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Typical American Family's Income Continues to Lag Behind Record Level of Late-1980s

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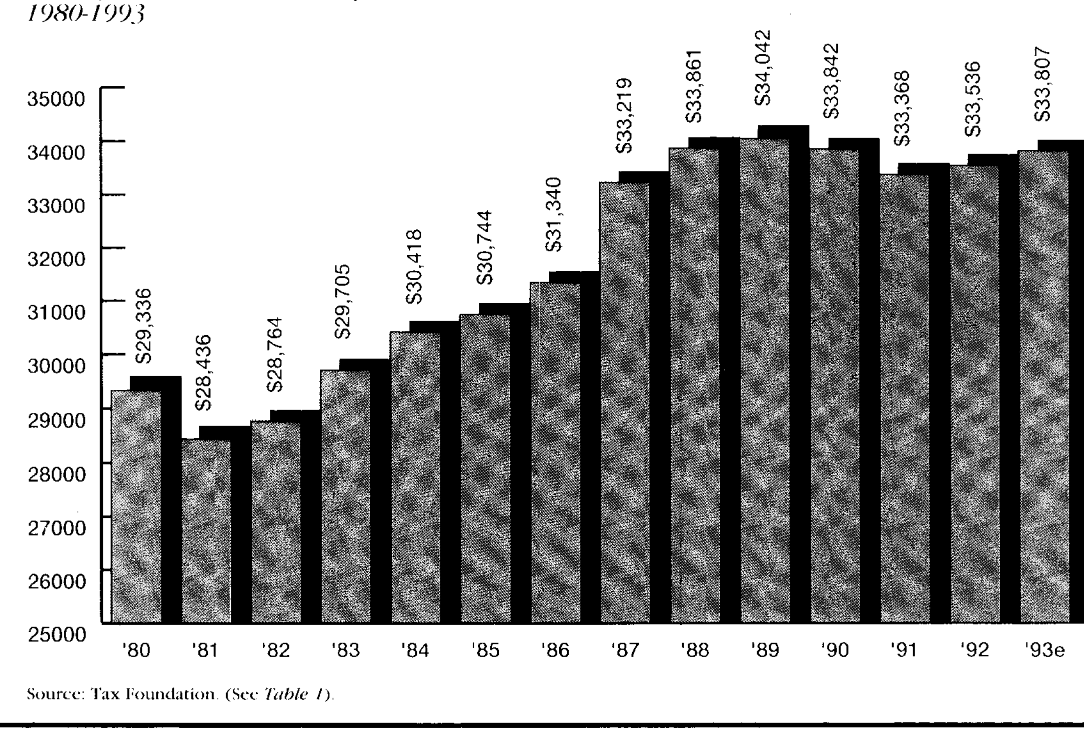
The typical American family's income, after taxes and inflation, still falls below the level reached in 1989 as the economy continues to grow slowly. *Figure 1* shows the growth in family income during the 1980s made possible by the booming economy and cuts in the federal individual income tax rate. But since 1989, the economic slowdown and a rise in state and local taxes and various federal taxes, such as the 1990 increase in the federal gasoline excise, have taken their toll on incomes.

The income of the median or typical family with two income earners, as measured by the Bureau of Census, is used as a starting point to analyze the change in federal, state, and local tax burdens since 1980. This family will earn $51,883 in 1993 but will be left with only $33,807 to spend on food, housing, transportation, and all other items after all taxes are paid.

While the two-earner median family income has climbed to its current level from $26,879 in 1980, according to the Bureau of

Figure 1
Real, After-Tax Median Family Income
1980-1993



Source: Tax Foundation. (See *Table 1*).

Census, most of that gain has been eroded by inflation and taxes. The 93 percent rise in pre-tax income has nearly been matched by a 90 percent rise in total taxes and a 73 percent rise in the general price level. The result: after-inflation, after-tax income for the typical family has risen only 15 percent since 1980 and has not risen at all since 1989 (see *Figure 1*).

Table 1 presents estimates of the tax load on the typical or median two-earner family from 1980 to 1993.

Income Tax Rates Fall as Payroll and State and Local Taxes Rise

The overall average tax rate for the typical family has hovered around 40 percent each year over the past decade. But *Figure 2* indicates that the composition of the tax load has changed. Whereas federal income tax rates have fallen for the typical family, from 15.0 percent in 1980 to 10.5 percent today, federal payroll taxes for Social Security have risen from 12.3 percent of income to 15.3 percent, and state and local taxes have risen from 11.4 percent of income to 12.6 percent.

Income tax rates fell following the Economic Recovery Tax Act (ERTA) of 1981 and the Tax Reform Act of 1986 (TRA86). TRA86 reduced the multiple income tax rate structure to two statutory rates of 15 and 28 percent (though various phase-outs of tax deductions complicated the structure somewhat). While two new top tax rates of 31 and 36 percent have been added since then, the median income earner continues to have almost all his income fall in the bottom 15 percent tax bracket. In addition, the personal exemption and standard deduction are now indexed for inflation, helping to keep the federal tax-take down.

