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LOOKING AT THE DETAILS OF THE NEW BUDGET LEGISLATION

Social Program Initiatives Decline over Time While Upper-income Tax Cuts Grow

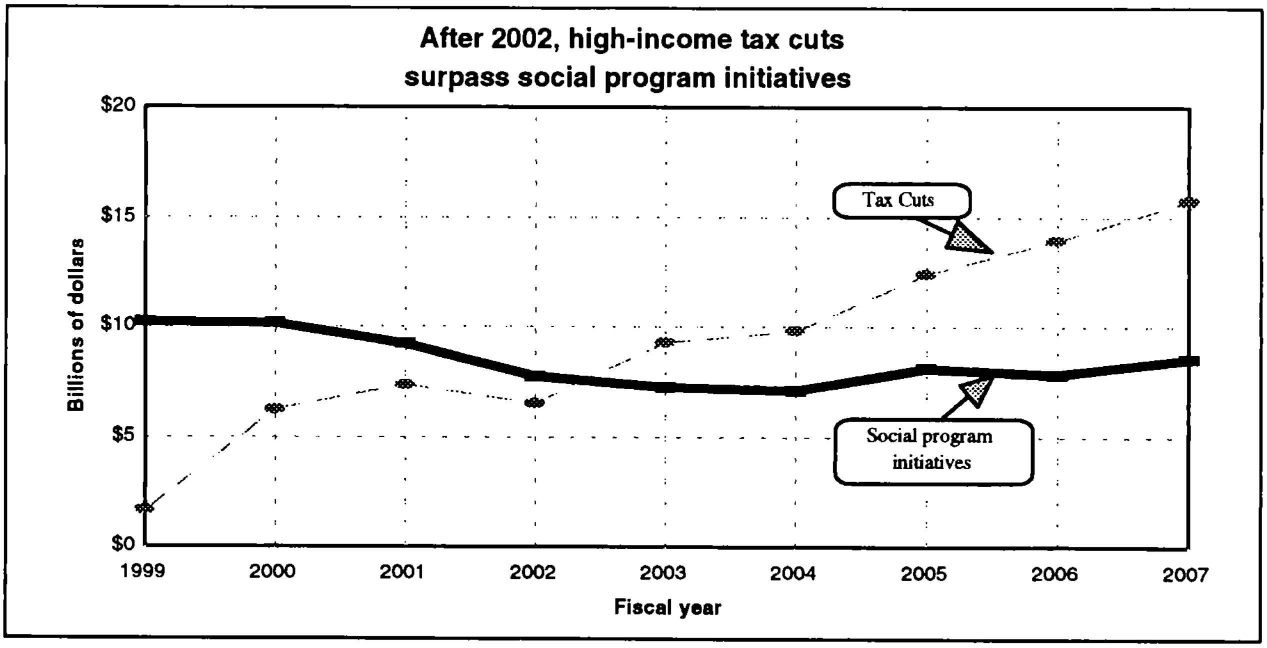
by Robert Greenstein

Some accounts of the new budget and tax legislation signed into law August 5 have portrayed the legislation as balancing substantial social program initiatives, such as increased funding for child health insurance, with tax cuts favored by the Congressional majority, such as capital gains and estate tax reductions. Examination of the new legislation, however, shows that its program initiatives — which primarily assist low- and moderate-income children and families, legal immigrants, and elderly people — are modest in size and dissipate over time. By contrast, its tax reductions for high-income individuals swell substantially and grow to large levels over time.

Within a few years, tax cuts targeted primarily on very high-income individuals will far exceed the combined cost of all the program initiatives in the new legislation. For example, by 2007, the estate tax reductions alone — which will benefit the heirs only of the wealthiest two percent of individuals who have died — will cost more than all social program initiatives combined.

- The legislation includes six significant social program initiatives, most of which operate through grants to states. *Funding for five of the six either terminates or declines after a few years.* These five initiatives are: 1) the child health block grant, which will insure fewer children as the years pass because its funding levels are either frozen or decline for a number of years; 2) funding to shield certain low-income elderly and disabled people from the costs of the legislation's increased Medicare premiums, an initiative that terminates after 2002; 3) the $3 billion in funding for states and cities to help move more welfare recipients into jobs, which is provided only in 1998 and 1999; 4) provisions softening the effects of the welfare law on legal immigrants, the effect and cost of which decline over time because they are largely limited to elderly and disabled immigrants present in the United States before August 22, 1996 and do not cover legal immigrants who arrive after that date; and 5) funding to create work slots for unemployed, childless food stamp recipients whose food stamp benefits are terminated after three months unless they can find such a work slot, an initiative for which the funding level is cut nearly in half after 2001. The one significant initiative for which funding does not decline after a few years involves the coverage of more preventive services under Medicare

820 First Street, NE, Suite 510, Washington, DC 20002 F:\BOB\BUDGET.LEG
Tel: 202-408-1080 Fax: 202-408-1056 center@center.cbpp.org http://www.cbpp.org HN0026



- In total, funding for these social program initiatives and restorations declines from $10.2 billion in fiscal year 1999 to $7.3 billion in fiscal year 2003, a decline of 37 percent, after adjusting for inflation. The funding level for these initiatives rises slightly in 2005 and in 2007, due largely to modest increases in those years in funding for the child health block grant, following a substantial reduction in the block grant funding level in 2002. In 2007, the funding level for these social program initiatives totals $8.6 billion, a 34 percent decline from the 1999 level, after adjustment for inflation.

  Looked at another way, funding for these social program initiatives declines from $46.7 billion in the first five years (fiscal years 1998 through 2002) to $39 billion in the second five years.

- By contrast, the tax cuts targeted primarily on wealthy individuals expand substantially as the years go by. Three major tax provisions focus the lion's share of their benefits on the top five percent — and especially the top one percent — of the population. These are the capital gains and estate tax cuts and the reduction in the corporate alternative minimum tax. These provisions lose $14.4 billion in revenue in the years through 2002, but $61.1 billion in the five years after that. Looked at on an annual basis, these tax cuts lose just $1.7 billion in fiscal year 1999. By 2007, they lose $15.7 billion, more than seven times their 1999 level, after adjustment for inflation. Their cost continues to rise significantly in years after 2007.[1]

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[1] The modest *revenue loss* figures for the high-income tax cuts in the first few years do not reflect the (continued...)

Table 1

CHANGES IN PROGRAMS AND TAXES OVER TIME UNDER THE NEW BUDGET AND TAX LEGISLATION[1]

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2007	1st 5 years	2nd 5 years
	(changes in outlays and revenues in billions of dollars)								
Social Program Initiatives	9.1	10.2	10.2	9.2	7.7	7.3	8.6	46.7	39.1
Reductions in Social Programs that are Entitlements	-7.8	-19.3	-34.5	-26.8	-48.8	-48.5	-68.6	-137.6	-318.1
Reductions in Discretionary Programs	8.5	-2.9	-15.1	-32.3	-53.8	-55.4	-62.6	-95.6	-294.7
Total Tax Cuts[2]	-9.3[3]	-9.8	-26.8	-27.6	-21.6	-32.7	-39.2	-95.1[3]	-180.1
High Income Tax Cuts	7.3[3]	-1.7	-6.2	-7.3	-6.5	-9.3	-15.7	-14.4[3]	-61.1
High Income Tax Cuts Plus IRAs	6.8[3]	-2.6	-7.1	-8.8	-8.5	-12.5	-23.4	-20.2[3]	-89.8

Source: Congressional Budget Office and Joint Committee on Taxation tables, as analyzed by the Center on Budget and Policy Priorities and adjusted to reflect effects of line-item vetoes.

