Entrepreneurial Investment Dynamics and the Wealth Distribution

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Abstract

This paper studies how entrepreneurial capital illiquidity and incomplete financial markets interact to influence entrepreneurial savings and investment behavior, and in turn shape the wealth distribution. To that end, I construct an endogenous occupational choice model, where an entrepreneur holds two assets: liquid risk-free assets and illiquid capital. I calibrate the model to match salient facts about entrepreneurial investment drawn from a nationally representative panel survey on startups, and find that an entrepreneurship model disciplined only by micro-data on investment can broadly match the high wealth dispersion in the data. I also find that entrepreneurs face severe illiquidity risk, which leads to an increase in precautionary liquid savings and an allocation of illiquid capital towards rich entrepreneurs who have low productivity. Moreover, illiquidity risk depresses overall wealth dispersion due to its distortion on the ability of high productivity entrepreneurs to efficiently accumulate wealth. Consequently, I find that a policy that taxes returns to liquid assets to provide partial insurance against illiquidity risk can be welfare improving, but also increases wealth dispersion. (JEL D31, E21, E22, L26)

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