Table 1 calculates the federal individual income taxes paid by the median two-earner family with two child exemptions and utilizing the standard deduction.

Table 1
Two-Earner Median Family Income Before and After Taxes and Inflation, 1980-1993

	Median Income[1]	Federal Income Taxes[2]	Social Security Taxes[3]	Other Federal Taxes	State & Local Taxes	Total Taxes	After-Tax Income[4]	Real After-Tax Income (1993$)	Real After-Tax Income Gain or Loss	Overall Effective Tax Rate %[5]
1980	$26,879	$4,022	$3,295	$1,210	$3,064	$11,591	$16,936	$29,336		41.3%
1981	29,247	4,646	3,890	1,345	3,246	13,128	18,064	28,436	-900	42.8
1982	30,342	4,320	4,066	1,062	3,520	12,967	19,407	28,764	328	40.8
1983	32,150	4,157	4,308	1,222	3,762	13,448	20,856	29,705	941	39.9
1984	34,668	4,546	4,854	1,352	4,056	14,808	22,287	30,418	713	40.7
1985	36,431	4,812	5,137	1,384	4,299	15,632	23,367	30,744	326	40.9
1986	38,346	5,133	5,483	1,380	4,640	16,637	24,451	31,340	596	41.3
1987	40,751	4,465	6,121	1,630	4,849	17,065	26,746	33,219	1,879	39.8
1988	42,709	4,512	6,415	1,666	4,997	17,589	28,327	33,861	643	39.1
1989	45,266	4,958	6,926	1,720	5,387	18,990	29,738	34,042	180	39.8
1990	46,777	5,057	7,157	1,684	5,613	19,511	30,844	33,842	-200	39.6
1991	48,169	5,080	7,370	1,782	5,973	20,205	31,649	33,368	-473	39.8
1992	49,984	5,218	7,648	1,999	6,298	21,163	32,645	33,536	168	40.2
1993e	51,883	5,442	7,938	2,127	6,537	22,045	33,807	33,807	272	40.4

1. Bureau of Census measure of median income of married couple with both husband and wife in paid labor force.
2. Married couple filing joint return with two dependent children.
3. Social Security taxes are total of employer's and employee's matching contributions.
4. After-tax income does not deduct employer's portion of payroll taxes from median income because this is assumed to reduce income before the "gross" seen on paycheck.
5. Total effective tax rate includes both shares of payroll taxes, but adjusts for the fact that the employer's share doesn't come directly out of median income as presented.

Source: Tax Foundation.

Social Security Payroll Taxes Rise

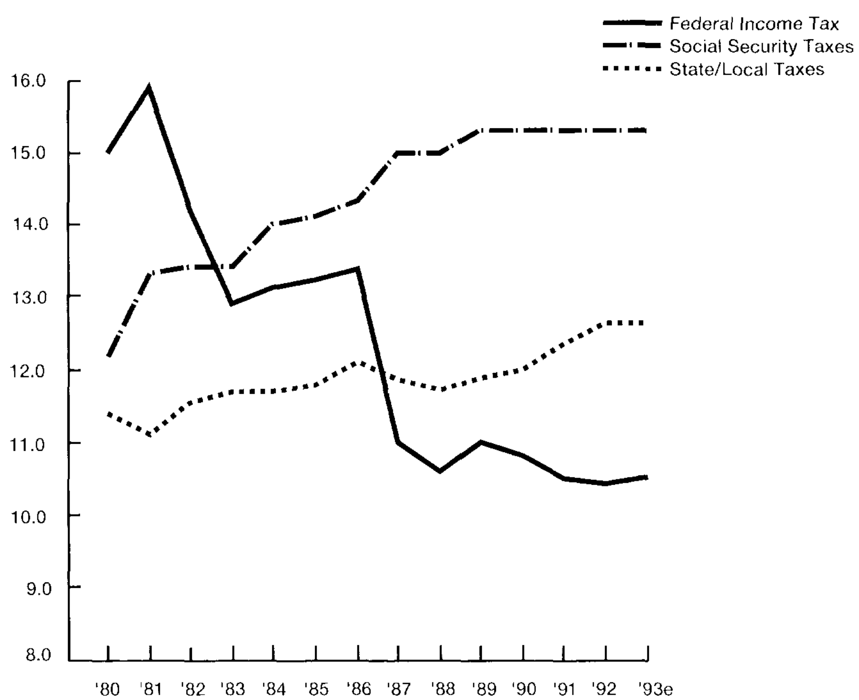
Federal income tax relief for the typical family has been offset by federal payroll tax increases to finance Social Security. The "Social Security," or "OASDHI," payroll tax actually funds three separate federal programs: the OASI (old-age and survivors insurance), which provides benefits for retired workers; the DI (disability insurance); and HI (hospital insurance), to provide Medicare health benefits for retired workers.

Working Americans may not be aware how much Social Security taxes they are paying because only half the tax burden is reflected in their paychecks. This is the "employee's contribution" of 7.65 percent of earnings. But for each employee, the employer must make a matching 7.65 percent contribution to the government as well. Most economists believe that the effect of the employer's share of payroll taxes is to simply reduce the gross pay of workers by the amount of the tax. (This effect is reflected in the calculations in *Table 1*.)