Note: Columns and rows may not add due to rounding.

[1] Spending reductions are indicated with a minus sign. Tax cuts also are indicated by a minus sign to indicate a reduction in revenue.

[2] "Total tax cuts" refers to total *net* tax cuts, after the legislation's revenue-raising measures, such as the increases in the airline ticket tax and cigarette tax, are taken into account.

[3] Includes 1997 revenue effects

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[1] (...continued)
amount of *tax cut benefits* that high-income individuals will receive in these years. Due to the reduction in the capital gains tax rate, some investors are expected to sell assets in the next few years that they would have held if the capital gains rate had not been reduced. The increased capital gains taxes paid on these asset sales will increase federal revenue collections, shrinking the overall revenue loss from the high-income tax cut provisions in the first few years that these provisions are in effect. These increased revenues, however, do not constitute tax increases and do not lessen the value of the tax benefits that high-income individuals will receive from these tax provisions. The overall tax benefits that the high-income tax cuts provisions confer in the next few years thus will substantially exceed the revenue loss that results from these provisions in those years.

- These three tax cut provisions aimed primarily at wealthy individuals cost *almost twice as much* in 2007 as all of the social program initiatives combined. The estate tax cut alone costs $8.9 billion in 2007, more than the $8.6 billion cost for all social program initiatives. After 2007, the initiatives, which (with the exception of the Medicare initiative) are focused on low- and moderate-income families and individuals, continue declining in cost while the high-income tax cuts continue to grow.

While the new law's social program initiatives erode over time, the reductions the legislation makes in those benefit entitlement programs that sustain cuts mount substantially over time. The reductions the legislation makes in discretionary (or non-entitlement) programs also grow sharply in ensuing years.

- The combined reductions in Medicare, Medicaid, veterans programs, and housing programs total $19.3 billion in fiscal year 1999, $48.8 billion in 2002, and $68.6 billion in 2007. These reductions total $137.6 billion in the first five years and $318.1 billion in the second five years.

  The trajectory of mounting budget reductions in this area is due to the pattern of the Medicare and Medicaid reductions. The Medicare savings equal $119.1 billion in the first five years and $274.9 billion in the second five years.[2] The Medicaid savings equal $14 billion in the first five years and $39.9 billion in the second five years.[3] These savings will continue growing at a substantial clip in years after 2007. A large majority of the Medicare savings and most of the Medicaid savings are achieved through reductions in payments to medical care providers. The remaining Medicare savings come primarily from increases in Medicare premiums.) In the case of Medicaid, these reductions are achieved primarily by reducing payments to states for "disproportionate share hospitals" (hospitals that serve a disproportionate number of low-income and uninsured patients).

- The reductions in discretionary programs also are substantial, rising from $2.9 billion in fiscal year 1999 to $53.8 billion in fiscal year 2002 and

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[2] These figures include savings both in Medicare Part A, which is financed through a trust fund funded by payroll tax revenues, and Medicare Part B, which is funded by general revenues and beneficiary premiums. References to extending the solvency of the Medicare trust fund refer to Medicare Part A and not to Part B.

[3] These figures reflect the Medicare and Medicaid savings provisions in the legislation exclusive of the effects of the Medicaid and Medicare initiatives in the legislation. In this report, these initiatives are included as part of the legislation's social program expansions. The *net* savings in the Medicare and Medicaid titles, including the effects of the initiatives, are: for the Medicare title, $115.1 billion over the first five years and $270.4 billion in the second five years; and for the Medicaid title, $10.4 billion in the first five years and $37.4 billion in the second five years.

totaling $95.6 billion over the first five years.[4] The discretionary program reductions in the second five years will be much larger; assuming the overall funding level for discretionary programs in years after 2002 rises with inflation (which may prove to be a generous assumption), the discretionary program reductions will total $294.7 billion in the second five years.[5] (The reductions in discretionary programs discussed here represent the amounts that discretionary program expenditures in coming years will fall below the amounts that would have been expended if the overall funding level for these programs after fiscal year 1998 remained at the 1998 level previously set in law, with adjustment for inflation.[6])

It should be noted that as part of the budget negotiations, an agreement was reached to accord priority status in the fiscal year 1998 appropriations process to certain discretionary programs the Administration favors, such as Head Start. As a result, some of those programs are slated to receive funding increases in fiscal year 1998. It is not clear to what extent the protected status for these programs will continue beyond 1998. To the extent these programs maintain their increases after 1998, other discretionary programs will have to be reduced (relative to their current levels, adjusted for inflation) by corresponding amounts.

Tax Benefits and Low- and Moderate-Income Households

The new legislation also includes provisions that cut taxes for many families with children, principally through the child tax credit. The new law extends the child credit to substantially more moderate-income families than the House and Senate tax bills would have done, including many families in the $15,000 to $25,000 range. At the same time, working poor families and some working families just above the poverty line will not benefit. The 31 percent of children with the lowest family incomes will not qualify for the new child credit.

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[4] The discretionary spending ceiling was adjusted upward for fiscal year 1998. Much of the increase is expected either to be used for increases for programs that the negotiators established as priorities at the Administration's behest or to be absorbed by the spending effects in FY 1998 of programs funded in FY 1997.

[5] The new budget law places annual caps on both appropriations and expenditures for discretionary programs through 2002 (with separate caps on defense and non-defense discretionary programs in 1998 and 1999). The law does not address discretionary spending levels in years after 2002.

[6] Stated another way, these discretionary program reductions are the reductions from the discretionary spending levels in CBO's "capped baseline with inflation," which assumes that the capped funding level for discretionary programs that was in statute for FY 1998 would grow with inflation in years after FY 1998.

The child credit will erode in value over time because it is not indexed for inflation. The tax benefits this credit provides decline from $21.6 billion in fiscal year 2000 (when the $500-per-child credit level is provided for the first time) to $18.3 billion in 2007, a 31 percent decline after adjusting for inflation.[7] The benefits the child credit provides continue to erode after 2007. The erosion in the value of the child credit contrasts with the large increases over time in the value of the tax cuts focused primarily on high-income households.

A number of moderate-income families and many middle-income families also will benefit from the education tax credits. Because these credits are not refundable, however, poor and near-poor families will derive little or no benefit from them. In addition, many moderate-income families that have one or more children in college and also have one or more children under age 17 will not receive the full benefit of both the child credit and the education tax credits; use of one of these credits can reduce the income tax liability of these families to a very low level or eliminate the tax liability, making the other credit of little or no value to them.[8] (For these and other reasons, critics of these credits have argued that while the credits will ease the burdens of middle-class families with children in college, the credits will not do much to make college more affordable to those who can least afford to attend college and are deterred by the costs. Some critics also forecast that as a result of the education tax credits, college tuition costs will rise and financial aid packages will be reduced, lessening the value of the credits.[9])

The tax bill also includes empowerment zone and "Brownfields" provisions intended to promote economic growth in low-income communities and an increased tax subsidy for employers who have welfare recipients. These provisions are small, and their principal elements expire or phase out after several years. These provisions cost $1.2 billion in the first five years and $400 million in the second five years. In 2007, their cost is $20 million.

In short, the tax cuts that are more broad-based still exclude working poor families, are of only modest value to a significant number of moderate-income families,

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[7] Other reasons that the aggregate amount of benefits the child tax credit provides will decline over time are: 1) the income limits for the credit are not indexed; and 2) a modest, but growing, number of middle-class families will become subject to the individual alternative minimum tax in future years and lose part or all of their child credit as a result.

