

Estate Taxation, Entrepreneurship, and Wealth

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Policy debate

“The estate tax is immoral and counter-productive. ... My office has received hundreds of letters and emails from individuals and small business owners in my district. These people are not rich, but they have worked hard and saved to create an inheritance for their children...” Ron Paul, 14 district of Texas.

”I believe that we need to repeal the estate tax. It is bad for businesses. It’s bad for workers and new job creation.” Senator Patty Murray, Washington State.

"I have continuously supported reforming the estate tax, but a complete repeal is fiscally irresponsible, and serves to benefit only mega multi-millionaires while harming our economy..." Bart Stupak, 1 district of Michigan.

"Do we really have to protect the billionaires? We are talking about the richest 2%." Former Senator Tom Daschle, South Dakota.

Model: heterogeneity and occupational choice

Households have heterogeneous productivity as

- workers
- entrepreneurs

High ability entrepreneurs face high implicit rate of return.

Borrowing constrained entrepreneurs save.

Households

Overlapping generations with altruism.

Two stages of life: young and old, stochastic aging

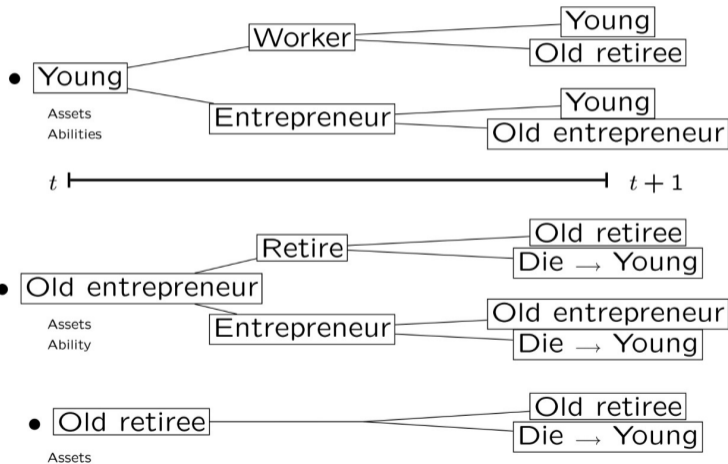
Technology

- entrepreneurial sector:
 $\theta(k_t^\gamma(1+n_t)^{1-\gamma})^\nu - \delta k_t$
- non-entrepreneurial sector:
Cobb-Douglas technology

Credit markets

- workers can save at \bar{r}
- imperfectly enforceable contracts, borrow $(k - a)$:
invest k , repay at the end of the period
be worker and keep fk
value (investing and repaying) \geq value (keeping fk) and being a worker
- e can borrow at \bar{r} , invest k

Time line of decisions



Government

- collects taxes
- pays old-age social security p
- government expenditures
- pays interest on government debt
- balanced budget

Taxes

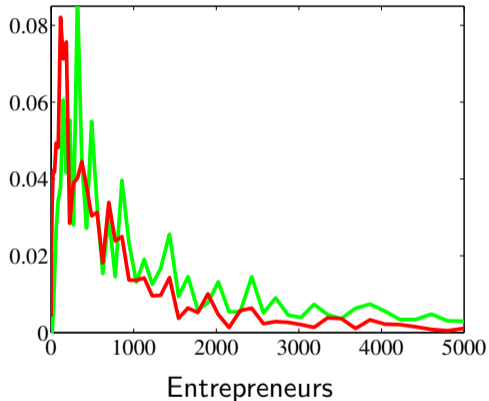
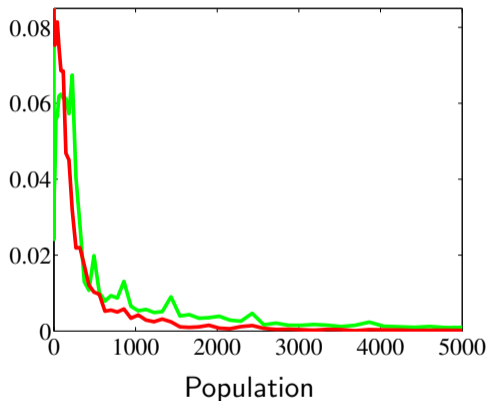
- Estates: exemption level ex_b , tax rate (τ_b)
- Consumption: τ_c
- Total income

$$T_i(Y) = \tau_i(Y)Y + \tau_s Y, \quad i = e, w$$

Adding up savings

- Entrepreneurial sector
- Non-entrepreneurial sector (Cobb-Douglas tech.)
- Government bonds
- market clearing \bar{r}

