

Institute for Research on Labor and Employment

Institute for Research on Labor and Employment

Working Paper Series

(University of California, Berkeley)

Year 2009

Paper iirwps'196'09

Striking it Richer: The Evolution of Top Incomes in the United States (Update with 2007 estimates)

Emmanuel Saez
University of California, Berkeley

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Striking it Richer:

The Evolution of Top Incomes in the United States

(Update with 2007 estimates)

Emmanuel Saez*

August 5, 2009

What's new for 2007?

From 2006 to 2007, average real income per family grew by a solid 3.7 percent. Average real income for the top percentile grew faster (6.8 percent growth), further increasing the top percentile income share from 22.8 to 23.5 percent (Figure 2). Year 2007 is therefore the second highest year on record since 1913 almost equalling 1928, the record year when the top percentile share reached 23.9 percent (Figure 2). Even within the top percentile, the gains from 2006 to 2007 are extremely concentrated. The top .01% (top 14,988 US families, making at least \$11.5m in 2007) share increased from 5.46% in 2006 to 6.04% in 2007 leaving well behind the 1928 peak of 5.04 percent (Figure 3). This shows that 2007 was an incredibly good year for the super rich.

Year 2007 was actually also quite good for the bottom 99 percent of US families as their average income grew by 2.8 percent. This is the best annual increase since 1998. Real income growth for the bottom 99 percent had been very meagre during the Bush expansion starting in 2002. Even including 2007—a good year for ordinary US families—the top percentile captured 65 percent of total real income growth per family from 2002 to 2007 (Table 1).

What will happen to income concentration next?

The economic landscape has obviously changed dramatically since 2007 which marks the peak of Bush expansion. We know from National Account statistics that real incomes per family will fall in 2008 and 2009. Evidence from past recessions suggests that, in general, the top percentile income share falls during recessions, as business profits, realized capital gains, and stock option exercises fall faster than average income. Therefore, the most likely outcome is that income concentration will fall in 2008 and 2009.

Based on the US historical record, falls in income concentration due to recessions are temporary unless drastic policy changes, such as financial regulation or significantly more progressive taxation, are implemented and prevent income concentration from bouncing back. Such policy changes took place after the Great Depression during the New Deal and permanently reduced income concentration till the 1970s (Figures 2, 3). In contrast, recent

* University of California, Department of Economics, 549 Evans Hall #3880, Berkeley, CA 94720. This is an updated version of "Striking It Richer: The Evolution of Top Incomes in the United States", *Pathways Magazine*, Stanford Center for the Study of Poverty and Inequality, Winter 2008, 6-7. Much of the discussion in this note is based on previous work joint with Thomas Piketty. All the series described here are available in excel format at <http://elsa.berkeley.edu/~saez/TabFig2007.xls>

downturns, such as the 2001 recession, lead to only very temporary drops in income concentration (Figures 2, 3).

Could we get income distribution data faster?

Distributional statistics used to estimate our series are produced by the Statistics of Income division at the Internal Revenue Service. Those statistics are extremely high quality and final, but come with a 2-year lag--year 2007 statistics were released on August 3, 2009. Timely statistics are central to enlighten the public policy debate, especially distributional statistics at this time of controversy about large bonuses paid by financial companies receiving government aid. As currently done for National Accounts, it should be possible to produce preliminary distributional statistics much earlier. In particular, individual tax returns filed before April 15, information returns (such as W2 and 1099 forms), and requests for filing extensions could be combined to create preliminary statistics perhaps one year earlier. Furthermore, individual quarterly wage income data gathered by the unemployment insurance system could be used systematically to analyze the distribution of wage income even faster.

Text of “Striking it Richer” updated with 2007 estimates

The recent dramatic rise in income inequality in the United States is well documented. But we know less about which groups are winners and which are losers, or how this may have changed over time. Is most of the income growth being captured by an extremely small income elite? Or is a broader upper middle class profiting? And are capitalists or salaried managers and professionals the main winners? I explore these questions with a uniquely long-term historical view that allows me to place current developments in deeper context than is typically the case.