[8] The fiscal year 1998 appropriations bills now moving through Congress include a $300 increase in the maximum Pell Grant for low- and moderate-income students, pursuant to the budget agreement. Whether this increase will endure through the substantial reductions in discretionary programs that Congress must make by fiscal year 2002 to meet the new law's steadily tightening discretionary spending ceilings is unknown.

[9] See William G. Gale, *Tax Reform is Dead, Long Live Tax Reform,* The Brookings Institution, Brookings Policy Brief No. 12, 1997.

and (in the case of the child credit) erode over time. The tax provisions targeted at poor communities are small and fade out over time. The tax cuts for those at high-income levels expand substantially over time.

The trends in costs or savings related to the social program initiatives, the tax cuts targeted to high-income individuals, and the program reductions are discussed below in more detail.

Social Program Initiatives

Most of the significant social program initiatives in the legislation either terminate after a few years or decline over time.

Terminations

The legislation provides states with $1.5 billion over five years (through a new block grant) to defray the Medicare Part B premium costs of elderly and disabled individuals with incomes between 120 percent and 135 percent of the poverty line.[10] Those in this income category have incomes between $9,470 and $10,650 a year, measured in 1997 dollars.[11] (Individuals below 120 percent of the poverty line are already eligible to have their Medicare premiums paid through Medicaid.)

The funding to cover the premium costs of these individuals terminates, however, after 2002.[12] Starting in 2003, these individuals will have to bear the full Medicare Part B premium costs, which are increased under the new law. The Congressional Budget Office estimates that the premiums, now $43.80 per month, will rise to $74.20 per month in 2003 and $105.40 a month by 2007. CBO projects the premium will rise 79 percent between 1997 and 2007, after adjustment for inflation. Under prior law, the premium would have risen to $59.70 in 2007. The Administration had proposed to have Medicaid cover the full premium costs of those in this income bracket (as well as of those between 135 percent and 150 percent of the poverty line) on a permanent basis.

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[10] These funds also are to be used to cover a very small portion of the premiums borne by beneficiaries with incomes between 135 percent and 175 percent of the poverty line. Few beneficiaries in this income range are likely to avail themselves of this benefits, as the burden of applying is not likely to seem worth a benefit of only a few dollars a month.

[11] If the number of beneficiaries applying for this premium assistance exceeds the federal funds made available, states are authorized to establish waiting lists.

[12] For this funding to be continued after 2002, new legislation would have to be enacted, and the cost of maintaining this premium assistance in years after 2002 would have to be offset dollar for dollar through cuts in other entitlement programs or tax increases.

Table 2

SOCIAL PROGRAM INITIATIVES IN THE NEW LEGISLATION									
	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2007	1st 5 Years	2nd 5 Years
	(outlays in billions of dollars)								
Child Health (total)	4.9	4.9	4.9	5.0	4.0	4.0	6.0	23.8	24.1
Block Grant	4.3	4.3	4.3	4.3	3.15	3.15	5.0	20.25	19.4
Medicaid and Other Expansions	0.6	0.6	0.7	0.7	0.8	0.9	1.0	3.6	4.7
Other Medicaid Initiatives[1]	0.5	0.6	0.7	0.7	0.7	0.3	0.4	3.2	1.9
Immigrants	2.8	2.5	2.4	1.9	1.9	1.8	1.0	11.5	7.3
Welfare-to-Work	0.4	1.1	0.8	0.4	0	0	0	2.7	0
Food Stamps	0.2	0.3	0.3	0.3	0.3	0.2	0.3[2]	1.5	1.3
Medicare Prevention Initiative	0.3	0.8	1.0	1.0	0.9	0.9	0.9	4.0	4.5
Total	9.1	10.2	10.2	9.2	7.7	7.3	8.6	46.7	39.0

Note:

Source: Congressional Budget Office tables

Note: Columns and rows may not add due to rounding.

[1] Includes $1.5 billion in the first five years to pay Medicare premiums for certain low-income elderly and disabled people.

[2] The food stamp level declines from $349 million in 2001 to $269 million in 2007.

Also temporary in nature is the funding the new law provides in grants to states and cities to place more welfare recipients in jobs. The legislation provides $3 billion in such grants over two years.[13] This funding ends after fiscal year 1999, although states and cities may retain these funds until they are expended, which CBO projects will occur during 2001.

[13] States must provide matching funds to receive these federal grant monies. CBO assumes that not all states will provide the full amount of matching funds and that as a result, only $2.7 billion of the $3 billion will actually be expended.

Initiatives That Decline but Do Not Terminate

The funding for the new child health block grant erodes over time. The legislation provides states with $4.3 billion a year in block grant funds in fiscal years 1998 through 2001. Since health care costs will be rising over this period, this frozen funding level may insure fewer children as these years pass. Furthermore, in fiscal year 2002, the funding level for the child health block grant plunges by more than a quarter to $3.15 billion, a level at which it remains through 2004. In fiscal years 2005 and 2006, the funding level climbs back to $4.1 billion, still below the original level. In fiscal year 2007, the funding level is $5 billion, an amount smaller than the original $4.3 billion level when the original level is adjusted for inflation (and significantly below the original funding level if the adjustment made is for projected health care inflation rather than for general inflation).

CBO estimates that the number of previously uninsured children who will be covered under programs funded with child health block grant funds will average 1.7 million a year over the next five years.[14] This is an average number, however; the number of children insured as a result of this initiative may be smaller in the latter part of the 1998-2002 period than in the earlier part. Moreover, the 1.7 million number substantially overstates the average number of children who will be insured as a result of the block grant funds in the *second* five years, from 2003 through 2007, when block grant funding will generally be at lower levels while health care costs are higher.[15]

Some accounts have described the child health provisions of the new law as the largest expansion of health insurance since the establishment of Medicaid. Although the new expansion is certainly significant, these claims appear to be overstated. The Medicaid expansions of the late 1980s and early 1990s, which are still phasing in, appear to have added more children and pregnant women to Medicaid than the new legislation is projected to cover.[16]

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[14] The legislation also includes several modest Medicaid expansions designed to insure more children. CBO estimates these expansions will provide insurance to an average of approximately 400,000 previously uninsured children, bringing the total number of previously uninsured children who receive coverage due the legislation to an average of 2.1 million over the next five years.

[15] The legislation contains funding for several small Medicaid expansions that do not decline over time. These include: increased federal matching rates for Alaska and the District of Columbia, increased Medicaid payment limits for the territories, a state option to maintain continuous Medicaid eligibility for children for 12 months, and a state option for presumptive eligibility for low-income children. These provisions, each of which carries an average cost of less than $300 million a year (and in most cases, well under $200 million a year), have a combined cost of $2.4 billion in the first five years and 3.0 billion in the second five years. (These provisions, along with other Medicaid provisions that *do* terminate or decline, are included in the "Medicaid and Other Expansions" and "Other Medicaid Increases" lines in Table 2.)

[16] Data compiled by John Holahan of the Urban Institute show that the number of children enrolled

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Funding for the new law's immigrant benefit restoration also declines over time. The immigrant provisions primarily protect elderly and disabled immigrants who were present in the country before August 22, 1996, the date the welfare law was signed. Proposals in this year's Administration budget to protect poor legal immigrants who arrive after that date and become disabled after they have been living in the United States were rejected in budget negotiations this spring. In addition, an Administration proposal to extend Medicaid coverage to poor legal immigrant children who enter the country on or after August 22, 1996 was adopted by the Senate but rejected in conference and is not part of the new law. (The conference also rejected a Senate provision to allow states the option of serving poor legal immigrant children who arrive after August 22, 1996 under the new child health block grant.)

