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ABSTRACT

Growing income disparities between wealthy Americans and those in low or moderate income brackets are contributing to a widening income gap between rural and urban areas. Proposed federal tax policy changes would primarily benefit upper income brackets and would likely widen the gap further. An analysis of census data indicates that since the early 1970s, the income gaps between rich and poor families and between rich and middle income families have widened considerably. Since a disproportionately large number of wealthy Americans live in cities, the income gap between rural and urban areas is also widening. The rural-urban impact of the following proposed tax policies that redistribute income upward are examined: (1) reduction of the capital gains tax, which would almost exclusively benefit urban residents; (2) expanded eligibility for tax-deductible contributions to Individual Retirement Accounts (IRAs), which would also go to urban taxpayers, causing significant revenue losses that would eventually have to be financed by tax increases or spending cuts; and (3) establishment of the Family Savings Account plan, which would also cause a transfer in income from rural to urban areas. These three proposals would provide little to the middle three-fifths of taxpayers and almost nothing to the poorest fifth but would benefit the wealthiest fifth; thus residents of urban areas would stand to benefit substantially more than their rural counterparts. Statistical data are included on one graph and three tables. A separate press release summarizing the report is also included. A form for ordering related publications is appended. (FMW)

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The Rural Disadvantage

Growing Income Disparities Between Rural and Urban Areas

Center on Budget and Policy Priorities

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Growing Income Disparities Between Rural and Urban Areas

Scott Barancik

Center on Budget and Policy Priorities
Washington, D.C.

The **Center on Budget and Policy Priorities**, located in Washington, D.C., is a nonpartisan, nonprofit research organization that studies government spending and the programs and public policy issues that have an impact on low income Americans. The Center is funded by grants from foundations.

About the Author

Scott Barancik is a research associate at the Center on Budget and Policy Priorities. He is the author of two recent Center reports on affordable housing for the poor and is co-author of various studies on poverty trends.

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Contents

Figures & Tables

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Executive Summary

Income disparities have widened in recent years both between the rich and the poor and between wealthy and middle income Americans. With most wealthy Americans residing in urban areas -- and rural areas accounting for a disproportionately large share of people with low incomes -- these widening income disparities have been accompanied by a growing rural-urban income gap. Tax policy changes now under consideration that primarily would benefit upper income Americans would likely widen these gaps further.

Gaps Between Wealthy and Other Americans Widen

Since the early 1970s, the income gaps between rich and poor families -- and between rich and middle income families -- have widened significantly. In 1988, the most recent year for which such data are available, these gaps were wider than at any time since the end of World War II.

- The richest fifth (or 20 percent) of all families in the United States received 44 percent of the national family income, the largest share recorded since the Census Bureau began collecting such data in 1947.
- The middle fifth of families received 16.7 percent of the national family income, a record low.
- The poorest fifth of families received 4.6 percent of the national family income, tying for the lowest share since 1954.

Other Census data tell a related story. Over the course of the 1980s, the average American family experienced two distinct income trends: a drop in income between 1979 and 1982 due to economic recessions, and a rebound between 1982 and 1988 due to an economic recovery. Not all families recovered from the recessions to the same extent, however.

Between 1979 and 1988, the average income of the richest fifth of families increased by 12 percent, or $9,100 per family, after adjusting for inflation. The average income of the wealthiest five percent of families rose 16 percent, or $17,900 per family. By contrast, the average income of the poorest fifth of families *fell* six percent over this period. The average income of families in the middle fifth rose a scant one percent.

These Census data reflect pre-tax income. As a result, they do not reflect the impact of changes in the federal tax code. In fact, at the very time income disparities were growing in the 1980s, federal tax burdens were increasing for low and middle income families, while declining for upper income families. These changing tax burdens further widened income disparities.

A recent analysis by the Congressional Budget Office found that between 1980 and 1990, the poorest fifth of American families will experience an average *after-tax* income loss of three percent, after adjusting for inflation. The middle fifth will experience an average increase in after-tax income of eight percent. Meanwhile, the top fifth of families will realize an average increase of 32 percent, the richest five percent will secure an average after-tax income gain of 46 percent, and the top one percent of families will obtain an average increase of *75 percent*.

In 1990, another CBO report found, the wealthiest one percent of the population will receive nearly as much after-tax income as will the poorest 40 percent of taxpayers put together.

Widening Rural-Urban Income Gap

This growing gap between wealthy and other Americans has somewhat different implications for rural and urban areas. Census data show that the vast majority of rural residents have low or moderate incomes, while only a small fraction have high incomes.

Urban residents are less likely than rural residents to have low or moderate incomes -- and more likely to have high incomes. As a result, to the extent that low income households are growing poorer and high income households are growing wealthier, overall income disparities between rural and urban settings tend to increase.

- In 1987, only 11 percent of rural households had incomes that placed them in the most affluent fifth of American households, while 23 percent of urban households had incomes this high. Thus, rural households were only half as likely as urban households to be in the top fifth. (See Table.)

- On the other hand, 26 percent of all rural households had incomes placing them among the *poorest* fifth of U.S. households, while 18 percent of urban households had incomes this low.

Distribution of Rural and Urban Households Within National Income Quintiles, 1987

National income category	Rural	Urban
Richest fifth	11%	23%
Next richest fifth	17	21
Middle fifth	21	19
Next poorest fifth	25	19
Poorest fifth	26	18
Total	100%	100%

Looked at another way, few wealthy people live in rural areas. The vast majority of the richest fifth of households -- 88 percent -- resided in urban locations in 1987. Only 12 percent of the households in the top fifth resided in rural areas. By contrast, some 29 percent of households in the poorest fifth lived in rural areas.