Federal Social Security payroll taxes have risen to the point where most American workers of lower and middle incomes now pay more in payroll taxes than they do in federal income taxes. In fact, the median family with two workers profiled in *Table 1* pays 46 percent more in payroll taxes than in federal individual income taxes—while a decade ago it was the opposite.

Table 1 documents this high burden of payroll taxes on wage and salary income. Whereas the federal government, in total, still collects more revenue from income taxes than payroll taxes, a family relying primarily on wage and salary income without significant income from savings will face a greater burden from payroll taxes.

Figure 2
Taxes as a Percentage of Median Family Income
1980-1993



Source: Tax Foundation.

Other Federal Taxes

A typical family can expect to lose another 4.1 percent of its income to a variety of other federal taxes. Americans started paying the recently passed 4.3-cent increase in the gasoline tax on October 1, 1993. The federal gasoline tax will then stand at 18.4-cents per gallon and will add to state government gasoline taxes, which now average 18-cents per gallon.

State and Local Taxes Steadily Rise

In the early 1990s, state governments have also been raising taxes, so that the typical American family now pays 12.6 percent of its income to state and local governments.

State and local governments raised tax rates during the economic slowdowns of both the early 1980s and early 1990s. In lieu of expenditure cuts, state and local governments generally raise taxes during slowdowns to balance budgets, since they generally don't have the option of continuously running deficits like the federal government.

Taxes Dominate the Family Budget

Figure 4 shows that taxes represent the largest component of a typical family's expenses. Federal, state, and local taxes represent 40.4 percent of a typical family's income in 1993. This is a larger bite out of the family's income pie than housing, food, and medical care combined.

Figures 3 and *4*, based upon Department of Commerce personal consumption expenditures data, show how the typical family's budget has changed since 1980. Most notably, expenditures on medical care, recreation, and "other" take a larger slice out of income now, while all other major spending categories take a smaller slice. Within "other," spending on education and foreign travel has increased quickly.

Outlook for the Family Income

After taxes and adjusting for inflation, *Table 1* indicates that the median or typical family's income has not yet reached the peak achieved in 1989 following the strong growth of the 1980s. The outlook for the typical family's income is uncertain. Small increases in income in 1992 and 1993 reflect the sputtering growth in the economy compared to the robust recovery and expansion experienced after the early 1980s recession.

In addition, increased payroll taxes on employers and employees may be on the way as Congress moves ahead with the Clinton administration's health care program. These and other tax increases may wipe out any increases in income from any stronger growth in the economy.

Figure 3
Typical American Family Expenses, 1980

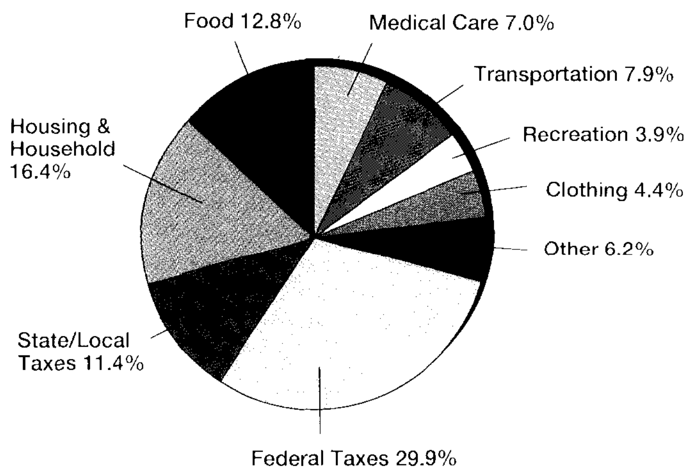
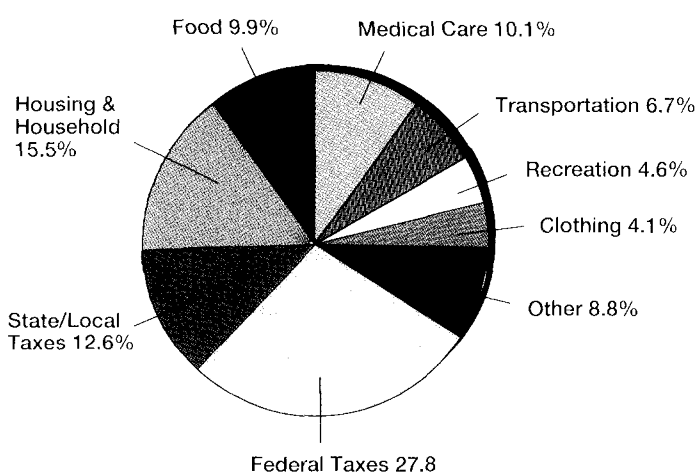


Figure 4
Typical American Family Expenses, 1993



Source: Tax Foundation calculations based on Commerce Department personal consumption expenditure data.

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