University of Minnesota

Department of APPLIED ECONOMICS

Trade and Development Seminar

A Life-Cycle Analysis of Wealth Taxation with Entrepreneurship and Housing

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This paper examines the impact of the tax shift from capital income taxation to wealth-based taxation on household asset allocation, focusing on unique features of age-wealth profiles in housing asset and liquid asset. With a computational experiment of tax policy, I take a life-cycle view of household savings behavior to describe how a tax reform affects allocation of resources, the transfer of tax burden, and the change of welfare. The work horse is a general-equilibrium, heterogeneous-agents model that explicitly characterizes the roles of entrepreneurship and home equity-based borrowing. In the experiment, a capital income tax system at a flat rate of 15% is introduced in the baseline model that mimics the U.S. economy, and a risk-neutral flat-rate wealth tax system is calibrated at 17% for a counterfactual economy. The experiment shows a surge of the Gini index from 41 to 46, which implies a more lopsided distribution of wealth among households. The social welfare measured in equivalent consumption decreases by 7.2%. Tax burden is transferred to the rich and the senior, because the two groups hold relatively more wealth than others. Worker households, however, experience greater losses than they would under the capital income tax regime due to the general equilibrium effect that discourages capital accumulation, which leads to declining wages, thereby making a negative impact on the wealth accumulation of worker households over the lifetime, especially in their later stages of lifetime.