

The distribution of wealth and fiscal policy in economies with finitely lived agents

Abstract

We study the dynamics of the distribution of wealth in an overlapping generation economy with finitely lived agents and inter-generational transmission of wealth. Financial markets are incomplete, exposing agents to both labor income and capital income risk. We show that the stationary wealth distribution is a Pareto distribution in the right tail and that it is capital income risk, rather than labor income, that drives the properties of the right tail of the wealth distribution. We also study analytically the dependence of the distribution of wealth, of wealth inequality in particular, on various fiscal policy instruments like capital income taxes and estate taxes. We show that capital income and estate taxes can significantly reduce wealth inequality. Finally, we study the effects of different degrees of social mobility on the wealth distribution.