It should not be surprising then that the growing income gap between the wealthy and those in other income strata has been accompanied by a growing income differential between rural and urban areas. Incomes traditionally have been higher in urban areas than in rural areas, but in recent years this gap has widened further. Data from the Bureau of Economic Analysis show that between 1979 and 1987, per capita income in rural areas fell from 77 percent to 73 percent of per capita income in urban areas. Similarly, data from a variety of sources suggest that there is a large and still widening earnings gap between rural and urban locations.

Rural-Urban Impacts of Policies that Redistribute Income Upward

The link between these two trends -- the growing gap between wealthy and other Americans and growing income disparities between rural and urban areas -- has implications for public policy. Judging from the available data, public policies that primarily benefit wealthier groups also would tend to benefit urban residents disproportionately -- and thus widen further the gaps between rural Americans and their urban counterparts.

Current legislative proposals that primarily would benefit affluent taxpayers include the proposed reductions in the capital gains tax, proposals to expand tax deductions on deposits made in Individual Retirement Accounts, and the Family Savings Accounts recently proposed by the Bush Administration.

The Capital Gains Tax Cut

Data from the Joint Committee on Taxation on the distribution of tax benefits that would result from President Bush's proposal show that:

- More than 94 percent of the benefits from the capital gains tax cut would go to the top fifth of taxpayers. The top one percent of taxpayers -- those with incomes of more than $200,000 -- would receive approximately 66 percent of the benefits. Those taxpayers with incomes above $200,000 who would benefit from the cut would receive an average annual tax reduction of more than $15,000 apiece.

- By contrast, the middle three-fifths of taxpayers would receive less than six percent of the benefits from the capital gains proposal. Virtually none of the benefits would go to the poorest fifth.*

Because urban areas account for nearly nine-tenths of the top fifth of U.S. households, residents of these areas would receive the lion's share of the capital

*A separate analysis of President Bush's capital gains proposal by the Congressional Budget Office projected that if the proposal becomes law, some 68 percent of the wealthiest one percent of taxpayers would have capital gains income in 1991 and would benefit from the new tax break. By contrast, only two percent of the poorest fifth of taxpayers -- and seven percent of the middle fifth -- would have capital gains income and would be affected by the tax change in 1991.

gains tax cut benefits. Rural residents would gain little. Furthermore, Census data show that the distribution of capital gains income already is skewed heavily toward urban areas, with urban households acquiring a disproportionately high share of such income and rural households a disproportionately low share.

The Joint Tax Committee estimates that the Administration's proposal would cause a revenue loss of $11.4 billion between fiscal years 1990 and 1995. These revenue losses create the potential for additional income reductions for poor and middle income households.

Congressionally mandated deficit limits under the Gramm-Rudman-Hollings law require legislative proposals that would reduce revenues significantly to be offset by spending cuts or increases in taxes. If a capital gains tax cut is financed by tax increases not targeted on high income taxpayers, or by funding reductions in programs primarily serving low or middle income people, the *net* effect almost certainly will be to transfer income and resources from low and middle income households to upper income households. This, in turn, will likely result in a transfer of income and resources from rural to urban areas and would further widen rural-urban income disparities.

Expanded IRA tax breaks

With some exceptions, current law restricts eligibility for tax-deductible contributions to Individual Retirement Accounts to single taxpayers with incomes below $35,000 and couples with incomes below $50,000. Under various proposals to expand IRA eligibility, contributions made by taxpayers with incomes above these levels also would qualify for these tax breaks.

The Joint Committee on Taxation estimates that the tax benefits from one of the principal proposals to expand IRA tax deductions would be distributed in this way:

- Some 95 percent of the tax benefits would accrue to the top fifth of taxpayers.
- The richest three percent of taxpayers -- those with incomes of at least $100,000 -- would collect nearly one-third of the tax benefits.
- The bottom four-fifths of all taxpayers would share the remaining five percent of the IRA tax benefits.

Because of the relative scarcity of high income people in rural areas, these data suggest that residents of rural areas would gain much less than urban residents from the expansion of IRA tax breaks. (While the IRA proposal heavily favors upper income households, its benefits are significantly less skewed toward the very richest taxpayers than are the tax benefits from the capital gains proposal. Some 66 percent of the capital gains benefits would accrue to those with incomes of more than $200,000, compared to six percent of the IRA benefits.)

The IRA expansion would cause significant revenue losses -- an estimated $15.4 billion over the first five years it was in effect, according to the Joint Committee on Taxation. As with the capital gains tax cut, these revenue losses eventually would need to be financed by tax increases or spending cuts. This creates a strong prospect that income would be transferred up the income scale as well as from rural to urban areas.

Family Savings Accounts

President Bush's fiscal year 1991 budget includes a proposal to establish Family Savings Accounts. Married tax filers could deposit up to $5,000 per year in such accounts and keep all the interest tax-free, so long as they did not make withdrawals for seven years. Single filers could deposit up to $2,500 per year and receive the same tax break.

Available data suggest that the taxpayers most likely to take advantage of the Family Savings Accounts are those who lost eligibility for IRA tax deductions under the 1986 Tax Reform Act and who have enough income and assets to deposit up to $5,000 per year for seven years. In other words, the principal beneficiaries would be those in higher income brackets. Treasury Department data show that nearly half of the top fifth of eligible taxpayers made IRA contributions in 1985, but only 13 percent of the middle fifth of taxpayers -- and two percent of the poorest fifth -- did.

Family Savings Accounts would cause revenue losses of $5 billion between fiscal years 1991 and 1995, including $1.8 billion in fiscal year 1995 alone, according to the Joint Committee on Taxation. Here, too, the net effect of the proposed tax break -- and subsequent measures to finance it -- likely would be to transfer income from rural to urban areas, as well as from low and moderate income families to those who are more affluent.

