

Trends in Income Mobility

From year to year, people can and do move from one income class to another. For periods as long as a decade, the changes in people's income, especially people in the lowest income group, are remarkable. This income mobility may affect statistics used to describe the income distribution. In particular, temporary changes in income from year to year exaggerate measures of income inequality. When properly accounting for earnings mobility, measures of income inequality decrease. Studies suggest that when income is averaged over several years, Gini coefficients are between 4 percent and 7 percent *lower* than they would have been if calculated using yearly data.

Evidence of Income Mobility

How frequently do people change from one income group to another? Table 1 shows movements in the income distribution from 1979 to 1988, as reported by an Urban Institute study on income mobility.¹ Almost half the people who were in the top-paid quintile in 1988 had been in a lower income category 10

years earlier. Only 30 percent of the people in the middle quintile in 1979 remained in that income category in 1988. Fifty percent of the people in the lowest-paid quintile in 1979 had risen to a higher income classification by 1988, and 6 percent of those individuals had moved all the way to the top income category. The people studied exhibited a movement toward the middle category, or average income. In other words, people who changed income over the study period tended to move from the extreme highs and lows toward the middle.

Because the Urban Institute study limits the sample to people between the ages of 25 and 54, a bias may be present in interpretations of this evidence. Bias may stem from the absence of two groups that are likely to experience dramatic swings over a seven-year period: people who are 25 or less are likely to receive income gains as they move into careers, and people who are 55 or older are likely to see income fall as their careers end. Thus, income mobility is likely to be understated in a study that is limited to individuals between the ages of 25 and 54.

The Effect of Income Mobility on the Distribution of Income

Statistics from the Urban Institute study seem to offer compelling evidence that substantial income mobility exists, but they cannot explain the effect income mobility has on the distribution of income. Temporary changes in income would not materially affect the

country's distribution of income if those random changes resulted in groups of equal size moving from one income classification to the next. For example, the income distribution (and, therefore, the Gini coefficients that describe it) would be unchanged if everyone in the lowest-paid quintile switched places with everyone in the highest-paid quintile.

One way to discern the effects of income mobility is to average income over several years, which subdues the effects of temporary changes in annual income. Conceptually, income averaging is an attempt to report people's lifetime income instead of highlighting momentary increases and decreases on a year-to-year basis. Joel Slemrod used IRS returns to examine income over four- and seven-year moving horizons.² He finds that Gini coefficients calculated from moving averages during the 1976–86 period are about 7 percent lower than Gini coefficients that are calculated from annual data. Thus, the evidence from these longer horizons suggests that income is more equally distributed than the year-to-year measures convey.

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¹ Sawhill, Isabel V., and Mark Condon (1992), "Is U.S. Income Inequality Really Growing?" *Policy Bites* (Washington, D.C.: Urban Institute, U.S. Department of the Treasury, June).

² Slemrod, Joel (1992), "Taxation and Inequality: A Time-Exposure Perspective," NBER Working Paper Series, no. 3999 (Cambridge, Mass.: National Bureau of Economic Research, February).

Table 1
Changes in Income Quintiles, 1979–88

Income Status in 1979	Income Status in 1988				
	Top-Paid Quintile	Next-Highest-Paid Quintile	Middle Quintile	Next-Lowest-Paid Quintile	Lowest-Paid Quintile
Top-Paid Quintile	53.0	25.0	11.0	6.5	4.0
Next-Highest-Paid Quintile	21.5	30.0	25.5	14.5	8.5
Middle Quintile	14.5	19.0	29.5	24.0	13.0
Next-Lowest-Paid Quintile	5.0	14.5	21.5	34.0	25.0
Lowest-Paid Quintile	6.0	11.0	12.5	20.5	50.0