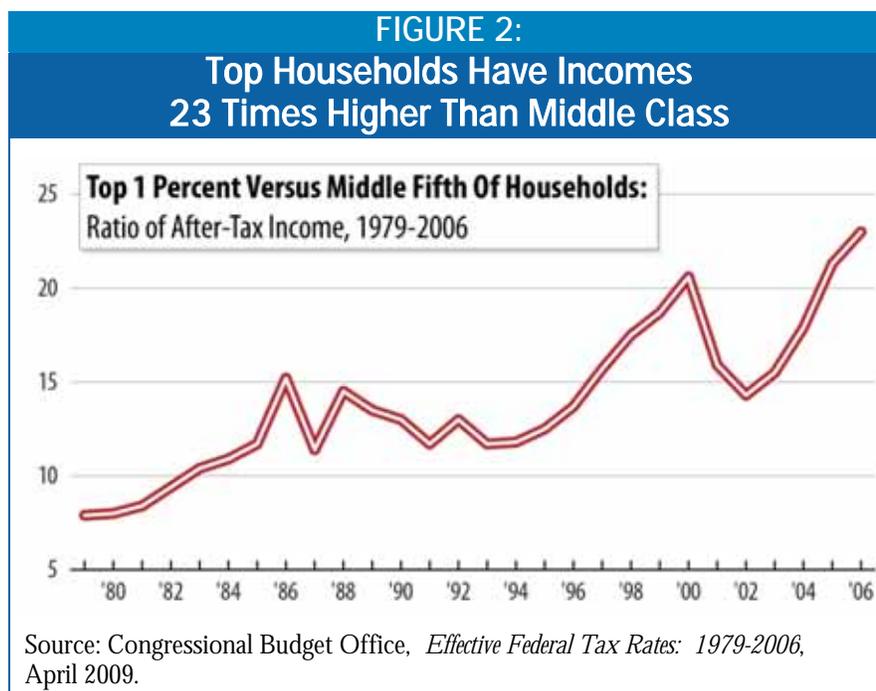
Source: Congressional Budget Office, *Effective Federal Tax Rates: 1979-2006*, April 2009.

³ In the CBO data, the income categories do not represent a fixed group of people from year to year but rather represent the people who fall into the various income categories in the year in question. As a result, the people in a given income category shift somewhat over time. This does not alter the findings of this paper but means that the trends shown in the data do not necessarily match the income trajectories of individual households.

Current Recession Likely to Reduce Inequality, at Least Temporarily

The CBO data do not show the effect of the recession that began in 2007. The recession is likely to lower incomes for all income groups, but if the previous recession is any guide, incomes may fall most sharply for the wealthiest households, due in large part to the severe drop in the stock market.

In the recession of 2001, the bursting of the dot-com bubble reduced inequality sharply. Real after-tax incomes of the top 1 percent fell by more than one-third between 2000 and 2002, while remaining close to flat for the middle and bottom fifths of the population, according to CBO. As a result, while in 2000 the top 1 percent had incomes 20.6 times higher than households in the middle, by 2002 their incomes were just 14.3 times higher. Nonetheless, the income gap resumed its expansion as the economy recovered, hitting a new high of 23 percent in 2006. (See Figure 2.)



Not all recessions follow this pattern, however. Inequality continued rising throughout the back-to-back recessions of the early 1980s, the CBO data show. The short- and long-term effects of the current recession will depend on the course of the stock market, trends in the labor market (including decisions about executive compensation packages, bonuses, and wages) and in the economy more broadly, and public policy choices.

Federal Tax Policies Exacerbating Income Gaps

Legislation enacted under the Bush Administration has provided taxpayers with about \$1.7 trillion in tax cuts through 2008. These large tax reductions have made the distribution of after-tax income more unequal. Because high-income households received by far the largest tax cuts — not only in dollar terms but also as a percentage of income — the tax cuts have increased the concentration of after-tax income at the top of the spectrum.

The CBO data do not provide a direct measure of the impact of these tax policy changes because they also reflect the effects of changes in household incomes and other factors that influence tax payments. However, estimates by the Urban Institute-Brookings Institution Tax Policy Center that consider *only* the impact of the tax policy changes provide definitive evidence that the tax cuts have widened income inequality. As a direct result of the tax cuts enacted since 2001, the Tax Policy Center found that in 2006:⁴

- Households in the bottom fifth of the income spectrum received tax cuts averaging \$20, which raised their after-tax incomes by an average of 0.3 percent.
- Those in the middle fifth of the income spectrum received tax cuts averaging \$740, which raised their after-tax incomes by an average of 2.5 percent.
- The top 1 percent of households received tax cuts averaging \$44,200, which raised their after-tax incomes by an average of 5.4 percent.
- Within the top 1 percent, those with incomes exceeding \$1 million received tax cuts averaging \$118,000, which raised their after-tax incomes by an average of 6.0 percent.⁵

Furthermore, additional tax cuts have been enacted since 2006, and some of the tax cuts enacted between 2001 and 2006 are still being phased in. The tax cuts still phasing in are heavily tilted to people at the top of the income scale; these include the temporary elimination of the tax on the nation's largest estates and two income-tax cuts that started to take effect in 2006 and go almost exclusively to high-income households.⁶

In 2010, when all of the 2001-2008 tax cuts will be in effect, their combined effect will be to reduce taxes by an average of 0.7 percent — or \$74 per household — for the bottom fifth of households, by 2.6 percent — or \$1,149 — for the middle fifth, and by 7.7 percent — or \$168,000 — for those with incomes of more than \$1 million.⁷ As a result, the tax cuts enacted under the

⁴ See Tax Policy Center tables T06-0273 and T06-0279 at <http://www.taxpolicycenter.org>.