Over time, many of the elderly and disabled legal immigrants who were here before August 22, 1996 will die. Some others will become citizens. The CBO estimates show that the benefits restored to legal immigrants as a result of the new law will equal \$2.8 billion in fiscal year 1998 but decline to \$1.9 billion by fiscal year 2002 and slightly less than \$1 billion by fiscal year 2007.

Finally, the funding the new law provides for the creation of work slots for jobless food stamp recipients aged 18 to 50 who are not raising children drops 43 percent in 2002, even without considering the effects of inflation. The legislation provides \$131 million a year in new funding for these work slots in fiscal years 1998-2001, but the level falls to \$75 million in fiscal year 2002.[17] Under the welfare law, these individuals may receive food stamps for only three months while unemployed in each

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[16] (...continued)
in Medicaid grew by 5.3 million between 1988 and 1993, after adjusting for population growth, while the number of pregnant women enrolled grew 200,000. Furthermore, CBO estimates that the Medicaid expansions for children that were enacted in 1990 and are phasing in through 2002 are still adding an additional 125,000 children a year to Medicaid. By contrast, CBO projects that the number of children who will be added to Medicaid or separate state health insurance programs by the just-enacted legislation will average 3.4 million over the next five years, a number that, for reasons explained above, should decline in the years after that. (The CBO and Urban Institute numbers cited in this footnote include increases in enrollment by children previously insured through other sources.) Although a portion of the 5.3 million increase in Medicaid enrollment between 1988 and 1993 represents caseload growth attributable to other factors, it is quite unlikely that the new expansion will ultimately have a larger coverage effect than the series of Medicaid expansions enacted between 1987 and 1990. (See John Holahan, *Expanding Insurance Coverage for Children*, The Urban Institute, 1997, Table 3, and Congressional Budget Office, *Behind the Numbers, An Explanation of CBO's January 1997 Medicaid Baseline*, April 1, 1997, p. 5.)

[17] The food stamp line in Table 2 reflects not only the cost of the funding the legislation provides to states for these work slots but also the cost of the additional food stamp benefits that will be paid, since participation in these work slots will enable individuals to receive food stamps for more than three months while unemployed. In addition, the food stamp line in the table reflects the cost of the provision in the new legislation that gives states the option of granting hardship exemptions from the three-month food stamp time limit to 15 percent of those who otherwise would have their benefits cut off.

three-year period unless they are enrolled in a work program. Most states currently do not run such work programs for food stamp recipients. (The new legislation also contains a smaller food stamp provision costing about $100 million a year that gives states the option of granting hardship exemptions from the three-month food stamp time limit to 15 percent of those who would otherwise have their benefits cut off. This provision does not decline over time.)

Tax Cuts

The tax cuts follow a different path, mushrooming over time. The official estimates of the Congressional Joint Committee on Taxation show the tax cuts will lose $95 billion in the first five years and $180 billion in the second five years, for a total revenue loss of $275 billion over the next 10 years. Estimates by the Center on Budget and Policy Priorities indicate the tax cuts will lose approximately $500 billion during their second 10 years.[18]

The sharply escalating cost of the tax cuts is due almost entirely to the rising cost of several tax cut provisions aimed at the affluent. Three major tax cut provisions would direct the lion's share of their benefits to those at very high income levels — the capital gains tax reductions, the estate tax cut, and the reduction in the corporate alternative minimum tax. (CBO data show that the top five percent of the population receives 75 percent of the capital gains income in a given year.[19] The estate tax changes will benefit the heirs of the wealthiest two percent of decedents; all other estates were already exempt from this tax under prior law. CBO analyses also assume that the benefits of corporate tax cuts such as the corporate AMT reduction are distributed among taxpayers in proportion to their ownership of capital; as a result, this tax reduction will principally benefit those with high incomes, among whom ownership of capital is concentrated.) The cost of these three upper-income tax cuts swells from $14.4 billion in the first five years[20] to $61.1 billion in the second five years. These three tax cuts lose only $1.7 billion in fiscal year 1999, but the loss climbs to $6.5 billion by fiscal year 2002 and $15.7 billion in fiscal year 2007, with the costs still rising at that point.

The mounting costs of the tax cuts geared to the affluent become even more striking if the Individual Retirement Account tax cuts in the new legislation also are taken into account. Seventy percent of households could already qualify under prior

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[18] See Iris J. Lav, *The Final Tax Bill: Assessing the Long-Term Costs and the Distribution of Tax Benefits,* Center on Budget and Policy Priorities, August 1, 1997.

[19] Congressional Budget Office, *Perspectives on the Ownership of Capital Assets and the Realization of Capital Gains,* May 1997.

[20] Consistent with the presentation of the Joint Committee on Taxation, all revenue figures for the first five years include the legislation's effects in fiscal year 1997.

Table 3

SELECTED TAX CUTS IN THE NEW LEGISLATION	FY 1997-1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2007	1st 5 Years[2]	2nd 5 Years
	(revenues in billions of dollars)								
High Income Tax Reductions	*+7.3*	*-1.7*	*-6.2*	*-7.3*	*-6.5*	*-9.3*	*-15.7*	*-14.4*	*-61.1*
Estate Tax	0.0	-0.9	-1.3	-1.9	-2.1	-2.7	-8.9	-6.4	-28.1
Corporate Alternative Minimum Tax	-0.3	-0.9	-2.0	-2.5	-2.6	-2.8	-1.9	-8.2	11.7
Capital Gains	+7.6	+0.2	-3.0	-2.9	-1.8	-3.7	-5.0	+0.1	-21.3
Individual Retirement Accounts	*-0.5*	*-1.0*	*-0.8*	*-1.4*	*-2.0*	*-3.3*	*-7.7*	*-5.7*	*-28.7*
Regular	-0.4	-0.3	+0.1	-0.3	-0.9	-1.8	-5.0	-1.8	-18.4
Education	-0.2	-0.6	-0.9	-1.1	-1.1	-1.4	-2.7	-3.9	-10.3
High Income Tax Cuts Plus IRA's	*+6.8*	*-2.6*	*-7.1*	*-8.8*	*-8.5*	*-12.5*	*-23.4*	*-20.2*	*-89.8*
Total Tax Cuts[1]	-9.2	-9.8	-26.8	-27.6	-21.6	-32.7	-39.2	-95.1	-180.1

Source: Joint Committee on Taxation tables, July 30, 1997.

Note: Columns and rows may not add due to rounding.

[1] Reflects the total net revenue loss after the effects of the legislation's revenue-raising measures, such as increases in the airline ticket tax and gasoline tax, are taken into account.

[2] Includes 1997 tax effects

law for IRA tax deductions. The new IRA tax breaks are geared primarily to those who did not previously qualify — i.e., to the top third of the population. The wealthiest households, however, are not eligible for the new IRA tax breaks, which contain an income limit of $160,000 for married couples.

The combined cost of the capital gains, estate, corporate AMT, and IRA tax cuts in the new legislation rises from $2.6 billion in fiscal year 1999 to $23.4 billion in fiscal year 2007. By 2007, these tax cuts cost nearly three times as much as all of the social program initiatives combined. The cost of these tax cuts climbs from $20.2 billion in the first five years to $89.8 billion in the second five years.