Efforts at analyzing long-term trends are often hampered by a lack of good data. In the United States, and most other countries, household income surveys virtually did not exist prior to 1960. The only data source consistently available on a long-run basis is tax data. The U.S. government has published detailed statistics on income reported for tax purposes since 1913, when the modern federal income tax started. These statistics report the number of taxpayers and their total income and tax liability for a large number of income brackets. Combining these data with population census data and aggregate income sources, one can estimate the share of total personal income accruing to various upper-income groups, such as the top 10 percent or top 1 percent.

We define income as the sum of all income components reported on tax returns (wages and salaries, pensions received, profits from businesses, capital income such as dividends, interest, or rents, and realized capital gains) before individual income taxes. We exclude government transfers such as Social Security retirement benefits or unemployment compensation benefits from our income definition. Therefore, our income measure is defined as market income before individual income taxes.

Evidence on U.S. top income shares

Figure 1 presents the income share of the top decile from 1917 to 2007 in the United States. In 2007, the top decile includes all families with market income above \$109,600. The overall pattern of the top decile share over the century is U-shaped. The share of the top decile is around 45 percent from the mid-1920s to 1940. It declines substantially to just above 32.5 percent in four years during World War II and stays fairly stable around 33 percent until the 1970s. Such an abrupt decline, concentrated exactly during the war years, cannot easily be reconciled with slow technological changes and suggests instead that the shock of the war played a key and lasting role in shaping income concentration in the United States. After decades of stability in the post-war period, the top decile share has increased dramatically over the last twenty-five years and has now regained its pre-war level. Indeed, the top decile share in 2007 is equal to 49.7 percent, a level higher than any other year since 1917 and even surpasses 1928, the peak of stock market bubble in the “roaring” 1920s.

Figure 2 decomposes the top decile into the top percentile (families with income above \$398,900 in 2007) and the next 4 percent (families with income between \$155,400 and \$398,900 in 2006), and the bottom half of the top decile (families with income between \$109,600 and \$155,400 in 2006). Interestingly, most of the fluctuations of the top decile are due to fluctuations within the top percentile. The drop in the next two groups during World War II is far less dramatic, and they recover from the WWII shock relatively quickly. Finally, their shares do not increase much during the recent decades. In contrast, the top percentile has gone through enormous fluctuations along the course of the twentieth century, from about 18 percent before WWI, to a peak to almost 24 percent in the late 1920s, to only about 9 percent during the 1960s-1970s, and back to almost 23.5 percent by 2007. Those at the very top of the income distribution therefore play a central role in the evolution of U.S. inequality over the course of the twentieth century.

The implications of these fluctuations at the very top can also be seen when we examine trends in *real* income growth per family between the top 1 percent and the bottom 99 percent in recent years as illustrated on Table 2. From 1993 to 2007, for example, average real incomes per family grew at a 2.2 percent annual rate (implying a growth of 35 percent over the fourteen year period). However, if one excludes the top 1 percent, average real income growth fall to 1.3 percent per year (implying a growth of 20 percent over the thirteen year period). Top 1 percent incomes grew at a much faster rate of 5.9 percent per year (implying a 122 percent growth over the fourteen year period). This implies that top 1 percent incomes captured half of the overall economic growth over the period 1993-2007.

The 1993–2007 period encompasses, however, a dramatic shift in how the bottom 99 percent of the income distribution fared. Table 1 next distinguishes between the 1993–2000 expansion of the Clinton administrations and the 2002-2007 expansion of the Bush administrations. During both expansions, the incomes of the top 1 percent grew extremely quickly at an annual rate over 10.3 and 10.1 percent respectively. However, while the bottom 99 percent of incomes grew at a solid pace of 2.7 percent

per year from 1993–2000, these incomes grew only 1.3 percent per year from 2002–2007. As a result, in the economic expansion of 2002–2007, the top 1 percent captured two thirds of income growth. Those results may help explain the disconnect between the economic experiences of the public and the solid macroeconomic growth posted by the U.S. economy since 2002. Those results may also help explain why the dramatic growth in top incomes during the Clinton administration did not generate much public outcry while there has been an extraordinary level of attention to top incomes in the press and in the public debate over the last two years. Moreover, top income tax rates went up in 1993 during the Clinton administration (and hence a larger share of the gains made by top incomes was redistributed) while top income tax rates went down in 2001 during the Bush administration.

