A Closer Look at the Wealth of the Wealthiest

By Editor Test *Wed, Oct 26, 2011*

This excerpt from a new Congressional Budget Office report on wealth inequality in the U.S. shows that "highly compensated workers have replaced people whose income is from property or securities at the top of the income distribution."

(The following excerpts from an October 2011 Congressional Budget Office study, *Trends in the Distribution of Household Income Between 1979 and 2007*, shed light on the composition of the wealth of the wealthiest Americans.)

Composition of income for the top 1%

Between 1979 and 2007, the composition of market income for the 1% of the population in households with the highest income changed significantly. The share of market income from wages and other labor compensation rose and then fell for little net change, while the share of income from capital assets declined. Business income was the fastest growing source of income for the top 1%.

Wages

Because of the volatile nature of income from capital gains realizations and its significance for the highest-income households, it is more illuminating to look at sources of income as shares of market income excluding capital gains. Wages and other labor compensation rose from 40% of market income excluding capital gains in 1980 to close to 50% in 2000 and 2001 before dropping back to about 40% in 2007.

Capital income

Capital income excluding capital gains—in other words, interest, dividends, and rents—has generally been a declining source of income among the highest-income households. Its share dropped from 42% of market income excluding capital gains in 1979 to 21% in 2002 and then increased to about 30% by 2007. Over the same period, the share of income from business activities grew sharply, increasing from a low of 10% of market income excluding capital gains in 1981 to a high of 27% in 2005 before dipping slightly in 2006 and 2007.

Capital gains

Capital gains are the most volatile source of income, and their importance as a share of household income for the top 1% of the population has fluctuated. That fluctuation appears to reflect movements in stock prices and changes in tax law. Between 1979 and 1985, capital gains for the top 1% were equal to 20% to 30% of market income excluding capital gains; in 1986, they spiked to more than twice that share. The ratio of income from capital gains to other market income declined in the late 1980s and then began to pick up in the mid-1990s before entering a period of rapid growth starting in 1995. That ratio peaked at 35% of market income in 2000 before falling to 16% in 2002 and then rebounding to 37% in 2007.

From C to S corporations

The fall in capital income and the increase in business income may in part reflect a recharacterization of income. Following the Tax Reform Act of 1986, which lowered the top statutory tax rate on individual income below the top rate on corporate income, many C corporations (which are taxed separately from their owners under the corporate income tax) were converted to S corporations (which pass corporate income through to their shareholders, where it is taxed under the individual income tax). As a result, corporate dividend income and capital gains from the sale of corporate stock were converted into S corporation income, which is counted here as part of business income. Business income jumped in the 1986–1988 period as those conversions began, and it continued to grow rapidly throughout the 1990s and 2000s as more conversions occurred and new businesses were formed as S corporations rather than C corporations.

Capital income declines in importance

The changing composition of income for the highest-income households reflects a much longer trend. Over the entire 20th century, capital income declined sharply in importance for high-income taxpayers. The labor share of income for the top income groups was higher in 2007 than before World War II, as highly compensated workers have replaced people whose income is from property or securities at the top of the income distribution.

Growth in Average Real After-tax Household Income (1979-2007, by Income Quintile)

- For the 1% of the population with the highest income, average real after-tax household income grew by 275%.
- For others in the 20% of the population with the highest income, average real after-tax household income grew by 65%.
- For the 60% of the population in the middle of the income scale, the growth in average real after-tax household income was just under 40%.
- For the 20% of the population with the lowest income, average real after-tax household income was about 18% higher in 2007 than in 1979.
- Between 2005 and 2007, the after-tax income of the 20% of the population with the highest after-tax income exceeded that of the remaining 80%.

Source: *Trends in the Distribution of Household Income Between 1979 and 2007*, Congressional Budget Office, October 2011.