Program Reductions and Long-Term Effects

While its social program initiatives dissipate over time and its high-income tax cuts expand sharply, the new legislation also displays one other distinguishing characteristic — the reductions it makes in the programs and parts of the budget it trims become substantially larger as time goes by. As Table 1 illustrates, the reductions in discretionary programs start small and then become substantially deeper. Similarly, Table 4 shows that the savings which the new law's Medicare and Medicaid savings provisions generate grow markedly over time as well.

On the one hand, the new law's inclusion of these steadily enlarging reductions in the health care entitlement programs and discretionary programs means that even with the swelling tax cuts, the legislation does *not* ultimately cause the deficit to be higher than would otherwise be the case. The legislation does produce long-term deficit reduction, although this deficit reduction is significantly smaller than it would be without the tax cuts.

Table 4

PRINCIPAL REDUCTIONS IN SOCIAL PROGRAMS FUNDED ON AN ENTITLEMENT BASIS[1]

	1998	1999	2000	2001	2002	2003	2007	1st 5 Years	2nd 5 Years
	(outlays in billions of dollars)								
Medicare title[2]	-7.0	-17.1	-30.7	-21.8	-42.4	-41.9	-57.8	-119.1	274.9
Medicaid title[3]	-0.4	-1.4	-2.7	-4.0	-5.2	-6.0	-10.1	-14.0	-39.9
Veterans title	-0.2	-0.5	-0.7	-0.6	-0.7	-0.1	-0.2	-2.7	-0.8
Housing[4]	-0.1	-0.2	-0.4	-0.5	-0.5	-0.5	-0.5	-1.8	-2.5
Total	**-7.8**	**-19.3**	**-34.5**	**-26.8**	**-48.8**	**-48.5**	**-68.6**	**-137.6**	**-318.1**

Source: Congressional Budget Office tables, July 30, 1997, as analyzed by the Center on Budget and Policy Priorities

[1] Includes reductions in mandatory spending only; does not include reductions in discretionary programs.

[2] Reflects reductions in the Medicare title of legislation; does not include effects of the Medicare expansions in the title, which are reflected in the "Social Program Initiatives" table (Table 2).

[3] Reflects reductions in the Medicaid title of legislation; does not include effects of the Medicaid expansions in the title, which are reflected in the "Social Program Initiatives" table (Table 2).

[4] Includes only mandatory savings in the housing area; does not include savings that are subject to appropriations action. Most funding for housing programs is discretionary, not mandatory.

On the other hand, since domestic discretionary programs tend primarily to benefit the middle class and the poor, the combination of steadily increasing discretionary program reductions, modest social program initiatives that erode over time, increased Medicare premiums, and large tax cuts for the affluent that mushroom over time means the new legislation will increase income disparities that already are wider here than in any other western, industrialized nation. (The reductions in Medicare and Medicaid provider payments are not mentioned here because it is difficult to assess the effects of these reductions on households in different income categories.[21])

In this regard, the reductions in discretionary programs, which will climb to $53.8 billion in fiscal year 2002, will likely prove to be of particular significance. Congress will determine each year through the appropriations process which specific discretionary programs to cut to meet the discretionary spending ceilings. Past experience suggests that families at low- and moderate-income levels could be affected significantly by the reductions made in this part of the budget. When discretionary programs were reduced during the 104th Congress, discretionary programs targeted on low- and moderate-income families and individuals bore a disproportionate share of that reduction. Discretionary programs targeted on those with low incomes constituted 21 percent of all funding for non-defense discretionary programs but bore 34 percent of the cuts made in such programs.[22]

Finally, even with the deficit reduction the legislation does achieve, deficits are projected to return and climb to levels dangerous for the economy when the baby boom generation retires. As a result, those elements of the new legislation that reduce taxes or increase expenditures likely will have to be offset eventually by further program cuts or by tax increases. In the years the baby boomers retire, the reduced effects of the social program initiatives in the new legislation will be small, but the revenue losses caused by the tax cuts will be substantial.

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[21] It remains to be seen to what extent these reductions in payments to medical care providers will result in reduced provider incomes and greater efficiency in the delivery of health care services and to what extent these reductions will lead to declines in the quality of care provided to beneficiaries and/or to cost-shifting to other payers (which, in turn, can result in higher co-payments or lower wages for employees whose employers face higher health insurance premium costs because of cost-shifting). Of particular significance from a low-income standpoint will be the effect of the substantial reductions in Medicaid payments to "Disproportionate Share Hospitals."

[22] The reductions in discretionary funding levels referred to here represent the changes between the funding levels appropriated for discretionary programs for fiscal year 1995 before the 104th Congress took office, as adjusted for inflation, and the levels the 104th Congress appropriated for fiscal year 1997. See Robert Greenstein, Richard Kogan and Marion Nichols, *Bearing Most of the Burden: How Deficit Reduction During the 104th Congress Concentrated on Programs for the Poor*, Center on Budget and Policy Priorities, December 1996.

NEWS RELEASE

CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE
Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@center.cbpp.org
http://www.cbpp.org
HandsNet: HN0026

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CONTACT: Herbert Schaffner,
Michelle Bazie, Isaac Shapiro
(202) 408-1080

TOP ONE PERCENT OF POPULATION RECEIVED AS MUCH AFTER-TAX INCOME IN 1994 AS THE BOTTOM 35 PERCENT, ANALYSIS FINDS

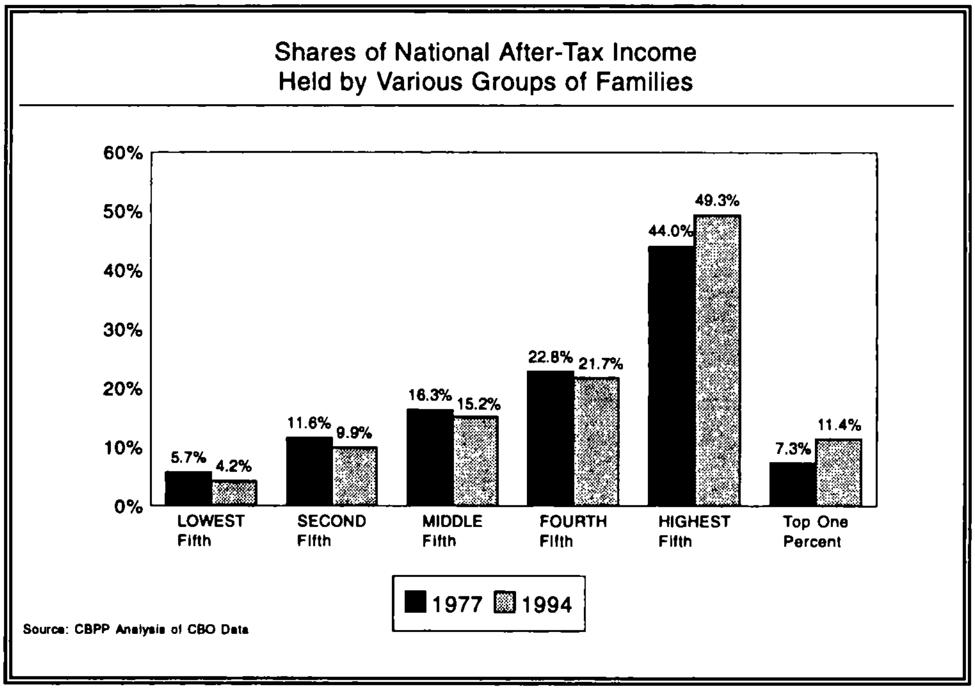
The wealthiest one percent of Americans received as much after-tax income in 1994 as the bottom 35 percent of the population combined — and the top 20 percent of the population had nearly as much income as the bottom 80 percent — a new analysis has found. The analysis, prepared by the Center on Budget and Policy Priorities, is based on data on income trends through 1994 that the Congressional Budget Office has compiled and issued in recent months for use by Congressional offices.

