Income Inequality: 1 Inch to 5 Miles

By David Cay Johnston

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The average increase in real income reported by the bottom 90 percent of earners in 2011, compared with 1996, if measured at one inch, would extend almost five miles for the top 1 percent of the top 1 percent.

Incomes and tax revenues have grown from 2009 to 2011 as the economy recovered, but an astonishing 149 percent of the increased income went to the top 10 percent of earners.

If you wonder how that can happen, the answer is simple: Incomes fell for the bottom 90 percent.

The rich really are getting richer while the vast majority is getting poorer. These facts should be at the center of any debate about changes in tax law and spending with the March 1 budget sequestration deadline just four days off.

The income growth and shrinkage figures come from analysis of the latest IRS data by economists Emmanuel Saez and Thomas Piketty, who have won acclaim for their studies of worldwide income patterns over the last century.

In 2011 entry into the top 10 percent, where all the gains took place, required an adjusted gross income of at least $110,651. The top 1 percent started at $366,623.

The top 1 percent enjoyed 81 percent of all the increased income since 2009. Just over half of the gains went to the top one-tenth of 1 percent, and 39 percent of the gains went to the top 1 percent of the top 1 percent.

Ponder that last fact for a moment — the top 1 percent of the top 1 percent, those making at least $7.97 million in 2011, enjoyed 39 percent of all the income gains in America. In a nation of 158.4 million households, just 15,837 of them received 39 cents out of every dollar of increased income.

That extreme concentration, however, is far from the most jaw-dropping figure that can be distilled from the new Saez-Piketty analysis. That requires a long-term comparison of those at or near the top with the bottom 90 percent.

In 2011 the average AGI of the vast majority fell to $30,437 per taxpayer, its lowest level since 1966 when measured in 2011 dollars. The vast majority averaged a mere $59 more in 2011 than in 1966. For the top 10 percent, by the same measures, average income rose by $116,071 to $254,864, an increase of 84 percent over 1966.

Plot those numbers on a chart, with one inch for $59, and the top 10 percent's line would extend more than 163 feet.

Now compare the vast majority's $59 with the top 1 percent, and that line extends for 884 feet. The top 1 percent of the top 1 percent, whose 2011 average income of $23.7 million was $18.4 million more per taxpayer than in 1966, would require a line nearly five miles long.

That disparity in income growth rates comes as the total federal tax burdens on those at the top have been slashed, compared with 1966, especially for the long-term capital gains that account for about a third of total income at the very top.