The top percentile share declined during WWI, recovered during the 1920s boom, and declined again during the great depression and WWII. This very specific timing, together with the fact that very high incomes account for a disproportionate share of the total decline in inequality, strongly suggests that the shocks incurred by capital owners during 1914 to 1945 (depression and wars) played a key role.¹ Indeed, from 1913 and up to the 1970s, very top incomes were mostly composed of capital income (mostly dividend income) and to a smaller extent business income, the wage income share being very modest. Therefore, the large decline of top incomes observed during the 1914–1960 period is predominantly a capital income phenomenon.

Interestingly, the income composition pattern at the very top has changed considerably over the century. The share of wage and salary income has increased sharply from the 1920s to the present, and especially since the 1970s. Therefore, a significant fraction of the surge in top incomes since 1970 is due to an explosion of top wages and salaries. Indeed, estimates based purely on wages and salaries show that the share of total wages and salaries earned by the top 1 percent wage income earners has jumped from 5.1 percent in 1970 to 12.4 percent in 2007.²

Evidence based on the wealth distribution is consistent with those facts. Estimates of wealth concentration, measured by the share of total wealth accruing to top 1 percent wealth holders, constructed by Wojciech Kopczuk and myself from estate tax returns for the 1916–2000 period in the United States show a precipitous decline in the first part of the century with only fairly modest increases in recent decades. The evidence suggests that top incomes earners today are not “rentiers” deriving their incomes from past wealth but rather are “working rich,” highly paid employees or new entrepreneurs who have not yet accumulated fortunes comparable to those accumulated during the Gilded Age. Such a pattern might not last for very long. The possible repeal of the federal tax on large estates in coming years would certainly accelerate the path toward the reconstitution of the great

¹ The negative effect of the wars on top incomes can be explained in part by the large tax increases enacted to finance the wars. During both wars, the corporate income tax was drastically increased and this reduced mechanically the distributions to stockholders.

² Interestingly, this dramatic increase in top wage incomes has not been mitigated by an increase in mobility at the top of the wage distribution. As Wojciech Kopczuk, myself, and Jae Song have shown in a separate paper, the probability of staying in the top 1 percent wage income group from one year to the next has remained remarkably stable since the 1970s.

wealth concentration that existed in the U.S. economy before the Great Depression.

The labor market has been creating much more inequality over the last thirty years, with the very top earners capturing a large fraction of macroeconomic productivity gains. A number of factors may help explain this increase in inequality, not only underlying technological changes but also the retreat of institutions developed during the New Deal and World War II - such as progressive tax policies, powerful unions, corporate provision of health and retirement benefits, and changing social norms regarding pay inequality. We need to decide as a society whether this increase in income inequality is efficient and acceptable and, if not, what mix of institutional reforms should be developed to counter it.