Between 1977 and 1994 — the first and last years for which CBO has issued these data — the share of the national after-tax income received by the top one percent of the population rose substantially. In 1977, the bottom 35 percent of the population had nearly twice as much after-tax income as the top one percent, the analysis found. By 1994, these two groups had essentially the same amount of income.

The Center's analysis of these data shows that in 1994, the 2.6 million wealthiest Americans (the top one percent of the population) had as much after-tax income as the 88 million with the lowest incomes (the bottom 35 percent of Americans). Similarly, the 52 million Americans with the highest income (the top fifth) received 49 percent of the nation's after-tax income, nearly as much as the other 206 million Americans.

"Income has become much more concentrated among a relative handful of the wealthiest Americans," noted Isaac Shapiro, a senior fellow at the Center and co-author of the report. Shapiro said that the average after-tax income of the top one percent of families equaled $374,000 in 1994, or 15 times the average after-tax income for the middle fifth of families, which stood at $25,650.

The analysis found that from 1977 to 1994, the average after-tax income of the wealthiest one percent of Americans rose 72 percent, after adjustment for inflation, and the average income of the nation's top 20 percent of families rose 25 percent. But the average after-tax income of the



poorest fifth of the population *dropped* 16 percent during this period, after adjusting for inflation, and the average after-tax-income of the middle fifth of the population was essentially unchanged, declining one percent.

Large Shifts in Income Between 1977 and 1994

The analysis found that these changes in the distribution of income since 1977 have had substantial effects on families across the income spectrum. The middle fifth of the population received 16.3 percent of the national after-tax income in 1977. By 1994, however, this share had declined to 15.2 percent. If the middle fifth of the population had received the same share of after-tax income in 1994 that it did in 1977 (i.e., if it had still received 16.3 percent of the after-tax income in 1994), families in the middle of the income scale would have received $38 billion more in after-tax income, or $1,800 more per family.

The middle fifth of families had average after-tax income of $25,650 in 1994. If these families had received the same share of the national after-tax income as they got in 1977, their average income would have been $27,540 in 1994. (See the table on the next page.)

— more —

	Average After-Tax Income in 1994		
	Actual	**If group's share of the national income had been the same as in 1977**	**The Difference**
Lowest Fifth	$7,175	$9,829	$2,654
Second Fifth	16,540	19,352	2,812
Middle Fifth	25,651	27,448	1,797
Fourth Fifth	37,226	39,129	1,903
Highest Fifth	80,417	71,736	-8,681
Top One Percent	374,131	241,176	-132,955

Similarly, if the poorest fifth of the population had received the same share of the after-tax income in 1994 as in 1977, it would have had $55 billion more in income in 1994, an average of $2,650 more per family.

On the other hand, if the richest one percent of the population had received the same share of the after-tax income in 1994 as in 1977, the group would have received $146 billion *less* in income, or $133,000 less per family. The share of the national after-tax income that the top one percent of the population received jumped from 7.3 percent in 1977 to 11.4 percent in 1994.

Trends Confirmed By Numerous Sources of Data

The CBO data on which the Center's analysis are based are derived from Census and IRS data. These CBO data are highly regarded for their comprehensive measurement of income and their portrayal of income trends.

The Center found that these CBO data are corroborated by other data that also document a significant concentration of income and assets among the wealthy. Census data on *before*-tax income show that between 1993 and 1995, the proportions of the national income that both the top 20 percent and the top five percent of households received were the largest proportions ever recorded since these data began being collected in 1967. In addition, data the Joint Committee on Taxation recently issued show that the wealthiest one percent of families will receive 11.0 percent of the national after-tax income in 1997, a finding almost identical to that reflected in the CBO data for 1994. Finally, Federal Reserve Board studies and other researchers have consistently found that the top fifth of families possesses an even larger share of the national *wealth* than of the national income.

New Tax Cuts Would Exacerbate These Trends

These income trends reflect the fact that the earnings of most middle- and lower-income workers failed to increase during the 1980s and 1990s, after adjusting for inflation. The budget agreements enacted in 1990 and 1993 sought to respond to the increasingly disparate distribution of the income gains from economic growth by asking high-income families to bear the preponderant share of the burden that those deficit reduction measures imposed and by providing substantial tax cuts to working poor and lower-middle-income families. By contrast, the tax provisions of the 1997 budget agreement, signed into law August 5, chart a different path.

"The tax cuts in the new budget agreement will not moderate the trend toward increasing income disparities," said Robert Greenstein, director of the Center and co-author of the report. "To the contrary, when fully in effect, the new tax cuts will exacerbate these trends and further intensify the concentration of after-tax income by providing the lion's share of their benefits to households at high income levels.

"Independent analysis by Citizens for Tax Justice indicates that the wealthiest one percent of households ultimately will receive nearly a third of the tax cut benefits," Greenstein continued. "This is a larger share of the tax cuts than the bottom 80 percent of the population will receive when the tax cuts are fully in effect."

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CENTER ON BUDGET
AND POLICY PRIORITIES

August 14, 1997

TRENDS IN THE DISTRIBUTION OF AFTER-TAX INCOME

An Analysis of Congressional Budget Office Data

by Isaac Shapiro and Robert Greenstein

The Congressional Budget Office recently released tables on after-tax income in the United States in 1994. A comparison of these data to data CBO previously had released for 1977 finds that the gains in after-tax income since the late 1970s have gone overwhelmingly to households in the upper parts of the income scale.

This analysis finds that *average* after-tax income climbed 9.5 percent during the 1977-1994 period, after adjustment for inflation. But most income groups did not share in these income gains. The bottom two-fifths of families experienced a *decline* in their average after-tax income over this period, after adjusting for inflation, while the after-tax income of the middle fifth of families remained essentially unchanged. By contrast, the after-tax incomes of high-income families rose sharply. The average after-tax income of the top 20 percent of families rose 25 percent during this period, after adjusting for inflation. The average after-tax income of the top one percent of households rose 72 percent.

As a result, the proportion of after-tax income that different groups of families received changed markedly over this period. In 1977, the top one percent of families received 7.3 percent of the national after-tax income. By 1994, they received 11.4 percent of after-tax income, as much as the bottom 35 percent of the population combined. The top one percent of families received $146 billion more in after-tax income in 1994 than they would have received if their share of national after-tax income had remained the same as in 1977.

Recent Income Trends

The Congressional Budget Office compiles information on after-tax family income based primarily on Census data and IRS data. The CBO data are currently available for selected years from 1977 through 1994. CBO only recently released data for 1994 to Congressional staff. This analysis examines the 1994 data and compares them to data for earlier years.

