Income Disparity and Sources of Income

SUMMARY

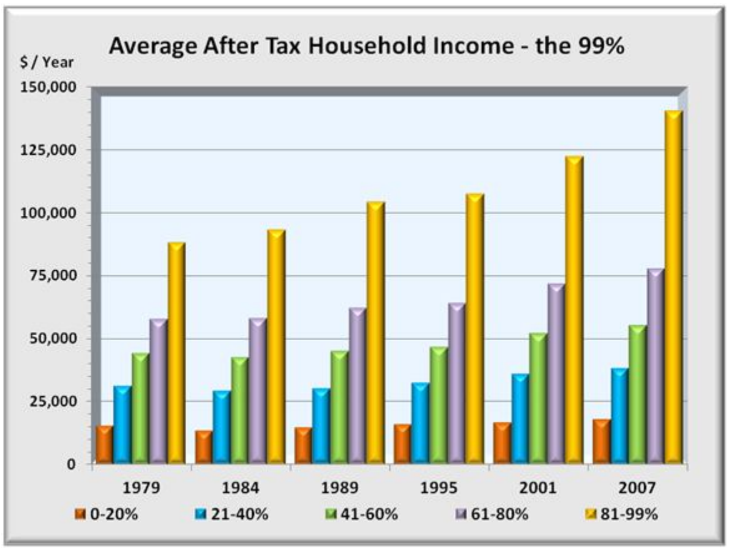
Regardless of how one views the Occupy Wall Street (OWS) movement and "*We are the 99 percent*", it has succeeded in raising awareness about wealth distribution. Also in October, 2011, the Congressional Budget Office (CBO) published an analysis of household incomes addressing that subject.

CBO first grouped households by quintiles (1/5 in each) and clearly the top fifth have done far better than the bottom fifth. CBO then divided the top 20% (fifth) into 10%, 5%, 4%, and the highest 1% of households. The income disparity was even more striking with the highest 1% <u>far</u> greater than the others.

This analysis further drills down within this top 1% and finds income disparity wider yet, and vastly greater than all other group comparisons. Pre-tax income for the top 1/100 of 1%, (or 12,000 households) totaled some <u>$450 billion,</u> greater than the combined pre-tax income of the 24 million lowest income households. To rephrase, income of just one of these richest households is more than 2,000 lowest income households.

INCOME AND GROWTH IN INCOME TRENDS

Chart 1 –Average After tax Household Income – the 99%

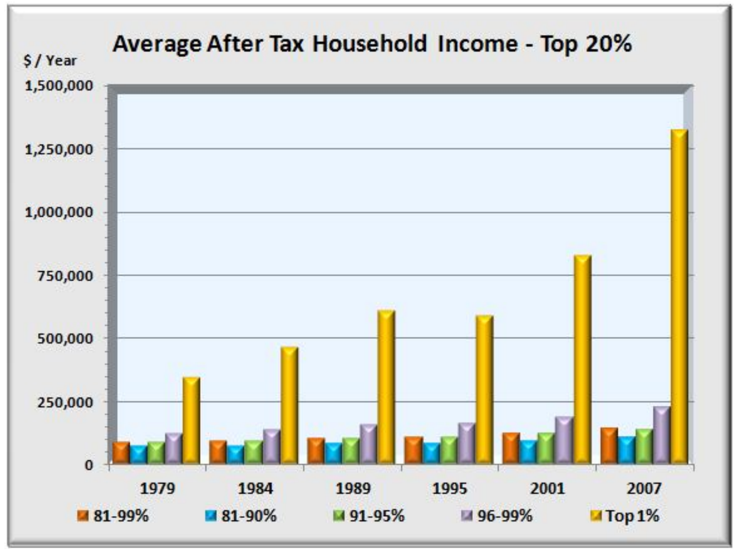


The CBO October, 2011 analysis first divided households by quintile, each containing 1/5 of all households. **Chart 1** is a slight modification in that it removes the top 1% from the highest 20%. Two facts stand out. First, income disparity for the highest group was greater than other groups, and second, their growth also exceeded the growth of all other groups.

