Is Capital Back? The Role of Land Ownership and Savings Behavior

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Abstract

Wealth inequality is one of the major political concerns in most OECD countries. Under this premise we analyze different policy instruments in terms of their impact on wealth inequality and output. We use a general equilibrium model in which we disaggregate wealth in its capital and land components, and savings in their life-cycle and bequest components. Households are heterogeneous in their taste for the 'warm glow' of leaving bequests. We show that a government has considerable freedom in reducing wealth inequality without sacrificing output: A land rent tax enhances output due to a portfolio effect and reduces wealth inequality slightly. The bequest tax has the highest potential to reduce inequality, and its effect on output is very moderate. By contrast, we confirm the standard result that a tax on capital income reduces output strongly, and show that it only has moderate redistributive effects. Furthermore, we analyze different revenue recycling options and find that lump-sum recycling of the tax revenue to the young generation enhances output the most and further reduces wealth inequality.

Keywords: theory

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