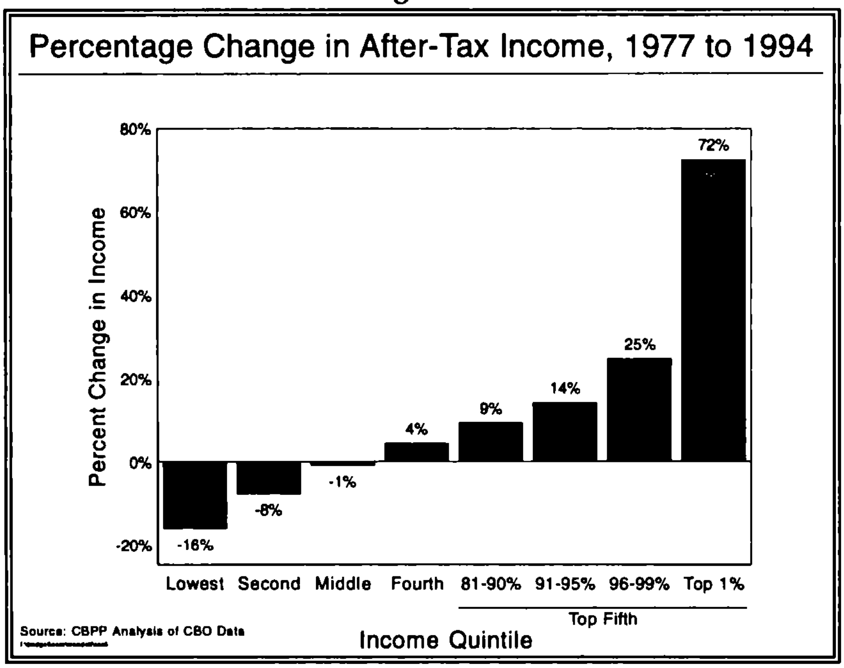
This analysis finds that average after-tax family income was 9.5 percent higher in 1994 than in 1977, after adjusting for inflation.[1] The increase in income was much greater than this for high-income families, while as a group, low- and middle-income families lost ground or simply stayed even.

- The top one percent of families experienced an average gain of 72 percent in their after-tax income from 1977 to 1994. (See Figure 1.) This was nearly eight times the 9.5 percent overall average gain.

- The average after-tax income of the top fifth of families rose 25 percent during this period.

- Among all other income groups, however, after-tax income either grew by less than the average or declined. For example, the average after-tax

Figure 1



[1] The CBO figures are based primarily on Census data on family incomes but reflect a fuller measure of income than Census data do. CBO also assigns families to different income quintiles in a somewhat different manner than the Census Bureau traditionally does. The Census Bureau groups families strictly by the amount of income they have, so that the 20 percent of families with the lowest incomes become the bottom fifth or quintile. CBO, on the other hand, accounts for the fact that larger families have greater income needs than smaller families. Accordingly, it adjusts each family's income according to the family's size before assigning the family to a quintile. This method accounts for the fact that a $20,000 income is far more ample for a single-person family than for, say, a family of five.

income of the next-to-the-top fifth of families grew just four percent over this period.

- The average income of the middle fifth of families was essentially stagnant, dropping one percent over this 17-year span.

- The bottom fifth of families saw a 16 percent decline in its average after-tax income. The average after-tax income of the next-to-the-bottom fifth fell eight percent.

Changes in Income Shares

The divergence in the extent to which different groups have benefited from recent economic trends has led to substantial growth in income disparities. Based on the CBO data, this analysis finds:

- From 1977 to 1994, the share of the national after-tax income received by the top one percent of the population jumped from 7.3 percent to 11.4 percent.

- In 1977, the bottom 35 percent of the population had nearly twice as much after-tax income as the top one percent. By 1994, these groups had essentially the same amount of income. Thus, *in 1994 the richest 2.6 million Americans had as much after-tax income as the 88 million people with the lowest incomes.*

- The top 20 percent of families received more than 49 percent of the nation's after-tax income in 1994, up from 44 percent in 1977.[2] Thus, in 1994, the top fifth of the population received nearly as much after-tax income as the other 80 percent of the population combined.

Figure 2 shows the share of after-tax income that the different income groups received in 1977 and 1994. Some of the changes shown in after-tax income shares may seem relatively small. For example, the middle fifth of the population received 16.3 percent of the national after-tax income in 1977; by 1994, this share had slipped to 15.2 percent. Yet seemingly small shifts in income shares reflect differences of tens of billions of dollars in the amounts of income going to various groups.

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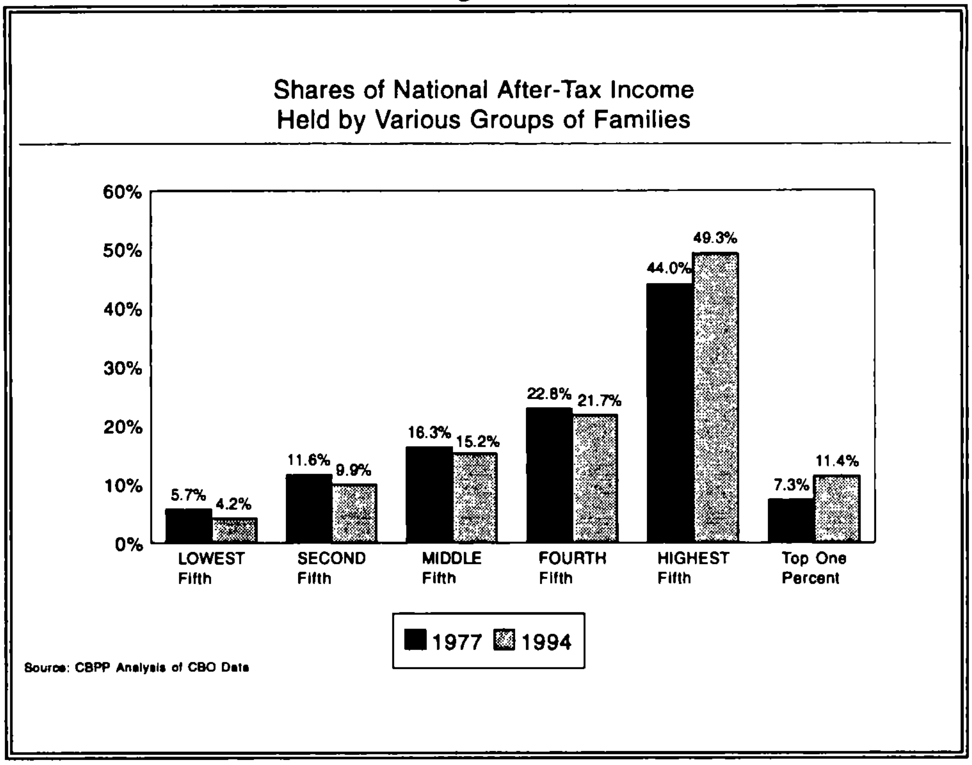
[2] This gain in the share of after-tax income that the top fifth of the population received actually was concentrated among the top 10 percent. The share of after-tax income received by the *next-to-the-top* 10 percent of the population decreased from 1977 to 1994.

Figure 2



- If the middle fifth of the population had received the same share of total after-tax income in 1994 that it did in 1977 (i.e., if it had received 16.3 percent of the after-tax income in 1994 instead of 15.2 percent), families in this income group would have received $38 billion more in after-tax income in 1994, the equivalent of $1,800 more per family.

  The average after-tax income of families in this bracket was $25,650 in 1994. If these families had received the same share of the national income as they received in 1977, their average income would have been $27,450 in 1994. (See Table 1.)

- Similarly, if the poorest fifth of the population received the same share of after-tax income in 1994 that it did in 1977, those families would have received $55 billion more in income in 1994, or $2,650 more per family. Stated another way, the bottom fifth of families had $2,650 less in income per family than it would have had if its share of national after-tax income had remained the same.