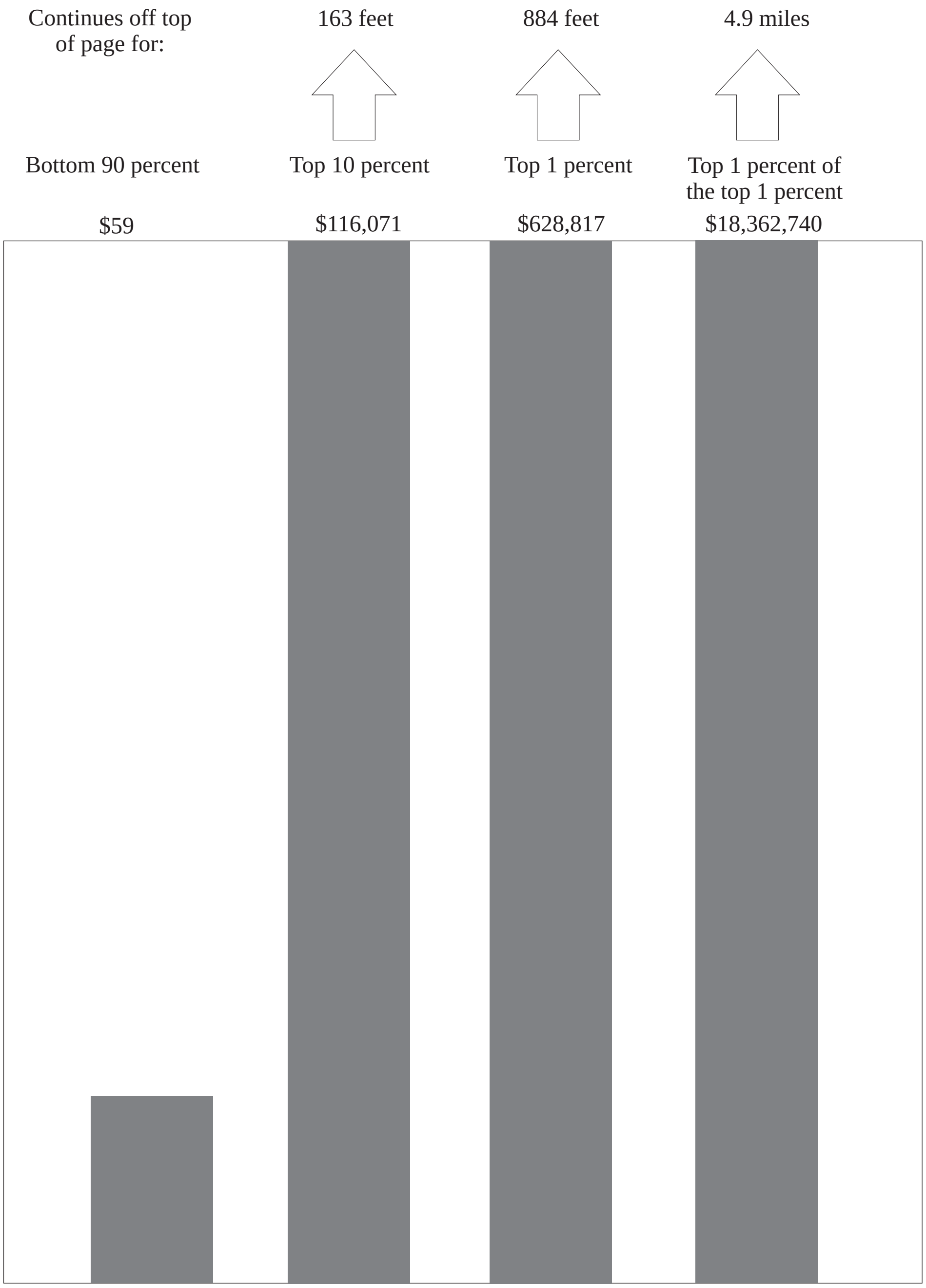
This $59 increase for the vast majority covers a time longer than most people work. Back in 1966, the first *Star Trek* episode aired and Barack Obama started kindergarten.

Skyrocketing growth at the top and, in recent years, plummeting income for the vast majority caused a major re-slicing of the national income pie. That re-slicing results in large part from tax, employment, and other rule changes that began with President Reagan and intensified under President George W. Bush. The situation changed slightly this year under President Obama, but the rules allow the rich to make their fortunes grow like a giant snowball rolling down a hill.

Candidate Bush said his tax cuts would make everyone prosper. But the real average pretax income of the bottom 90 percent in 2011 was $5,340 less than in 2000, a decline of more than $100 per week, or 15 percent, in pretax income. The top 1 percent of the top 1 percent saw their incomes plummet even more after the Bush tax cuts were enacted, down $7.5 million or 24 percent in real terms in 2011 compared with 2000.

Income Growth, 1966 to 2011

In 2011 the average income of the bottom 90 percent was just $59 more than in 1966 in real terms, depicted here as one inch. This graphic shows the comparable income growth of those within the top 10 percent.



Source: Author's calculations from analysis of IRS data by Saez and Piketty.

It has become widely understood that we cannot balance our federal budget by raising taxes only on those at the top, because there is not enough income there, even if we taxed away everything the top makes. What is equally true is that we cannot increase tax revenue if the incomes of the vast majority keep falling. That, however, has yet to become part of the debate on how to finance government.