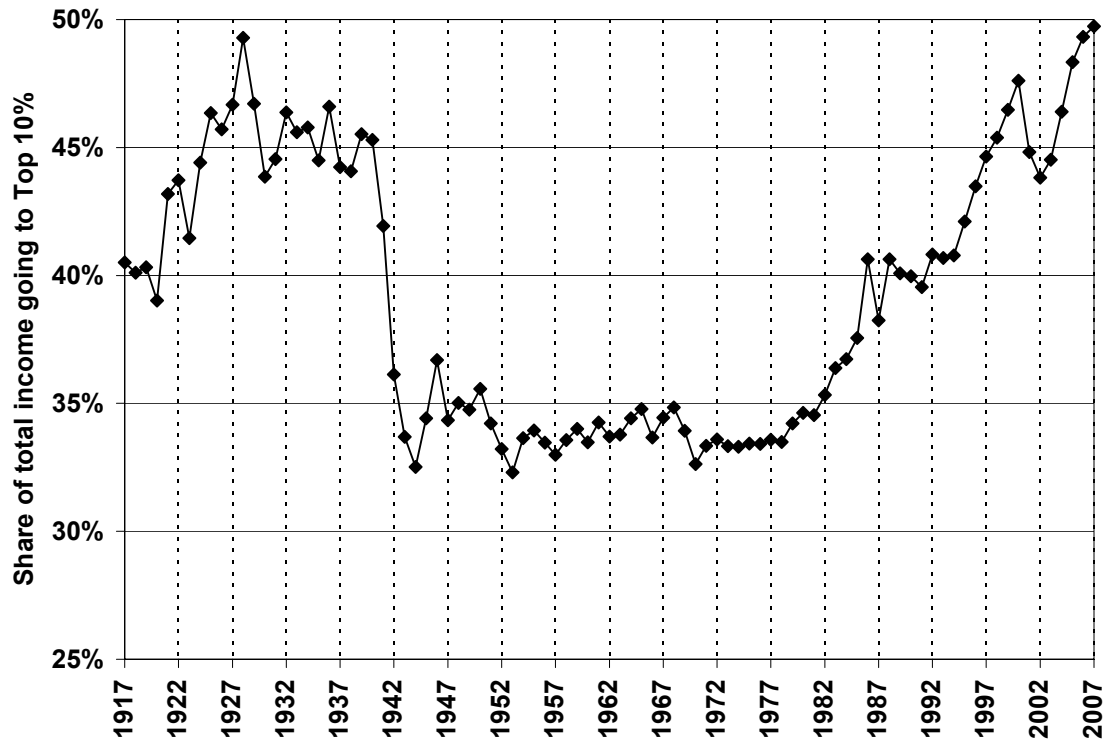


FIGURE 1

The Top Decile Income Share in the United States, 1917-2007

Source: Piketty and Saez (2003), series updated to 2007.

Income is defined as market income including capital gains.

In 2007, top decile includes all families with annual income above \$109,630.

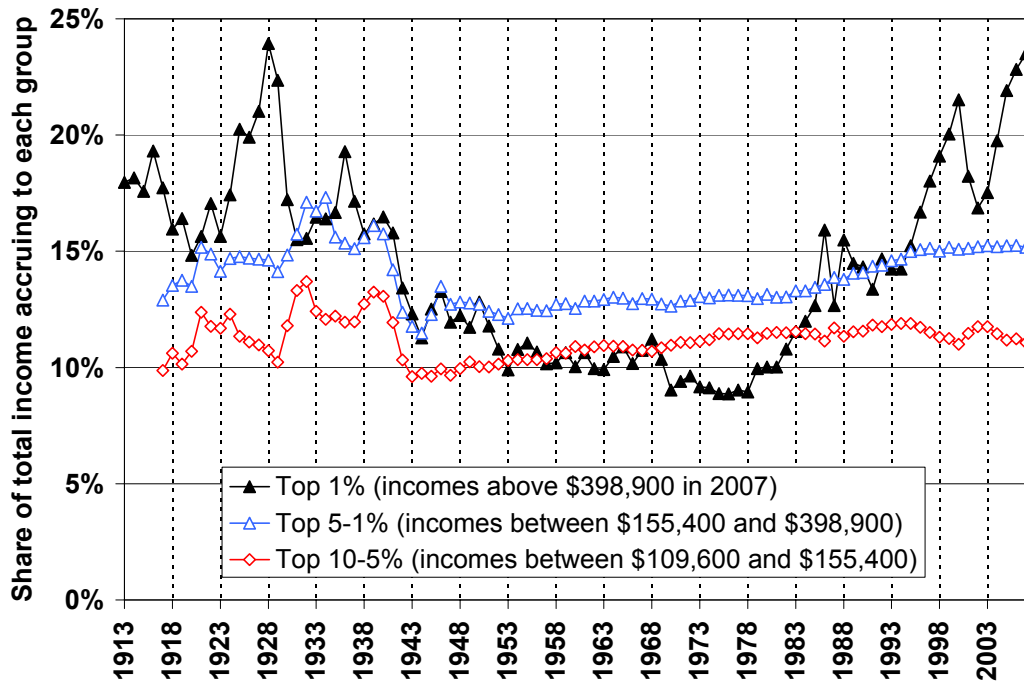


FIGURE 2

Decomposing the Top Decile US Income Share into 3 Groups, 1913-2007

Source: Piketty and Saez (2003), series updated to 2007.