I. Widening Rural-Urban Income Gap

Data from the Census Bureau show that the income gaps between rich and poor families -- and between rich and middle income families -- have been widening for nearly two decades. In 1988, the most recent year for which data are available, the rich-poor income gap was wider than at any time since the end of World War II. The gap between the rich and the middle class also reached a post-war high in 1988.

The widening gap between wealthy and other Americans has a distinct impact on rural areas. Census data show that the great majority of rural residents have low or moderate incomes. Only a small fraction have high incomes. As a result, most rural residents are among those hurt by growing disparities in income.

People living in urban areas are somewhat less likely than people in rural areas to have low or moderate incomes and are considerably more likely to have high incomes. The vast majority of wealthy families live in urban areas.

It should not be surprising then that the growing income gap between the wealthy and those in other income strata has been accompanied by growth in the income gap between urban and rural areas. Incomes traditionally have been higher in urban areas than in rural areas, but in recent years this already substantial gap has widened further.

The link between these two trends -- the growing gap between the wealthy and other Americans, and growing income disparities between rural areas and urban areas -- has implications for public policy. Judging from the available data, policies that primarily benefit wealthier groups also would benefit urban residents disproportionately -- and thus widen further the gaps between rural Americans and their urban counterparts.

Definition of Rural and Urban Areas

In this paper, the phrase urban areas is used to describe those areas designated by the Census Bureau as metropolitan statistical areas (MSA). The Census Bureau defines a metropolitan statistical area as "a geographic area consisting of a large population nucleus together with adjacent communities which have a high degree of economic and social integration with that nucleus. The definitions specify a boundary around each large city so as to include most or all of its suburbs. Entire counties form the MSA building blocks, except in New England where cities and towns are used... An area qualifies for recognition as an MSA if (1) it includes a city of at least 50,000 population, or (2) it includes a Census Bureau-defined urbanized area of at least 50,000 with a total metropolitan population of at least 100,000 (75,000 in New England)." (Bureau of the Census, U.S. Department of Commerce, *Poverty in the United States: 1987*, Series P-60, No. 163, February 1989, p. 153.)

The term rural areas is used here to describe those areas that the Census Bureau designates as being outside a metropolitan statistical area.

Gaps Between Wealthy and Other Americans Widen

One of the most distinctive economic trends of the 1970s and 1980s has been the growth of income inequality. Inequality began to increase in the early 1970s, although the increase has accelerated since the late 1970s. By 1988, the share of national income held by the richest Americans reached a historic high, while the shares of income held by low and middle income Americans had fallen to historic lows. In 1988:

- The richest fifth (or 20 percent) of all families in the United States received 44 percent of the national family income, the largest share recorded since the Census Bureau began collecting such data in 1947. (See Table I.)

- The middle fifth of families received 16.7 percent of the national family income, a record low.

Table I
Income Distribution of American Families in 1988

Population Category	Percentage of Total National Family Income Received	Historical Relation to Previous Shares
Poorest fifth	4.6%	Tie for lowest since 1954
Second poorest fifth	10.7	Lowest ever recorded
Middle fifth	16.7	Lowest ever recorded
Next richest fifth	24.0	
Richest fifth	44.0	Highest ever recorded
Richest five percent	17.2	Highest since 1952
Middle three-fifths	51.4	Lowest ever recorded

Note: Families with incomes of $15,102 or less made up the poorest fifth of families in 1988. Those with incomes between $15,103 and $26,182 made up the second poorest fifth. The income cutoff for the middle fifth of families was $38,500, while the cutoff for the next-to-the-top fifth was $55,906. All families with income above $55,906 were in the top fifth of families. The minimum income of the wealthiest five percent of families was $92,001.

- The poorest fifth of families received 4.6 percent of the national family income, tying for the lowest share since 1954.[1]

Other Census data tell a related story. From 1979 to 1982, a period marked by economic recessions, the average American family experienced a drop in income. These recessions were followed by an economic recovery, during which the average family saw its income rebound. Not all families recovered from the recessions to the same extent, however. The richest fifth of families were better off in 1988 than in 1979. But middle income families were at about the same income level -- and the poorest fifth of families were well below 1979 income levels, after adjusting for inflation.

[1] In fact, data from the Census Bureau understate the degree of income inequality that exists. Census data recognize only the first $299,999 of a household's income. If a household has income above that level, the data record the household as having income of $299,999. Income above that level thus is not counted as part of the share of income going to the top fifth. If the Census data did reflect income above $299,999, the distribution of national income in any year would be shown to be more unequal.

Moreover, as the late Joseph Pechman observed in his 1989 presidential address to the American Economics Association, Census data "greatly understate the *increase* in inequality that has occurred during the 1980s." Over the course of the 1980s, Pechman reported, the incomes of the wealthy -- particularly the top one percent of the population -- increased at a much more accelerated pace than the incomes of other Americans. Because the Census data on income distribution do not count household income above $299,999, the data miss most of this sharp increase in income at the very top of the income scale.

In short, the wealthiest families suffered the smallest percentage income drops during the recessions of the early 1980s while reaping the largest gains during the ensuing recovery. Meanwhile, the poorest families suffered the largest losses during the recessions and received smaller gains during the recovery.

- From 1979 to 1982, the average income of the richest fifth of families fell five percent, compared with an income decline of 10 percent among the middle fifth of families and a drop of 17 percent among the poorest fifth of families.

- From 1982 to 1988, the average income of the richest fifth of families rose 18 percent. The incomes of the middle and poorest fifths of families rose 12 percent and 13 percent, respectively.

