Entrepreneurial Investment Dynamics and the Wealth Distribution

Eugene Tan*

First draft: Dec 2017. This draft: Oct 2018.
Please click here for the most updated version of the paper.

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)

*Duke University. email: eugene.tan@duke.edu. Acknowledgements: I am indebted to my advisors, Andrea Lanteri and Craig Burnside, for their tireless support and advice in writing this paper. I would also like to thank the rest of my committee members Matthias Kehrig, Cosmin Ilut, and Kyle Jurado, as well as the rest of the macroeconomics group at Duke for their helpful comments and advice. I have also benefited substantially from conversations with Sungki Hong, B. Ravikumar, Juan Sanchez, Daniel Xu and Chen Yeh. I would also like to thank the participants at the Fall 2017 Midwest Macro conference, 2017 SEA conference, the 2018 NASMES conference, and the 2018 EEA-ESEM conference for helpful discussion and comments. In addition, I would like to thank the Federal Reserve Bank of St Louis for hosting me during the writing of this paper. Finally, I would like to thank the Kauffman Foundation for providing sponsorship to access the Kauffamn Firm Survey at the NORC enclave. All errors are my own.