National Economic Trends

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Income Mobility

Every year the U.S. Census Bureau ranks all households by annual household income and divides this distribution into quintiles.[1] Income quintiles from different years are often compared to demonstrate the growing income inequality over time between, say, the poorest 20 percent of households and the wealthiest 5 percent of households. For example, in 1970 the income of the wealthiest 5 percent of households was 6.3 times greater than the income of the poorest 20 percent of households, whereas in 2007 the income of the wealthiest 5 percent of households was 8.8 times greater than the income of the poorest 20 percent of households.[2] When such comparisons are made, it is implicitly assumed that each quintile contains the same households over time.

For most people, income increases over time as they move from a usually low-paying first job to better-paying jobs later in life. Some others, however, may lose income over time due to business cycle contractions, demotions, career changes, retirement, and so on. Because incomes are not constant over time, the same households do not necessarily remain in the same income quintiles. Thus, comparing income quintiles from different years is a proverbial apples-to-oranges comparison because the households compared are at different stages in their earnings profile.

A recent study examined income mobility in the United States from 1996 to 2005.[3] Using data from individual tax returns, the study documented household movement along the distribution of real income over the 10-year period. As shown in the upper panel of the chart, nearly 58 percent of the households in the lowest income quintile (lowest 20 percent) in 1996 moved to a higher income quintile by 2005. Similarly, nearly 50 percent of the households in the second-lowest quintile in 1996 moved to a higher income quintile by 2005. Even a significant number of households in the third and fourth income quintiles in 1996 moved to a higher quintile by 2005.

The study also documented declines in household income. Of particular note are the findings regarding the wealthiest households. As shown in the lower panel of the chart, more than 57 percent of the wealthiest 1 percent of households in 1996 fell out of that category by 2005. Similarly, more than 45 percent of the wealthiest 5 percent of households in 1996 fell out of that category by 2005.

Over time a significant number of households move to higher or lower positions along the income distribution. As a result, public policies such as income taxation and income redistribution affect "classes" of people differently over each person's lifetime. In addition, income mobility muddies the picture of income inequality derived from a simple comparison of income quintiles from different years because such comparisons incorrectly implicitly assume that each income quintile contains the same households over time.

—Thomas A. Garrett

[1] Here the Census defines (gross) income as money received on a regular basis from wages, interest and dividends, and government transfer payments.

[2] See U.S Census Bureau, Income Inequality; www.census.gov/hhes/www/income/data/historical/inequality/index.html. All data referred to here are from Table H-1 for all races.

[3] Auten, Gerald and Gee, Geoffrey. "Income Mobility in the United States: New Evidence from Income Tax Data." *National Tax Journal*, June 2009, *62*(2), pp. 301-28.