The net result was that from 1979 to 1988, the average income of the richest fifth of families increased by 12 percent -- an average of $9,100 per family, after adjusting for inflation. Furthermore, the average income of the wealthiest one-twentieth of all families rose even more -- by 16 percent, or an average of $17,900 per family. By contrast, the average income of the poorest fifth of families *fell* six percent from 1979 to 1988, after adjusting for inflation. The average income of the families in the middle fifth remained essentially unchanged, rising a scant one percent. (See Figure 1.)

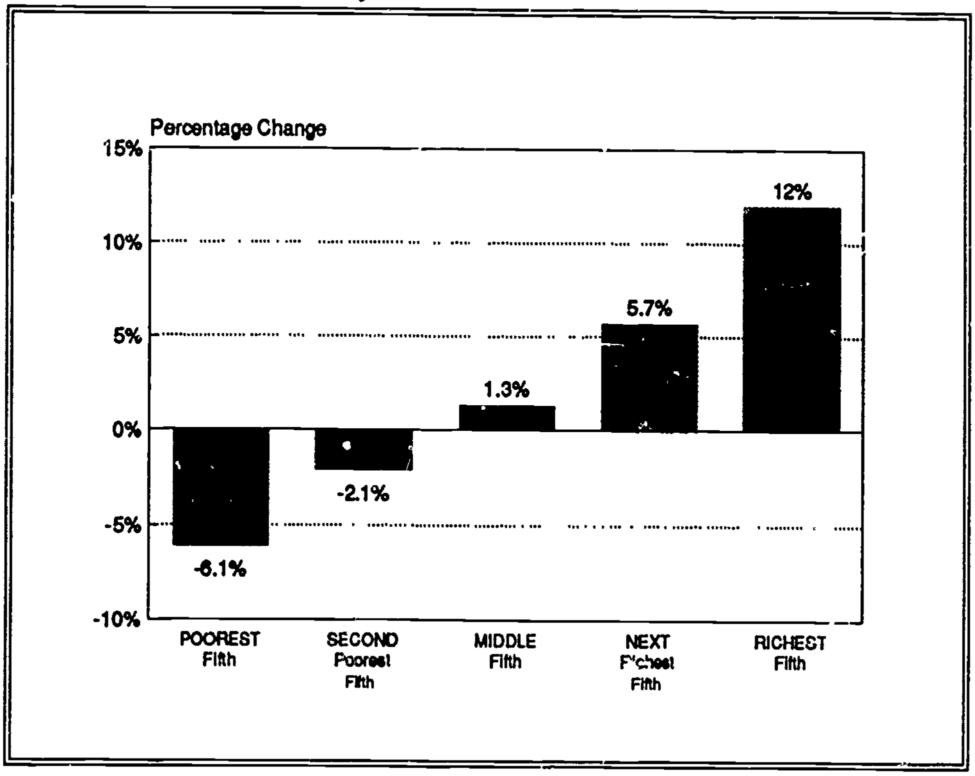
The Census data cited here are based on pre-tax income. They do not reflect the impact of federal tax code changes that widened income inequality still further. The impact of tax policy changes made in the 1980s is examined in a recent analysis by the Congressional Budget Office. CBO found that while income disparities were growing, federal tax burdens were increasing on low and middle income families and declining for upper income families. CBO projected that:

- From 1980 to 1990, the percentage of income that the poorest fifth of families pay in major federal taxes -- including income, payroll, and excise taxes -- will rise 16 percent.

- Over the same period, the percentage of income paid in taxes by the middle fifth of families will climb one percent.

- Among high income families, however, the percentage of income consumed by federal taxes will decrease. From 1980 to 1990, the percentage of income paid in federal taxes by families in the top fifth

Figure 1
Average Percentage Income Gains and Losses Between 1979 and 1988,
By Fifths of All Families



is expected to *drop* six percent. For the wealthiest one percent of families, the percentage of income paid in federal taxes is expected to decline 14 percent.[2]

CBO also found that these changing tax burdens have further increased income disparities. From 1980 to 1990, CBO estimated, the poorest fifth of American families will experience an average *after-tax* income loss of three percent, after adjusting for inflation, while the middle fifth will experience an average increase of eight percent. Meanwhile, the top fifth of families will realize an average increase of 32 percent, the richest five percent will secure an average after-

[2]In another recent report, CBO found that if federal tax rates in 1990 were the same as they had been in 1980, the bottom four-fifths of taxpayers would pay less in federal taxes, while the top fifth would pay somewhat more, and the top five percent would pay considerably more. Congressional Budget Office, data provided to the Committee on Ways and Means at the request of chairman Dan Rostenkowski, March 7, 1990, Table 1.

tax income gain of 46 percent, and the top one percent of families will obtain an average increase of *75 percent.*[3]

In 1990, another CBO report found, the wealthiest one percent of the population will receive nearly as much after-tax income as will the poorest 40 percent of taxpayers put together.[4]

Pechman Found Tax Policy Contributing to Growing Income Inequality

A recent study by the late Joseph Pechman underscores the contribution of tax policy changes to the growing gap between wealthy and other Americans.[5]

In his 1989 presidential address to the American Economic Association, Pechman showed that the tax burden on the wealthiest Americans has fallen substantially over the past several decades. Using "Statistics of Income" data from the Internal Revenue Service, Pechman found that in 1966, the top five percent of taxpayers paid an average of 33 percent of their incomes in federal, state and local taxes. By 1988, these taxpayers were being taxed at a rate of 27 percent.

Tax rates fell even further for the richest one percent of taxpayers. They paid 40 percent of income in taxes in 1966, but 27 percent in 1988. Over this period, their effective tax rate was reduced by one-third. By contrast, Pechman found that over this 22-year period, the percentage of income paid by other income groups changed relatively little.