⁵ CBO's data show that the share of total federal taxes paid by the top 1 percent of households rose from 27.7 percent in 2005 to 28.3 percent in 2006, the highest share on record in the CBO data. The rising share of taxes paid by the wealthy is often cited erroneously as evidence that the tax burden on the highest-income households is rising. In fact, the increase in the share of taxes paid by the top 1 percent of households from 2005 to 2006 occurred *despite* a slight decline in the effective federal tax rate (i.e., in the percentage of income paid in federal taxes) the top 1 percent of households faces — from 31.6 percent of income in 2005 to 31.2 percent of income in 2006. The increase in the share of taxes paid by those at the top did not occur because this group's taxes were raised — they were not — but because the share of pretax income going to the top 1 percent of households rose from 18.1 percent of total income in the country in 2005 to 18.8 percent in 2006. Indeed, the effective tax rate of the top 1 percent of households was *lower* in 2006 than in any year since 1992.

⁶ See Aviva Aron-Dine and Robert Greenstein, "Two High Income Tax Cuts Not Yet Fully in Effect Will Cost Billions Over the Next Five Years," Center on Budget and Policy Priorities, February 1, 2007, <http://www.cbpp.org/2-1-07tax.htm>.

⁷ See Tax Policy Center tables T08-0156 and T08-0157 at <http://www.taxpolicycenter.org>.

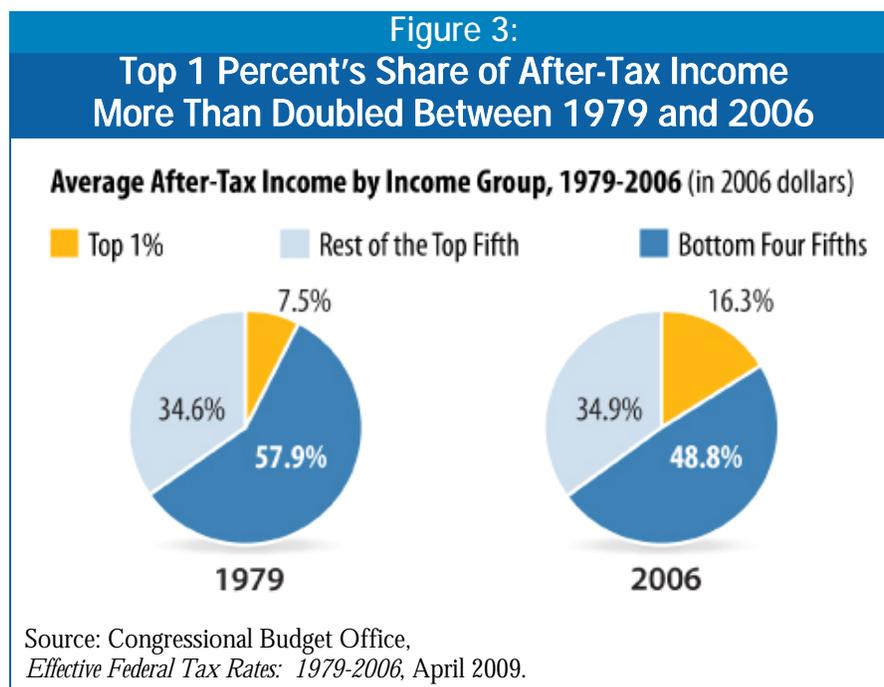
Bush Administration will ultimately be even more skewed toward high-income households — and will increase income inequality to a still larger degree — than in 2006.⁸

CBO Data Offer Most Comprehensive Look at Inequality

These CBO data are the most comprehensive data available on changes in incomes and taxes for different income groups, capturing trends at the very top of the income scale that other data sources, such as Census data, do not show.

Census income data do not include significant amounts of income received by high-income households. For instance, they ignore earnings above \$1 million in order to help preserve confidentiality. If an individual makes \$10 million a year, the Census records those earnings as \$1 million. Partly for this reason, the Census data do not break out trends among the top 1 percent of households, where income gains may have been especially concentrated.

CBO compiles its data from a variety of sources, combining Census survey data with IRS data on the income of the very wealthy. CBO also considers a broader range of income sources than do official Census income figures, including capital gains, non-cash benefits, and employer-provided health benefits.



⁸ The most recent tax cuts, enacted as part of the 2009 economic recovery legislation, are progressive; by targeting a larger share of relief to the lower- and moderate-income households who are most likely to spend it rather than save it, they both provide effective stimulus and are likely to counterbalance a portion of the inequality created by earlier tax cuts. However, the 2009 tax cuts are scheduled to expire after 2010.