Income is defined as market income including capital gains.

Top 1% denotes the top percentile (families with annual income above \$398,900 in 2007)

Top 5-1% denotes the next 4% (families with annual income between \$155,400 and \$398,900 in 2007)

Top 10-5% denotes the next 5% (bottom half of the top decile, families with annual income between \$109,600 and \$155,400 in 2007).

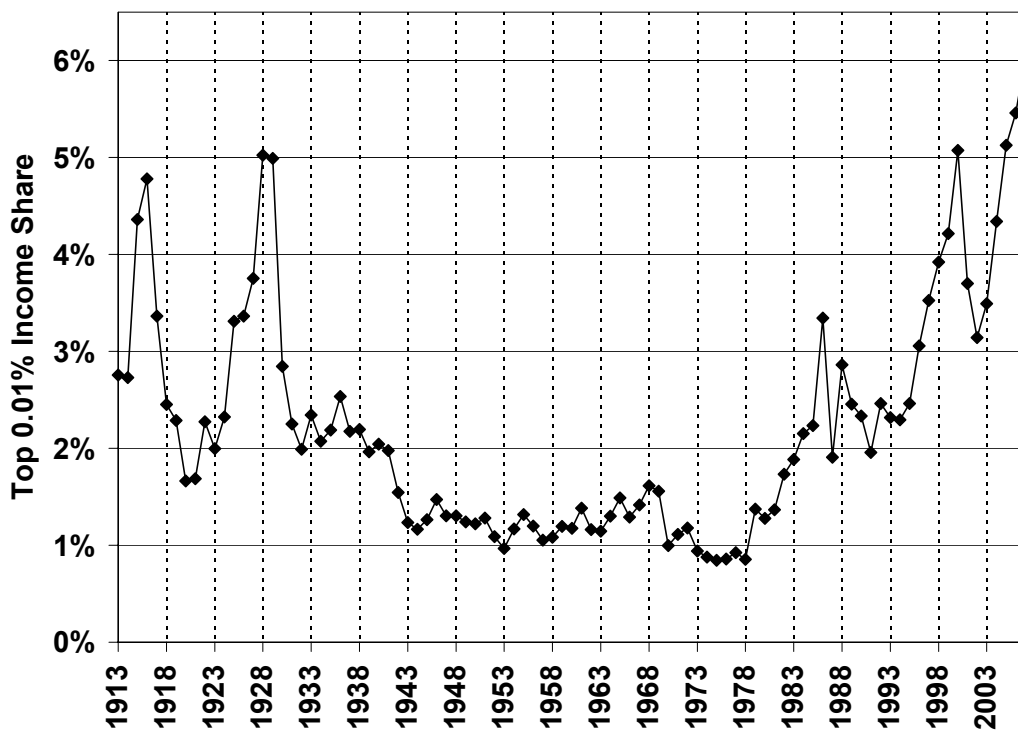


FIGURE 3
The Top 0.01% Income Share, 1913-2007

Source: Piketty and Saez (2003), series updated to 2007.
 Income is defined as market income including capital gains.
 In 2007, top .01% includes the 14,588 top families with annual income above \$11,477,000.

Table 1. Real Annual Income Growth by Groups, 1993-2007

	Average Income Real Annual Growth	Top 1% Incomes Real Annual Growth	Bottom 99% Incomes Real Annual Growth	Fraction of total growth captured by top 1%
	(1)	(2)	(3)	(4)
Full period 1993-2007	2.2%	5.9%	1.3%	50%
Clinton Expansion 1993-2000	4.0%	10.3%	2.7%	45%
Bush Expansion 2002-2007	3.0%	10.1%	1.3%	65%

Computations based on family market income including realized capital gains (before individual taxes).

Incomes are deflated using the Consumer Price Index.

Column (4) reports the fraction of total real family income growth captured by the top 1%.

For example, from 2002 to 2007, average real family incomes grew by 3.0% annually but 65% of that growth accrued to the top 1% while only 35% of that growth accrued to the bottom 99% of US families.

Source: Piketty and Saez (2003), series updated to 2007 in August 2009 using final IRS tax statistics.