The steeply reduced tax burden on the wealthiest Americans aggravated the already wide and growing gap between wealthy and other Americans, Pechman found. "The inescapable conclusion is that the well-to-do in our society have had very large reductions in tax rates in recent years, while the tax rates at the low and middle income levels have not changed much. Since the before-tax distribution has become much more unequal in the 1980s, it follows that inequality has increased even more on an after-tax basis."

Considering the magnitude of before-tax income gains by the wealthy in recent years, the fact that the tax system magnified these gains is particularly noteworthy. Pechman's analysis of IRS data showed that between 1981 and 1986, the share of *before-tax* income held by the richest one percent of taxpayers rose 81 percent.

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[3]Committee on Ways and Means, U.S. House of Representatives, *Background Materials on Federal Budget and Tax Policy for Fiscal Year 1991 and Beyond*, prepared for hearings held on February 6, 1990, pp. 10-11. Although based primarily on Census Bureau data, the CBO figures reflect a somewhat broader measure of income than do Census data. For example, CBO adjusts the Census data on pre-tax income to include the employer share of the Social Security payroll tax and the taxes that corporations pay on income. CBO assumes that the costs of these taxes are ultimately borne by individual taxpayers -- either by employers, in terms of lost income, or by employees, in lower wages.

[4]Congressional Budget Office, data provided to the Committee on Ways and Means at the request of chairman Dan Rostenkowski, March 7, 1990, Table 4.

[5]Joseph A. Pechman, "Why We Should Stick with the Income Tax," *The Brookings Review*, Spring 1990, pp. 10-11.

Rural Areas Hit Hard By Widening Income Gaps

The growing gaps between rich and poor -- and between the rich and the middle class -- have somewhat different implications for rural and urban areas. The vast majority of rural residents have low or moderate incomes, while only a small fraction have high incomes. Relatively few rural residents are among those high income Americans who have benefited most from the growth in income inequality.

By comparison, urban residents are less likely than rural residents to have low or moderate incomes and are more likely to have high incomes. As a result, to the extent that low income households are growing poorer and high income households are growing richer, overall income disparities between rural and urban settings increase.

- Only 11 percent of rural households had incomes that placed them in the most affluent fifth of American households in 1987. By contrast, 23 percent of households residing in urban areas had incomes placing them in this category. Thus, rural households were only half as likely as urban households to be in the top fifth.[6] (See Table II.)

- On the other hand, 26 percent of all rural households had incomes placing them among the *poorest* fifth of U.S. households -- while 18 percent of urban households had incomes this low.

- Furthermore, half of all rural households -- 51 percent -- had incomes that placed them in the bottom two-fifths of the national income distribution. Some 37 percent of urban households had incomes this low.

These data indicate that rural residents account for a disproportionately large share of Americans with low and moderate incomes and a disproportionately small share of high income Americans.

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[6]A modest portion of the gap between rural and urban incomes might be offset by differences in the costs of living in these areas. However, only certain items in the family budget are more costly in urban areas. Housing costs, for example, tend to be higher in urban areas, but some cost items, such as transportation, tend to be more expensive in rural areas. One recent study also suggests that food costs may be higher in some rural areas, due to lack of access to supermarkets. No study has conclusively quantified rural-urban cost differences across the whole range of family budget items, in part because the necessary data are unavailable. Nevertheless, rural-urban cost-of-living differences are likely to be relatively small when compared to the substantial disparities between rural and urban incomes. It is unlikely that any adjustment for cost-of-living variations would have much effect on the finding that a highly disproportionate share of the wealthiest Americans reside in urban areas.

Table II
Distribution of Rural and Urban Households
Within National Income Quintiles, 1987

National income category	Rural	Urban
Richest fifth	11%	23%
Next richest fifth	17	21
Middle fifth	21	19
Next poorest fifth	25	19
Poorest fifth	26	18
Total	100%	100%

Even when rural areas are compared with central cities (urban areas consist of both central cities and surrounding suburban areas), the income profile in rural areas is lower.

- While 11 percent of rural households had incomes placing them in the top fifth of all U.S. households in 1987, some 16 percent of all households residing in central cities had incomes this high.

- Fifty-one percent of rural households fell into the bottom two-fifths of the income distribution in 1987, while 47 percent of central city households did.

Widening Gaps Between Rural and Urban Areas

Income disparities between rural and urban areas have grown in recent years. Data from the Bureau of Economic Analysis of the U.S. Department of Commerce show that, over time, rural incomes have declined relative to urban incomes.[7]

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[7] A discussion of the factors behind the growth of the urban-rural income gap is beyond the scope of this paper. However, in a February 1987 report, one expert on rural economies, Robert A. Hoppe of the Economic Research Service of the U.S. Department of Agriculture, cited a number of possible factors. He pointed to the vulnerability of some rural ind[illegible] (agriculture, energy, forestry products, labor-intensive manufacturing) to foreign competition; a declining number of small farms, which has hurt communities that are dependent on them; "the shift to a service-based economy," which "has left much of [rural] America behind"; and the tendency of rural economies to be more specialized than urban economies, which has increased their vulnerability to declines in certain rural industries.

- In 1979, per capita income in rural areas was 77 percent of per capita income in urban areas.[8]

- During the economic downturns between 1979 and 1982, per capita income fell faster in rural areas than in urban areas. In the ensuing economic recovery, incomes rose more slowly in rural areas.

- By 1987, per capita income in rural areas was 73 percent of per capita income in urban areas.[9]

This widening income gap between rural and urban areas appears to have resulted in part from a growing gap in earnings. Other data from the Bureau of Economic Analysis demonstrate that average annual earnings per job fell eight percent in rural areas between 1979 and 1987, after adjusting for inflation. In urban areas, however, average annual earnings fell less than two percent during this period. (These earnings data include both full-time and part-time jobs.)