The highest did well, earning 6 times that of the lowest group in 1979. Over 28 years, income of the lowest 20% grew just 16% in contrast to the 59% growth of the 81-99%. The three middle groups also had "middle" growth of 23%, 25% and 35%. The disparity caused by growth differences resulted in the 81-99% earning 8 times more than the 0-20% by 2007.

Chart 2 focuses on the top 20%, dividing it into four groups with ratios of 50:40:9:1 where 1 is the top 1%. Chart 2 also increases the scale of Chart 1 by 10 times, from $150,000 max to $1,500,000. Also, the highest bar of Chart 1 becomes the left-most bar of Chart 2, and is the average of the next 3 bars.

Chart 2 –Average After-tax Household Income – Top 20%



As well as the 81-99% group did compared to lower-income groups in Chart 1, the income disparity within the top 20% is even greater. The top 1% had 5 times the earnings of the 81-90% group in 1979. That disparity grew to over 12 times by 2007. Clearly the top 1% was running away from ALL other groups, substantiating the claims of the "99%".

Chart 3 again takes the left-most bar (top 1%) of Chart 2 and divides that into four groups with the same ratios of 50:40:9:1 where 1 is the top 1/100 of 1%, or just 1 in 10,000. Chart 3 also increases the scale over 20 times, to $35,000,000. Again, Chart 2's highest bar becomes the left-most bar of Chart 3.

Chart 3 –Average After-tax Household Income – Top 1%

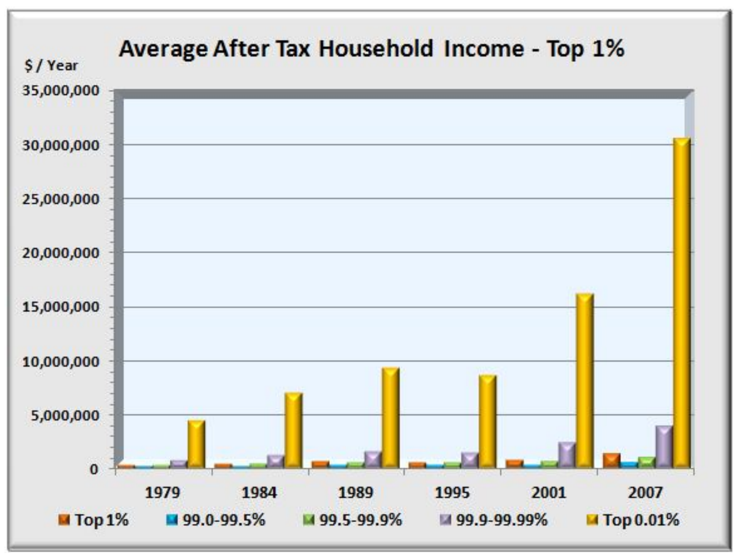


Chart 3 clearly shows the disparity of income in the U.S. The left-most bars which are barely visible are actually the average of the top 1% that was so much higher in Chart 2. Further, the lowest 90% within the top 1% barely make a blip on the chart. Only when one gets to the 1/10 of 1% is there some upward movement. The startling fact is that just the top 1/100 within the top 1% of the population has after tax income virtually off the charts compared to all others. Not only is the disparity huge, but the recent growth appears unprecedented.

What can explain not only the raw inequality, but the growth in inequality that has occurred? For this, there is similar CBO table that factors each group into nine source components of income. This analysis combined these nine into five groups.

- Wages
- Business Income
- Investment Income
- Pensions, Social Security and Cash Transfers
- Imputed Taxes and Other

Of note is the last item that includes employer paid taxes on behalf of the employee. Thus, even those who pay no income taxes incur payroll taxes and contribute to tax revenues.