Distribution of wealth: matches well also for entrepreneurs



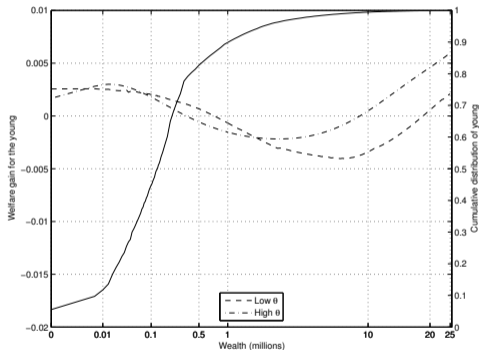
Red line: data; green line: baseline model.

Abolishing the estate tax and

- cutting wasteful government spending
- increasing the consumption tax
- increasing the proportional tax on total income

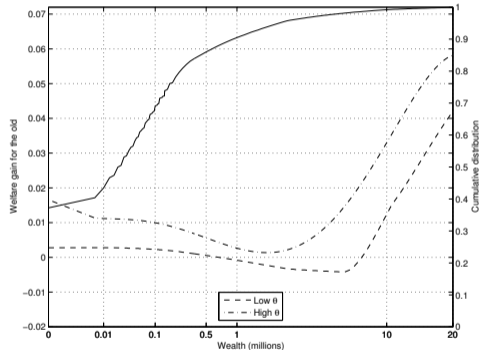
| K | Y | Interest rate | Perc. Entr. | Perc. wealth held by top | | | |
|--------------------------------|-------|---------------|-------------|--------------------------|------|------|------|
| | | | | 1% | 5% | 10% | 20% |
| Benchmark economy | | | | | | | |
| 9.02 | 3.00 | 3.33% | 7.6 | 29.5 | 59.5 | 73.6 | 85.4 |
| No estate tax, lower g | | | | | | | |
| +2.4% | +1.3% | 3.14% | 7.6 | 30.5 | 60.6 | 74.2 | 85.8 |
| No estate tax, higher τ_c | | | | | | | |
| +2.7% | +1.4% | 3.12% | 7.6 | 30.5 | 60.6 | 74.2 | 85.8 |
| No estate tax, higher τ_s | | | | | | | |
| +0.8% | +0.1% | 3.22% | 7.6 | 30.4 | 60.3 | 74.0 | 85.7 |

Welfare gains and losses from abolishing the estate tax and cutting government spending.



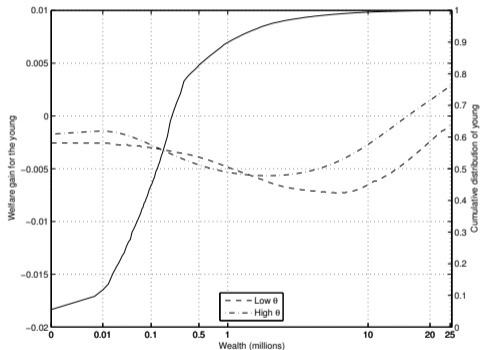
Young

Average gain: 0.2% yearly consumption.



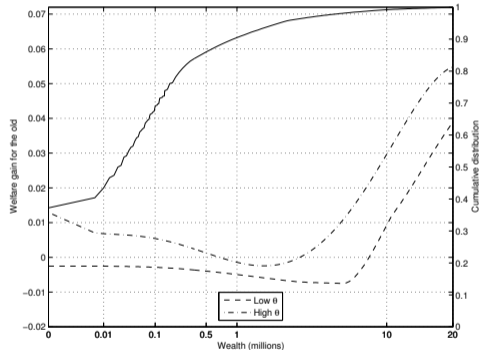
Old

Welfare gains and losses from abolishing the estate tax and increasing the consumption tax.



Young

Average cost: 0.3% yearly consumption.



Old

Conclusions

- Effective estate tax: exemption level is \$ 5 mil. per household and marginal tax rate is 16%.
- Effects of abolishing estate taxation:
 - on long-run inequality are small.
 - on long-run output and capital are positive and significant when the tax government spending is cut, or the consumption tax is increased.
 - on aggregates are negligible when the tax on total income is raised.
 - welfare: large redistribution from everyone to the rich and to the rich old.