- In 1979, the average rural job produced earnings of $19,945. This was 20 percent less than the $24,908 in earnings produced by the average urban job. (All figures are expressed in 1989 dollars.)

- By 1987, the average rural job produced earnings of $18,270, nearly $1,700 less than in 1979. The average urban job produced earnings of $24,455 that year, or about $450 less than in 1979.

- As a result, by 1987, the average earnings from a job in a rural area were 25 percent less than the average earnings from an urban job. The gap in earnings between rural and urban jobs grew from about $5,000 in 1979 to nearly $6,200 in 1987.

A recent study by researchers at the Massachusetts Institute of Technology provides further evidence on this point. The researchers used Census data to

[8] "Per capita income" equals the total income of all residents within a given jurisdiction divided by the number of residents in that jurisdiction.

[9] Unlike Census Bureau income data, these data from the Bureau of Economic Analysis include non-cash income from some major government assistance programs, including food stamps, Medicare, and Medicaid. In addition, the BEA data and the Census data are based on somewhat different assumptions about which areas nationwide are classified as urban or rural. Data from the BEA for 1979, 1982 and 1987 are based on a constant designation of areas, introduced by the Office of Management and Budget in June 1988. Census data for 1979 and 1987 are based, respectively, on designations defined in the 1970 Decennial Census and on somewhat different designations introduced by OMB in June 1984.

determine how many workers were paid wages so low that the wages would fail to lift a family of four out of poverty if the worker were employed full time, year round. The M.I.T. study found that between 1979 and 1987, the proportion of workers receiving wages at such low levels increased markedly in both rural and urban areas, but that the increase was sharpest in rural areas. This was significant because the proportion of workers receiving such low wages was already considerably higher in rural than in urban areas in 1979.[10]

- In 1979, some 32 percent of rural workers earned a wage too low to lift a family of four out of poverty with full-time year-round work. Some 23 percent of urban workers earned wages this low.

- By 1987, some 42 percent of rural workers earned wages too low to lift a four-person family out of poverty, compared with 29 percent of urban workers.

Table III
Proportion of Rural Workers Earning Wages Too Low to Lift a Family of Four Out of Poverty with Full-Time Year-Round Work, 1979 and 1987

Census Region	1979	1987
New England	27%	31%
Mid-Atlantic	26	37
East North Central	28	39
West North Central	33	45
South Atlantic	33	43
East South Central	35	46
West South Central	39	47
Mountain	33	44
Pacific	27	36
U.S., Rural	32%	42%

Source: Lucy Gorham and Bennett Harrison, Massachusetts Institute of Technology.

[10] Lucy Gorham and Bennett Harrison, Massachusetts Institute of Technology, "Working Below the Poverty Line: The Growing Problem of Low Earnings Across the United States," prepared for the Ford Foundation and the Aspen Institute Rural Economic Policy Program, forthcoming (spring 1990). For a discussion of earnings trends in rural areas, also see Isaac Shapiro, *Laboring for Less: Working But Poor In Rural America*, Center on Budget and Policy Priorities, October 1989.

- Between 1979 and 1987, the proportion of rural workers earning wages this low increased in every region of the nation.[11] (See Table III.)

Urban Areas Home to Vast Majority of Richest Americans

As noted earlier, relatively few wealthy people live in rural areas. The vast majority of the very affluent reside in urban locations.

- Seven of every eight households in the richest fifth of Americans -- 88 percent -- lived in urban areas in 1987.[12] Only 12 percent of the households in the top fifth resided in rural areas.

- By contrast, 29 percent of households in the *poorest* fifth lived in rural areas.

Other data provide further evidence that few of the richest Americans live in rural areas.

- In 1987, more than nine of every 10 households with incomes of $75,000 and above -- 92 percent -- lived in urban areas.

- Only eight percent of the households above this income level resided in rural areas.

[11]The nine Census Bureau divisions are: *New England* (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont); *Middle Atlantic* (New Jersey, New York, and Pennsylvania); *East North Central* (Illinois, Indiana, Michigan, Ohio, and Wisconsin); *West North Central* (Iowa, Kansas, Minnnesota, Missouri, Nebraska, North Dakota, and South Dakota); *South Atlantic* (Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, and West Virginia); *East South Central* (Alabama, Kentucky, Mississippi, and Tennessee); *West South Central* (Arkansas, Louisiana, Oklahoma, and Texas); *Mountain* (Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, and Wyoming); and *Pacific* (Alaska, California, Hawaii, Oregon, and Washington).

[12]Affluent Americans are most likely to live in suburban areas. In 1987, some 61 percent of all households in the top fifth resided in the suburbs.

II. Rural-Urban Impacts of Policies that Redistribute Income Upward

The tendency for higher income people to live in urban areas means that policies primarily benefiting wealthy Americans also tend to benefit urban residents disproportionately.

Current legislative proposals that would primarily benefit higher income people include the proposed reductions in the capital gains tax, proposals to expand tax deductions on deposits made in Individual Retirement Accounts, and the Family Savings Accounts recently proposed by the Bush Administration. Under these proposals, affluent taxpayers stand to garner substantially larger tax benefits than poor or middle income taxpayers.

The Capital Gains Tax Cut

The Joint Committee on Taxation has analyzed the distribution of the tax benefits that would result from the President's proposal to reduce the capital gains tax. The Committee's data show that:

- More than 94 percent of the benefits from the capital gains tax cut would go to the top fifth of taxpayers. The richest three percent of taxpayers -- those with incomes of $100,000 or more -- would capture more than 83 percent of the tax benefits.[13]

[13] A small fraction of the tax units described here and in the section on Individual Retirement Accounts do not pay federal taxes. Most of those tax units not paying federal taxes are exempt because of their very low incomes.

