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Income Taxes and Income Inequality Since 1979

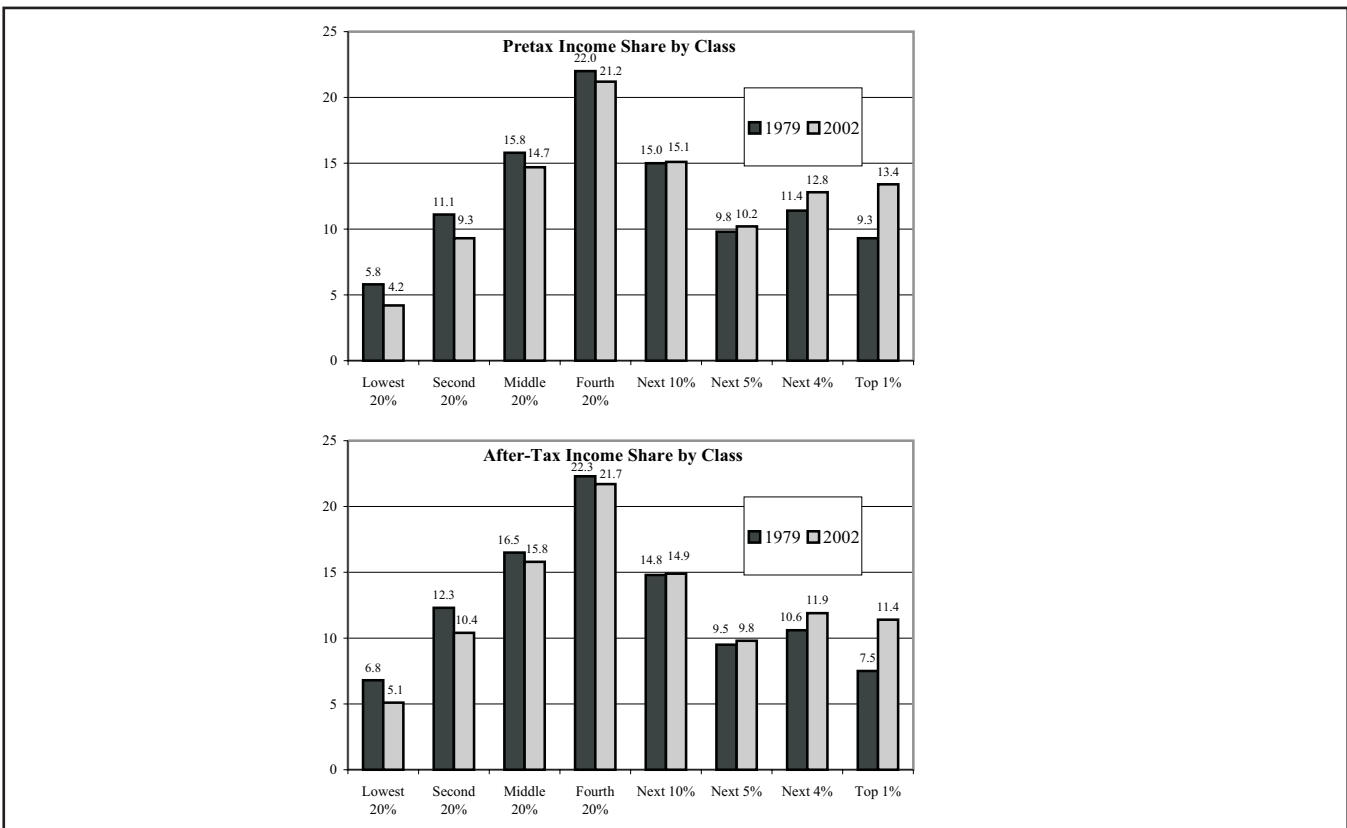
By Troy Kravitz

Following decades of relative stability, income inequality has risen sharply in the United States since the 1970s. Data from the Congressional Budget Office indicate that between 1979 and 2002, the share of pretax income accruing to households in the top quintile increased by almost 15 percent, from 45.5 percent to 51.5 percent. The increase was greatest for those with very high incomes: The top 1 percent earned 9.3 percent of pretax income in 1979, and 13.4 percent in 2002 — a 44 percent increase. Pretax income shares declined for each of the bottom four quintiles, with the decline sharpest among those making the least: The lowest quintile saw

their pretax income share decrease from 5.8 percent to 4.2 percent, a reduction of more than 27 percent.

By design, progressive federal taxes offset some of the disparity in pretax incomes.¹ Analysis of estate and income tax returns among the very wealthy indicate that progressive taxation played a significant role in the decline of income inequality during the mid-20th century (Kopczuk and Saez, 2004). At the end of the century, however, the distribution of after-tax incomes is growing more unequal too. In fact, the changes in after-tax income shares for the highest and lowest quintiles display not only the same trend as that for pretax shares, but the trends are of about the same magnitude.

¹Taxes can also affect pretax incomes if individuals and businesses respond to taxation by reporting less income.



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