Chart 4 – 0-95% Sources of Income $

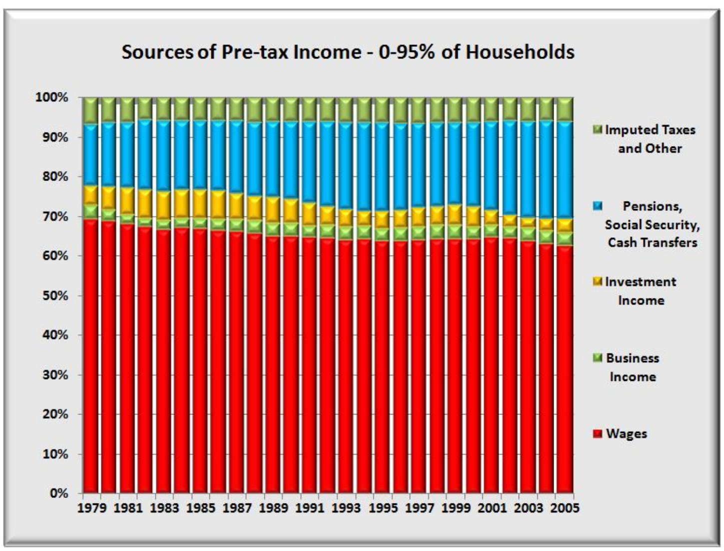


Chart 4 shows wages as the dominant source of income for 95% of all households. In every subgroup, however, the part from wages has declined. Business and investment income provides a rather small part of income for 95% of households. Pensions and Social Security from an aging population are responsible for a noteworthy and growing part of household income. Imputed taxes for the 95% are mostly payroll taxes for Social Security, Medicare, and Federal unemployment insurance. CBO includes these taxes as indirect compensation that would have gone to the individual in the form of wages had not the government required these payments.

The sources of income for the 95% to 99% rely less on wages and wage related income, and more on business and investment income. Business income is from proprietors and farms as well as S corporations and positive rental income. This segment is where most small business resides, businesses that create most new jobs. Still, wage related income and pensions comprise 75% of total income, similar to Chart 3.

Sources of income change dramatically for the top 0.01% as shown in Chart 5. Investment income is more passive than business income and consists of interest, dividends and capital gains. Investment income come is more related to the stock market than to the job market.

Chart 5 – Top 0.01% Sources of Income $

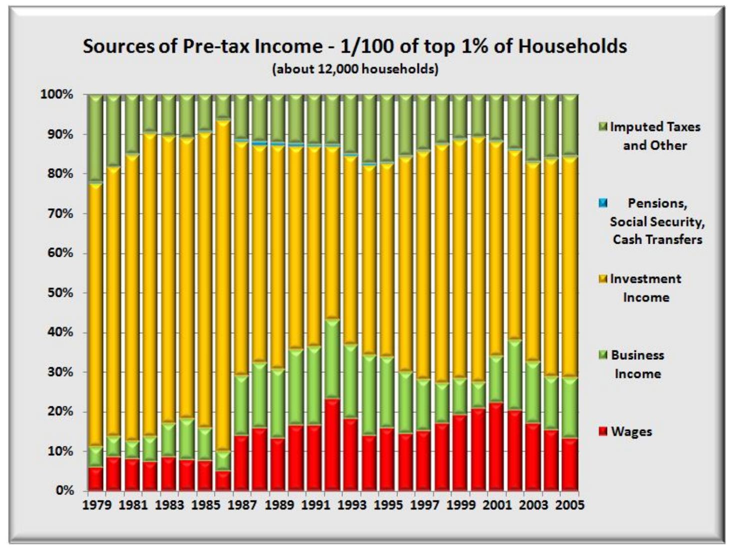


Chart 5 highlights sources of income for the top 1/100 of 1% of households. The lower two bars represent those actively working, either for someone else (wages) or in running their own business (business Income). Their combined income is less than 30% but greater than the 1980's when executive salaries were lower. In 1986, investment income spiked as investors sold stocks before Reagan's capital gains tax increase took effect. For this group, imputed taxes are not payroll taxes but an allocation of corporate income taxes.

Overall, Chart 5 emphasizes that investment income is far and away the dominant source of income. However, it is business income, not passive investment income that creates jobs. In contrast to the lower 95%, pensions and Social Security play virtually no role in the income mix for the top 1/100 of 1%.

Finally, it is fair to ask how much income this top group earned. 2007 pre-tax income for the top 1/100 of 1%, (or 12,000 households) totaled some $450 billion, greater than the combined pre-tax income of the 24 million lowest income households. To rephrase, income of just one of these richest households is more than 2,000 lowest income households. The U.S. has not seen such income inequality in over 80 years.