Maybe this debate can change if we understand how the national income pie is being sliced now and how it was in more prosperous times.

Back in 1966, the top 1 percent of the top 1 percent reported 1.3 percent of all pretax income. In 2011 that tiny number of American households saw their slice of pie more than triple, to 4.5 percent.

Overall, the top 10 percent got a bigger share of the pie in 2011 than in 1966, but the biggest increases went to those at the top, with just a sliver extra for those down near the 90/10 dividing line.

What of the vast majority who make too little to be in the top 10 percent? The bottom 90 percent saw their slice of the national income pie shrivel, from two-thirds in 1966 to barely half in 2011 (66.3 to 51.8 percent).

Between 1980 and 2005, more than 80 percent of the total increase in income went to the top 1 percent of American households.[1]

Those at the top are pulling away from everyone else not because of hard work, but the shift of income from labor to capital and changes in federal income, gift, and estate tax rules.

The median wage has been stuck since 1999 at a bit more than $500 per week in real terms and job growth has lagged far beyond population growth. But capital gains and dividends have soared, a new Congressional Research Service study shows. And, of course, the rich get most of that income. Thomas Hungerford concluded:

> By far, the largest contributor to increasing income inequality (regardless of income inequality measure) was changes in income from capital gains and dividends. Capital gains and dividends were less equally distributed in 1991 than in 2006. . . . Tax policy may have also have had an indirect effect on rising income inequality, especially between 2001 and 2006. The reduction in the tax rate on long-term capital gains and qualified dividends may have led to the increased importance of this source in after-tax income.[2]

The Saez-Piketty analysis shows the concentration of growth at the very top increasing. That is bad for tax revenue and bad for social stability. The drop in incomes among the vast majority holds back economic growth, because there is just not enough aggregate demand to support creating enough new jobs to keep up with population growth.

And who was hit hardest by the new federal taxes that took effect this year? The vast majority.

Ending the temporary 2 percentage point cut in the visible half of the Social Security tax has, predictably, dampened spending. Wal-Mart suffered very weak sales in early February, e-mails obtained by Bloomberg revealed.[3] That is a predictable result for any retailer whose customer base is downscale.

Adding to this strain is the shift in federal tax burdens, which despite the higher rates this year are still well below 1966 levels.

If we look at the half-century from 1961 to 2011, ignoring inflation, we can see how federal tax burdens have shifted, especially the Social Security tax. It expanded from 3.1 percent of GDP to 5.5 percent. That tax stops this year at $113,700 of wages, just about the threshold for the top 10 percent.

Over those 50 years, federal corporate income tax receipts grew 764 percent and personal income taxes 2,540 percent, while Social Security taxes soared 4,881 percent.

Visualize it this way: Increases in national income are becoming more and more concentrated on the top rung, while the combined federal income and payroll tax burden grows down the ladder, where incomes are getting smaller.

That is a lot of stress being placed on people between the bottom rung and the top. I think it is more stress than the social ladder can bear, although when and how it will break no one will know until it happens.

Tax policy is driving these trends.

Ponder again that ratio in income growth after 45 years between the vast majority and the top 1 percent of the top 1 percent — $59 more to $18.7 million more. For each extra dollar of annual income going to each household in the vast majority, an extra $311,233 went to households in the top 1 percent of the top 1 percent. One inch to almost five miles.

What do you think will happen to our tax system, and to the United States, as tax policy helps extend that line to 10 miles?

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[1] *See* http://www.nationalaffairs.com/publications/detail/how-to-think-about-inequality.

[2] *See* Thomas L. Hungerford, "Changes in the Distribution of Income Among Tax Filers Between 1996 and 2006: The Role of Labor Income, Capital Income, and Tax Policy," Congressional Research Service, R42131 (Jan. 11, 2013).

[3] *See* http://www.bloomberg.com/news/2013-02-15/wal-mart-executives-sweat-slow-february-start-in-e-mails.html.