The Distribution of Wealth: Theoretical Microfoundations and Empirical Evidence

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Abstract

This paper studies the distribution of wealth in an economy where dynasties with different wealth have constant marginal saving rates, firms’ productivities are subject to idiosyncratic shocks, returns on factors are determined in competitive markets and within each dynasty wealth is equally shared among its members. Government imposes taxes on capital and labour incomes and equally redistributes the collected resources to individuals. The equilibrium distribution of wealth is explicitly calculated and it follows a Paretoian law in the top tail. The Pareto exponent depends on the saving rate, on the net return on capital, on the growth rate of population and on the degree of portfolio diversification. On the contrary, the bottom tail of the distribution of wealth mostly depends on the characteristics of the labour market. The analysis also suggest a positive relationship between growth and wealth inequality. The theoretical predictions find a corroboration in the empirical experiences of Italy and United States in the period 1987-2004.

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