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Wealth Inequality, Family Background, and Estate Taxation[☆]

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Abstract

This paper generates two main contributions. First, it provides a new theory of wealth inequality that merges two empirically relevant forces generating inequality: bequest motives and inheritance of ability across generations; and an earnings process that allows for more earnings risk for the richest. Second, it uses the resulting calibrated framework to study the effects of changing estate taxation. Increasing the estate tax reduces the wealth concentration in the hands of the richest few and the economic advantage of being born to a rich and super-rich family at the cost of reduced aggregate capital and output. However, all of these effects are quite small. In contrast, increasing estate taxation can generate a significant welfare gain to a newborn under the veil of ignorance, but this comes at a large welfare cost for the super-rich.

Keywords: Wealth Inequality, Parental Background, Estate Taxation, Bequests, Earnings Shocks.

JEL Classification: E21; J14

1. Introduction

Since its introduction in 1916, the estate tax has been one of the most controversial taxes in the United States tax code. Estate tax opponents call it the “death tax.” Among legislators supporting the abolition of the estate tax, former representative Ron Paul (14th district of Texas) stated: “The estate tax is immoral and counter-productive. ... My office has received hundreds of letters and emails from individuals. ... These people are not rich, but they have worked hard and saved to create an inheritance for their children...”¹

Estate tax supporters see the estate tax as an extremely progressive tax and a very effective way to tax the richest (and dead) few. Former representative Bob Etheridge (2nd district of North Carolina) stated “the so-called Death Tax Elimination Act should be called the Multi-millionaire Protection Act.”²

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¹http://lobby.la.psu.edu/027_Estate_Tax/Congressional_Statements/House/H_Paul_090800.htm

²<https://www.congress.gov/crec/2000/06/09/CREC-2000-06-09.pdf>

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