APPENDIX

METHODOLOGY

This analysis uses the same tables as an October 2011, CBO analysis of household incomes.
http://www.cbo.gov/publications/collections/collections.cfm?collect=13

That report derives data from two CBO tables:
(1) Number of Households, Average Income and Income Shares by Household Income Category, 1979-2007,
http://www.cbo.gov/publications/collections/tax/2010/all_tables.pdf and
(2) Sources of Income for All Households, by Household Income Category, 1979 to 2007.
http://www.cbo.gov/publications/collections/tax/2010/income_by_source.pdf

VOLUME WEIGHTING METHODOLOGY

CBO tables provided data for a number of groups. A method called Volume weighting allows creation of other household groups from the raw data. For instance, the 96 -99% group can be derived by "subtracting" the top 1% from the top 5%.

With volume weighting, it is possible to derive additional group combinations beyond the original data. For example, if 30 households earned an average of $15,000 and the highest sub group of 10 earning an average $25.000, one computes the average for the remaining group of 20 not by simple subtraction but by volume weighting as follows:

Raw Data – two groups

	Household #	Average
All Groups	30	$15,000
Highest Group	10	$25,000

Step 1: multiply Household # by Average to get Amount

	Household #	Average	$ Amount
All Groups	30	$15,000	**$450,000**
Highest Group	10	$25,000	**$250,000**

Step 2: subtract Household # and $ Amounts

	Household #	Average	$ Amount
All Groups	30	$15,000	$450,000
Less Highest Group	-10	$25,000	-$250,000
Remaining Groups	**20**		**$200,000**

Step 3: Divide $ Amount by Household # to derive Average

	Household #	Average	$ Amount
All Groups	30	$15,000	$450,000
Less Highest Group	-10	$25,000	-$250,000
Derived Average	20	**$10,000**	$200,000

DEFINITIONS OF INCOME SOURCES (CHARTS 4 & 5)

Wages include cash wage and salary payments as well as employees' contributions to 401(k) retirement plans.

Business Income includes Proprietors' income is net income from businesses and farms operated solely by their owners. It also includes other business income including partnership income, income from S corporations, and positive rental income.

Investment Income includes Interest and dividends and includes taxable and non-taxable interest and dividends paid by C corporations. It also includes Capital gains that are the profits from the sale of assets. Unrealized capital gains are not included.

Pensions, Social Security and Cash Transfers includes Pension income received in retirement for past services. It also includes taxable withdrawals from individual retirement accounts and deferred compensation plans. Cash transfers include payments from Social Security, unemployment insurance, Supplemental Security Income, Aid to Families with Dependent Children, Temporary Assistance for Needy Families, veterans' benefits, and workers' compensation.

Imputed Taxes and Other includes in-kind income like employer-paid health insurance premiums, food stamps, school lunches and breakfasts, housing assistance, energy assistance, and the fungible value of Medicare and Medicaid, as estimated in the Current Population Survey. Imputed taxes are taxes paid by businesses (corporate income taxes and the employer's share of Social Security, Medicare, and federal unemployment insurance payroll taxes). It is assumed that income would have been higher in absence of those taxes.

LINK TO A DYNAMIC INTERACTIVE GRAPH

This interactive Chart graphs changes in income from 1979 as well as absolute income amounts for selected CBO groups. Click HERE to run dynamic charts for the top 10% and 1%.

Extending data using historical ratios

Data from Table 2 (*Additional Data on Sources of Income and High-Income Households*) ends in 2005. This report extends that data to 2006 and 2007 by applying 2005 ratios to 2006 and 2007 from table 1 (*Sources of Income by Income Category*).

Merging Charts 1-3 into single Chart 6

Recall that the lowest quintile averaged less than $11,000 while the richest averaged over $30 million, nearly 3,000 times greater. To combine all into one chart required using a logarithmic scale. Chart 6, where each grid line is 10 times the next lower grid, emphasizes this huge income inequality.

Chart 6 – Average After-tax Income – All – Log Scale