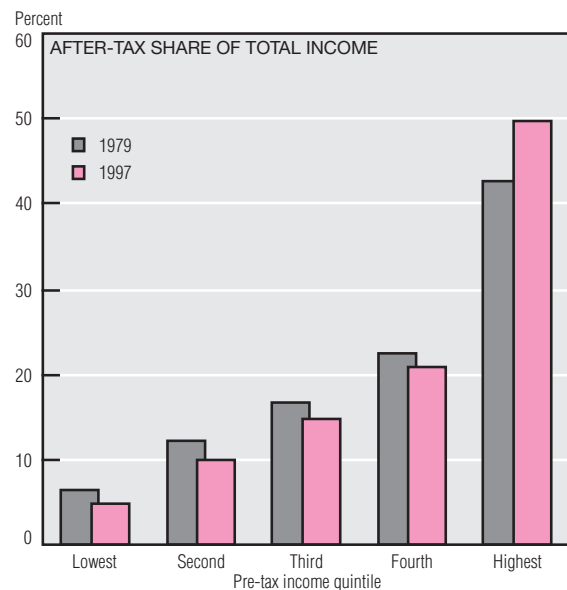
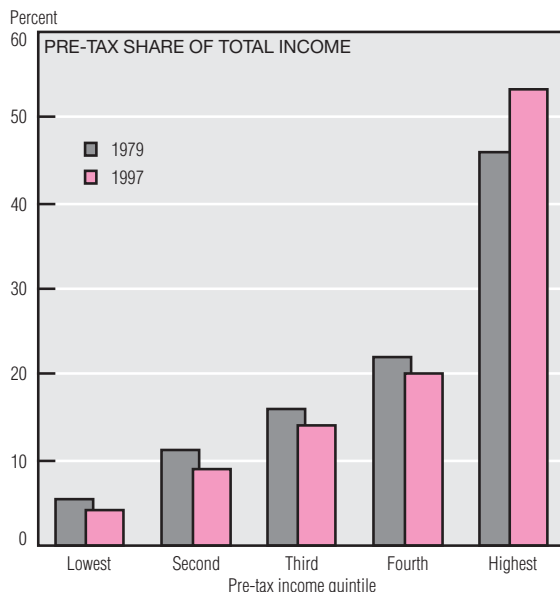
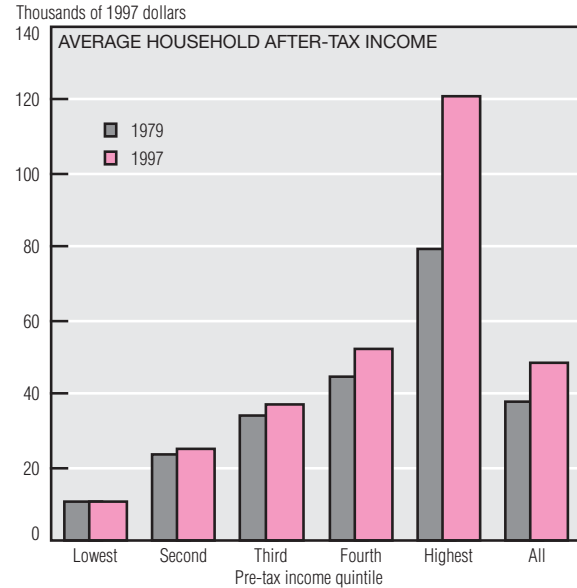
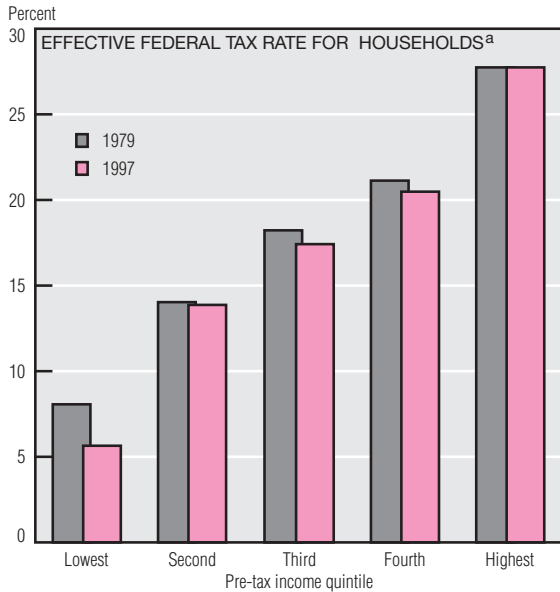


Effective Federal Tax Rates and Income Distribution



NOTE: Household classification by quintiles is based on comprehensive (pre-tax) income adjusted for household size. Comprehensive income includes earnings, asset income, welfare and retirement transfers, employer-paid payroll taxes, retirement plan contributions, health insurance premiums, and receipts of in-kind benefits, including health benefits.

a. Calculations of the effective tax rate include only the four major sources of federal tax revenue: income, social insurance, corporate income, and excise. Corporate income taxes are allocated in proportion to households' income from interest, dividends, rents, and capital gains. Excise taxes are allocated in proportion to households' purchases of taxed items.

SOURCES: Congressional Budget Office, *Effective Federal Tax Rates, 1979-1997*, October 2001; and the Urban Institute.

Between 1979 and 1997, effective tax rates dropped for all income levels. During this period, 15 legislative changes were enacted, affecting both tax rates and tax bases; income grew rapidly, especially at the upper end of the distribution. Demographic changes in household composition, notably the increasing share of childless non-elderly households, was another major cause of shifts in effective tax rates across income groups.

Distribution of pre-tax income became more unequal over the past two decades. The highest quintile's

share of income rose from 46% of total income to 53%. For the two lowest income quintiles taken together, in contrast, the share declined from 16% of total income in 1979 to 13% in 1997.

Although the share of pre-tax income for the middle three quintiles declined, lower effective tax rates and robust income growth resulted in higher average after-tax income in 1997 than in 1979. However, despite the sizable drop in the effective tax rate, average after-tax income for the lowest income quintile did not increase and overall

after-tax income inequality grew during the last two decades.

These numbers do not tell us whether any particular household became richer or poorer during this period. Because of life-cycle changes in composition, demographic status, and earning ability, most households do not stay in the same income quintile throughout their lives. One study suggests that only about half of the households in either the highest or the lowest income quintile in the 1970s and 1980s remained in the same quintile after 10 years.