Science & Technology

Is the Wealth Gap Really New?

Spring 2017

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Many economists say that income inequality in the US has risen sharply in recent decades. However, a forthcoming paper by Columbia economist Wojciech Kopczuk and Yale legal scholar Conor Clarke suggests that the gap between rich and poor has not grown as much as is commonly believed. Comparisons to previous eras are off, the authors say, because economists have failed to account for the fact that many business owners used to hide some of their personal income in company coffers.

Kopczuk and Clarke came to this conclusion after analyzing corporate tax records dating back to the 1950s. In comparing the yearly earnings of tens of thousands of companies — whose tax returns the IRS periodically releases to researchers in aggregate, anonymized form — they found evidence that the owners of small-to-medium-sized corporations would often keep some of their earnings in the company rather than taking the money home as salary. The researchers speculate that this practice was common because for most of the twentieth century the highest US corporate-tax rate was lower than the highest individual income-tax rate — thus giving wealthy entrepreneurs incentive to treat their companies' ledgers as personal savings accounts.

"This strategy fell out of favor rather abruptly when, in 1986, individual tax rates were lowered, finally putting them below the corporate rates," says Kopczuk. "We think that many business owners up until then had been limiting the compensation they gave themselves because they knew they could always access their company's money down the road."

Kopczuk and Clarke say that more research will need to be done to determine how much of the income retained by US companies before the 1980s ought to be considered the personal earnings of their owners. But they say that their preliminary findings suggest that economists who have previously studied US income inequality have dramatically underestimated the true proportion of the nation's income once earned by the richest 1 percent.

"Understanding how income inequality affects a nation's long-term growth is of critical importance," says Kopczuk. "Gaining a more nuanced picture of how our economy has operated in the past, and learning whether or not inequality has hindered it, is essential to developing sound economic policies in the future."

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