Striking It Richer

The Evolution of Top Incomes in the United States

By Emmanuel Saez

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 2005 in the United States. In 2005, the top decile includes all families with market income above $99,200. 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 postwar 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 2005 is equal to 48.3 percent, a level higher than any other year since 1917, except 1928, which was the peak of the stock market bubble in the "roaring" 1920s.

Figure 2 decomposes the top decile into the top percentile (families with income above $350,500 in 2005), the next 4 percent (families with income between $140,100 and $350,500 in 2005), and the bottom half of the top decile (families with income between $99,200 and $140,100 in 2005). 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 above 20 percent in the late 1920s, to only about 9 percent during the 1960s–1970s, and back to almost 22 percent by 2005. 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. From 1994 to 2005, for example, average real incomes per family grew at a 1.9 percent annual rate (implying a growth of 23 percent over the eleven-year period). However, if one excludes the top 1 percent, average real income growth is halved to about 1 percent per year (implying a growth of 12 percent over the eleven-year period). Top 1 percent incomes grew at a much faster rate of 6 percent per year (implying a 90 percent growth over the eleven-year period). This implies that top 1 percent incomes captured about half of the overall economic growth over the period 1994–2005.

The 1994–2005 period encompasses, however, a dramatic shift in how the bottom 99 percent of the income distribution fared. I next distinguish between the 1994–2000 expansion of the Clinton administration and the 2002–2005 expansion of the Bush administration. During both expansions, the incomes of the top 1 percent grew extremely quickly, as seen in Figure 2, at an annual rate of over 10 percent. However, while the bottom

99 percent of incomes grew at a solid pace of 2.7 percent per year from 1994–2000, these incomes grew less than 1 percent per year from 2002–2005. Therefore, in the economic expansion of 2002–2005, the top 1 percent captured almost three-quarters 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. 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 12.0 percent in 2006.

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 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. ■

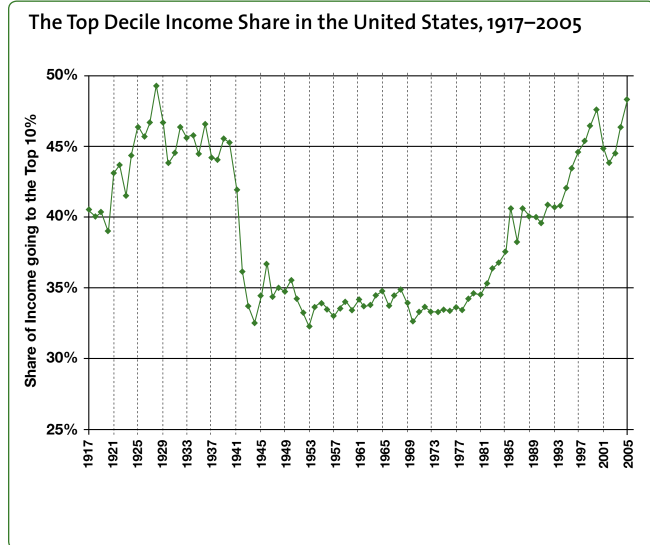

Figure 1

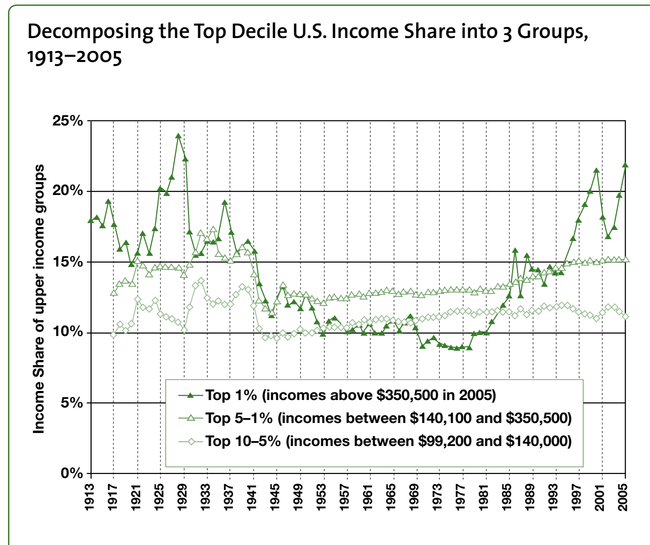

Figure 2

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