- The outcome is very different for those at the high end of the income scale. If the richest one percent of the population received the same share

Table 1

	Average After-Tax Income in 1994		
	Actual	If group's share of national income had been the same as in 1977	The Difference
Lowest Fifth	$7,175	$9,829	$2,654
Second Fifth	16,540	19,352	2,812
Middle Fifth	25,651	27,448	1,797
Fourth Fifth	37,226	39,129	1,903
Highest Fifth	80,417	71,736	-8,681
Top One Percent	374,131	241,176	-132,955

Source: CBPP analysis of CBO data

of after-tax income in 1994 as in 1977, these families would have received $146 billion *less* in income. The average after-tax income of the top one percent of the population was $374,000 in 1994. Had the top one percent received the same share of the national income in 1994 as it did in 1977, its average after-tax income would have been $241,000 in 1994.

Joint Committee on Taxation and Census Data Show Similar Trends

Tables issued by the Joint Committee on Taxation provide an additional source of data on the distribution of after-tax income. The data derived from the Joint Tax Committee tables are similar to those derived from the CBO tables.

- Both sets of figures indicate that the top 20 percent of families receive about half of the national after-tax income. The Joint Tax Committee tables indicate that the top 20 percent of households will receive 50.4 percent of after-tax income in 1997. The CBO data indicate that the top 20 percent of households received 49.3 percent of after-tax income in 1994.

- The Joint Tax data indicate that the wealthiest one percent of families will receive 11.0 percent of after-tax income in 1997. The CBO data indicate they received 11.4 percent of after-tax income in 1994.

Census data on *before*-tax income, which are available for a longer time period, also depict the marked trend toward greater income disparities. The Census data show that from 1993 through 1995, the proportion of national before-tax income that the top 20 percent of households received — as well as the proportion that the top five percent of households received — were the highest proportions recorded since these data began being collected in 1967.[3] Meanwhile, the share of national before-tax income that the bottom 40 percent of households received was at the lowest level ever recorded. (Inclusion of in-kind benefits in these calculations would have only a small effect on these findings. This matter is discussed in the appendix.)

Income Levels

The disparities in income levels among families in different parts of the income spectrum are large.

- The CBO data show that the average after-tax income of the top one percent of families equaled $374,000 in 1994.
- For the top 20 percent of families, it averaged $80,400.
- The middle fifth of families had average after-tax income of $25,650, one-fifteenth the average income of the wealthiest one percent.
- The bottom fifth of families had average after-tax income of $7,175.[4]

Policy Implications

The findings of this analysis of CBO data underscore the extent to which income has become concentrated in the United States. Federal Reserve Board and other studies show that the top fifth of families possesses an even larger of the national *wealth* than of the national income. In addition, these CBO data on after-tax income (as well as the

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[3] While the various Census indicators of income inequality were at record levels during this period, the shares of income that the top 20 percent and top five percent of households received were slightly lower in 1995 than in 1994. For example, the top fifth of households received 48.7 percent of before-tax income in 1995, compared to 49.1 percent in 1994. (These Census data are available through 1995.)

[4] The second poorest fifth had average after-tax income of $16,540, while the average income of the next-to-the-top fifth was $37,226. Switching to *before*-tax income, the average figures are: bottom fifth, $7,650; second poorest fifth, $19,337; middle fifth, $31,905; next-to-the-top fifth, $47,989; top fifth, $112,984; and top one percent, $576,929.

Joint Tax Committee data on after-tax income cited above) reflect income after *federal* taxes are subtracted; they do not subtract state and local taxes. Since state and local taxes are generally regressive — that is, low- and middle-income households pay a larger share of their income in these taxes than upper-income households do — the distribution of after-tax income would be shown to be even more uneven if state and local taxes were taken into account.

These income trends since 1977 primarily reflect the effects of changes in the private economy. Earnings trends have diverged widely for different groups, with those on the higher rungs of the wage scale gaining substantially, and other workers receiving wages that have essentially been stagnant or have declined. Changes in technology and international trade, as well as the weakening of unions, are among the factors that appear to be driving these diverging paths.

During the late 1980s and early 1990s, there was a widespread view that government policies should not exacerbate the increasing income disparities that developments in the economy are causing. This view was reflected in both the 1990 and 1993 budget laws. In both acts, high-income families were asked to bear a larger proportion of the deficit-reduction burden than middle- and low-income families. Partly as a result, the share of national after-tax income that the top 20 percent of families received fell from 49.8 percent in 1992 to 49.3 percent in 1994. The share of after-tax income received by the wealthiest one percent of families fell from 12.1 percent in 1992 to 11.4 percent in 1994. (Their share of income before taxes rose from 1992 to 1994.) Even so, the shares of after-tax income that the top 20 percent and top one percent of the population received in 1994 were far above their shares in the late 1970s.

The new budget agreement signed into law on August 5, 1997 charts a distinctly different path from the 1990 and 1993 budget laws. Under the tax provisions of the just-enacted legislation, low- and moderate-income families would receive relatively little tax relief, after the increases in excise taxes are accounted for, while the wealthiest families would receive the largest boost.

- An analysis by Citizens for Tax Justice estimates that the richest one percent of the population will receive 32.3 percent of the benefits from the tax cuts when the tax reductions are fully in effect. This is a larger share of the tax cuts than will go to the bottom 80 percent of the population.

- The top 20 percent of households will ultimately receive 78 percent of the tax cut benefits under the budget agreement, the CTJ analysis estimates.

Logic Used by Some Defenders of High-Income Tax Cuts Suggests That The Wealthier High-Income Households Become, The More They Need Tax Relief

In defending their tax cut proposals, some Congressional leaders have argued that the reason the tax legislation provides the lion's share of its tax relief to high-income taxpayers is that these taxpayers pay the majority of federal taxes. However, as this analysis indicates, the principal reason that high-income taxpayers pay the majority of federal taxes is that they receive the majority of the national before-tax income.

Moreover, the growth in the share of the national income going to high-income families points to a problem with the logic used by these defenders of the tax legislation's distribution of the tax cuts. Their logic suggests that as the share of national income received by high-income families grows — and thus, the share of federal tax payments borne by high-income families increases — the need of these high-income families for tax relief grows commensurately. The richer those with the highest incomes become relative to the rest of the country, this logic suggests, the more they — rather than other families — need tax relief.

The tax provisions of the budget agreement consequently will accentuate the already-large disparities in the distribution of income. High-income families — the one group whose average after-tax income has risen sharply since the 1970s — will ultimately be the principal beneficiaries.

Appendix

INCOME DISTRIBUTION AND IN-KIND BENEFITS

The standard Census data on income and the CBO data analyzed here do not include the value of in-kind benefits. Since low- and moderate-income households receive more assistance from government in-kind benefits than high-income households do, these benefits moderate income disparities somewhat. The effect, however, is relatively modest.

This can be seen by examining various experimental measures of income the Census Bureau uses. These measures, which provide information back to 1979, incorporate several types of income not included in the official Census income data — capital gains income, in-kind benefits, and the effects of federal income and payroll taxes, including the Earned Income Tax Credit.

Under all of these experimental measures, income disparities were wider in 1994 than in any other year since 1979, with the exception of 1986. Some measures of income disparities were wider in 1994 than in 1986, while others were narrower. The 1986 data are skewed at the top, however, because of a one-time jump in capital gains income, which reflected the "cashing in" of capital gains before higher capital gains tax rates took effect in 1987 as a result of the 1986 Tax Reform Act.

Also of note, the share of national resources that the bottom fifth of households receives does not increase dramatically when in-kind benefits are considered. Even when an expansive measurement of in-kind benefits that includes some valuation of Medicare and Medicaid benefits is used, the share of national income received by the bottom fifth of households rises by only 0.7 percentage points. Excluding Medicare and Medicaid, the share rises by 0.5 percentage points.