

Would a Flat Tax Stimulate Entrepreneurship in Germany? A Behavioural Microsimulation Analysis Allowing for Risk

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Abstract:

When possible income tax reforms are debated, the suspected impact on entrepreneurship is often used as an argument in favour or against a certain policy. Quantitative ex-ante evaluations of the effect of certain tax reform options on entrepreneurship based on microeconomic research have not been provided by the literature, however. This paper estimates the ex-ante effects of the German tax reform 2000 and of two hypothetical flat tax scenarios on entries into and exits out of self-employment in Germany. For the estimation I apply a microsimulation model which is based on the tax-benefit model STSM and on structural microeconomic models of transitions into and out of self-employment. These structural models include an estimated parameter of risk aversion. The simulation results indicate that flatter tax systems do not encourage, but rather discourage people from choosing self-employment. This is explained by the reduction of entrepreneurs' income risk through progressive taxation.

JEL classification: H24, J23, L26, D81

Keywords: Entrepreneurship, Income Taxation, Risk, Tax Reform 2000, Flat Tax

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