- The top one percent of taxpayers -- those with incomes of at least $200,000 -- would receive approximately 66 percent of the benefits. Taxpayers with incomes of more than $200,000 who would benefit from the cut would receive an average tax reduction of more than $15,000 per year.

- By contrast, the middle three-fifths of taxpayers would receive less than six percent of the benefits from the capital gains proposal.

- Virtually none of the benefits would go to the poorest fifth of taxpayers.[14]

A separate analysis of President Bush's capital gains proposal by the Congressional Budget Office underscores these data.[15] CBO projected that if the capital gains proposal becomes law, some 68 percent of the wealthiest one percent of taxpayers would have capital gains income in 1991 and would benefit from the new tax break. By contrast, only *two percent* of the poorest fifth of taxpayers and seven percent of taxpayers in the middle fifth would have capital gains income and would be affected by this tax change in 1991.

Because urban areas account for nearly nine-tenths of the top fifth of U.S. households, residents of these areas would obtain the lion's share of the capital gains tax cut benefits. Rural residents would gain relatively little.

Furthermore, Census data show that the distribution of capital gains income is already heavily skewed towards urban areas.[16]

- Urban households made up 78 percent of all U.S. households in 1987, but they accounted for nearly nine-tenths -- or 89 percent -- of total capital gains income nationwide.

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[14] Joint Committee on Taxation, "Estimate of Administration Proposal for A Reduction in Taxes in Capital Gains on Individuals (JCX-5-90)," February 14, 1990. This document provides data on the distribution of the tax benefits from this proposal among taxpayers in different income brackets. Data on the proportion of taxpayers in each income bracket are from Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 1990-1994*, February 28, 1989. Both sets of data reflect 1990 income levels.

[15] Congressional Budget Office, "Distributional Effects of the Administration's Capital Gains Proposal," March 5, 1990, pp. 2-3.

[16] Center calculations based on unpublished data from the Bureau of the Census, *Measuring the Effects of Benefits and Taxes on Income and Poverty: 19[illegible]*, pp. 82-86.

- Rural households made up 22 percent of all households in 1987 but accounted for just over one-tenth -- or 11 percent -- of all capital gains income.

The Joint Committee on Taxation has reported that over time, a capital gains tax cut would lose large amounts of revenue and significantly increase the federal deficit. The Joint Committee's analysis of the President's capital gains proposal finds that it would increase federal revenue in fiscal years 1990 and 1991 as taxpayers cashed in assets to benefit from the new tax break. But this effect would be temporary. The Joint Committee estimates that in the four years after FY 1991, the Administration's proposal would cause a loss in revenue of $15.3 billion. Thus, there would be a net revenue loss of $11.4 billion from fiscal year 1990 to fiscal year 1995.

The revenue losses associated with the capital gains tax cut create the potential for additional income reductions for poor and middle income taxpayers. As a result of Congressionally mandated deficit limits under the Gramm-Rudman-Hollings law, most legislative proposals that would reduce revenues ultimately must be offset by spending cuts or tax increases. If the capital gains tax cut is financed by tax increases not targeted at high income taxpayers, or by funding reductions in programs that primarily serve low or middle income people, the *net* effect almost certainly will be to transfer income and resources from lower and middle income households to upper income households. This, in turn, will likely result in a transfer of income and resources from rural to urban areas, thereby widening rural-urban income disparities.

Expanded IRA Tax Breaks

With some exceptions, current law restricts eligibility for tax-deductible contributions to Individual Retirement Accounts to single taxpayers with incomes below $35,000 and couples with incomes below $50,000.[17] Under various proposals before Congress to expand IRA eligibility, contributions made by taxpayers with incomes above these levels also would qualify for these tax breaks, as they did prior to the Tax Reform Act of 1986.

[17] For those taxpayers participating in an employer-sponsored retirement plan, only single filers with incomes below $25,000 and married couples filing jointly with incomes below $40,000 can make the maximum deductible contribution to an IRA. The deductible amount is phased out for singles with incomes between $25,000 and $35,000 and for couples with incomes between $40,000 and $50,000. Taxpayers who do not participate in an employer-sponsored retirement plan are eligible to make fully deductible contributions to an IRA regardless of their income level.

The Joint Committee on Taxation has studied the distribution of the tax benefits that would result from one of the principal proposals to expand IRA tax deductions.[18] The Committee's findings show that:

- At least 95 percent of the tax benefits from the IRA proposal would accrue to the top fifth of taxpayers.

- The richest three percent of taxpayers -- those with incomes of at least $100,000 -- would collect nearly one-third of the tax benefits.

- The bottom four-fifths of all taxpayers would receive the remaining five percent of the tax benefits.[19] (However, this distributional pattern is still significantly less skewed toward the extremely wealthy than a capital gains tax cut.)[20]

Because of the relative scarcity of high income people in rural areas, these data indicate that residents of rural areas would gain much less from the expansion of IRA tax breaks than would urban residents.

Moreover, the IRA expansion would cause significant revenue losses. The Joint Committee on Taxation estimates that the IRA proposal discussed above would lose $15.4 billion over the first five years. Here, too, the revenue losses must be financed in some manner.

As with capital gains, the nature of the financing strategy would be of particular significance for rural residents. Unless the IRA proposal is financed by revenue increases targeted at higher income households, the net effect will be to transfer income from low to high income taxpayers -- and, accordingly, from rural to urban areas.

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[18]The IRA proposal cited here, introduced by Senator Lloyd Bentsen (D-TX), also would allow penalty-free withdrawals from IRAs for the purpose of paying costs associated with higher education or the purchase of a first home.

[19]Figures on the distribution of expanded IRA tax benefits by income bracket were calculated from two sources. To arrive at the figures for each income bracket, data on the distribution of expanded IRA tax benefits by income level, compiled by the Joint Committee on Taxation and issued by the Senate Finance Committee, were matched with Joint Committee data on the number of taxpayers within each income bracket. The latter data are from the Joint Committee on Taxation publication, *Estimates of Federal Tax Expenditures for Fiscal Years 1990-1994*, February 28, 1989.

[20]Some 83 percent of the benefits from the capital gains tax cut would go to taxpayers with incomes of at least $100,000 -- compared with 31 percent of the IRA benefits. Similarly, while some 66 percent of the capital gains benefits would go to taxpayers with incomes of $200,000 or more, a comparatively low proportion of the IRA benefits -- six percent -- would go to these taxpayers. The bulk of the IRA benefits would go to those in the $50,000 to $100,000 income range.

Family Savings Accounts

President Bush's fiscal year 1991 budget includes a proposal to establish Family Savings Accounts. Married tax filers could deposit up to $5,000 per year in such accounts and keep all the interest tax-free, so long as they did not make withdrawals for seven years. Single filers could deposit up to $2,500 per year and receive the same tax break.

The Congressional Budget Office projects that taxpayers with annual incomes above $50,000 -- many of whom currently are ineligible to make deductible contributions to an IRA -- would be the principal beneficiaries of this plan.[21] This projection is consistent with Treasury Department data on contributions to IRAs in 1985, prior to the elimination of IRA tax deductions for most upper income households.

The Treasury data show that in 1985, some 48 percent of the wealthiest fifth of eligible taxpayers made contributions to an IRA.[22] By contrast, only two percent of those in the poorest fifth of eligible taxpayers -- and only 13 percent of the middle fifth of taxpayers -- made IRA contributions in 1985.[23]

If low and moderate income taxpayers do not make contributions to IRA accounts -- under which they can now receive an *immediate* tax deduction -- it is unlikely they would take advantage of a Family Savings Account, which does not provide any immediate tax benefit. The taxpayers most likely to take advantage

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[21] Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1991*, p. 44, March 1990.

[22] These IRA participation rates may be somewhat overstated. Some taxpayers who were eligible for IRA tax breaks in 1985 could not be included in the count of eligibles reflected in these participation rates, due to limitations in the published data available from the Treasury Department. Under the tax laws that prevailed in 1985 (and under current law), eligibility for IRA tax breaks was restricted to taxpayers who had earned income -- income from wages, salaries, self-employment or a jointly owned business. To estimate the number of taxpayers who had earned income in 1985 -- and thus who were eligible for IRA tax breaks -- Treasury Department data on the number of taxpayers with wage and salary income were used. Using the published Treasury data, it was not possible to include in the count of eligibles the small number of taxpayers who had earned income from self-employment or a jointly owned business but did not also have any wage and salary income.

[23] The income data from the Treasury Department are based on a somewhat different concept of income than are the definitions employed by either the Census Bureau or the Bureau of Economic Analysis. The Treasury data represent "adjusted gross income" and exclude or make adjustments for certain types of income. For example, income from alimony, child support, and public assistance benefits are excluded from adjusted gross income. These forms of income are included in the Census and BEA definitions of income, however. (As noted earlier, the BEA's measure of income also includes the value of non-cash benefits from several major government programs; neither the Census nor the Treasury income measures include these non-cash benefits.) As a result of these differences, some taxpayers identified by the Treasury data as being among a certain fifth of taxpayers might be placed elsewhere in the income distribution by Census or the BEA.

of the Family Savings Accounts are those who lost eligibility for IRA tax deductions under the 1986 Tax Reform Act and who have enough income and assets to deposit up to $5,000 per year for seven years - in other words, taxpayers in the higher income brackets.[24]

According to the Joint Committee on Taxation, Family Savings Accounts would cause revenue losses of $5 billion between fiscal years 1991 and 1995, including a loss of $1.8 billion in fiscal year 1995 alone. As with the capital gains and IRA proposals, the revenue losses associated with the Family Savings Accounts ultimately must be paid for through tax increases or through reductions in funding for government programs. This creates the potential for income losses for poor and middle income taxpayers and for rural residents in particular.

Conclusion

The three legislative proposals described here would provide little to the middle three-fifths of taxpayers and almost nothing to the poorest fifth. Instead, these proposals primarily would benefit the wealthiest fifth of taxpayers.

Since nearly nine in 10 of the country's wealthiest households reside in urban areas, residents of urban areas would stand to benefit substantially more than their rural counterparts. Even so, few but the richest of urban households would benefit significantly. The vast majority of urban residents would receive no tax savings from these new or expanded tax breaks.

At the same time, these proposals would result in substantial losses of revenue, with corresponding increases in the federal deficit. Somehow, these revenue losses eventually must be "paid for." If the costs of these proposals are financed by increases in taxes that burden low and middle income taxpayers, or by reductions in funding for programs that serve low or middle income people, the effect will be to make many rural residents worse off -- and to aggravate the already wide income disparities between the wealthy and other Americans and between urban and rural areas.

[24]President Bush's proposal would limit eligibility for Family Savings Accounts to married filers with adjusted gross income below $120,000 and to single filers with adjusted gross income below $60,000. In practice, relatively few taxpayers would be ineligible for the tax breaks. Tax data from the Treasury Department show that in 1985, the most recent year for which published data are available, only two percent of all taxpayers filing joint returns had incomes exceeding $100,000 (an income of $120,000 in 1991 is approximately equivalent to an income of $96,000 in 1985). Thus, most of those in the top fifth of taxpayers would be eligible for the Family Savings Accounts.

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