

# Bequest taxation and efficient allocation of talents

Stefano Staffolani\*, Enzo Valentini

*Polytechnic University of Marche, Department of Economics, Piazzale Martelli 8, 60121 Ancona, Italy*

Accepted 22 December 2006

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## Abstract

In this paper we analyze intergenerational mobility on education. After a brief empirical analysis of the influence of family background on educational attainment, we present a dynamic model where the decisions concerning education may be financially constrained. Therefore, people who get higher educational levels are not necessarily the most talented. This “misallocation effect” causes a reduction in the efficiency of the economic system. We show that a proportional bequest taxation, whose yield is redistributed among all “youths”, increases efficiency.

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*JEL classification:* D33; I22; I30; J24

*Keywords:* Education; Bequest; Talent allocation

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## 1. Introduction

A large body of empirical findings has shown that a correlation between father/mother and children socio-economic status exists.<sup>1</sup> Among the most recent papers, [Chevalier et al. \(2005\)](#), using the Labor Force Survey database, confirm that, in the UK, parents’ and children’s income and education are highly correlated, with stronger effects of maternal education than paternal and stronger effects on sons than on daughters. [Comi \(2004\)](#), using the LIS database, studied intergenerational mobility in income and education in European countries, finding that Italy is the most “immobile” country in Europe.

The aim of this paper is to check the relationship between intergenerational mobility and allocational efficiency, the latter requiring that higher educational levels be attained by more talented individuals.

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\* Corresponding author.

*E-mail addresses:* [s.staffolani@univpm.it](mailto:s.staffolani@univpm.it) (S. Staffolani), [e.valentini@univpm.it](mailto:e.valentini@univpm.it) (E. Valentini).

<sup>1</sup> See, among others, [Charles and Hurst \(2003\)](#), [Ermisch and Francesconi \(2001\)](#), [Behrman and Rosenzweig \(2002\)](#), [Erikson and Goldthorpe \(2002\)](#).

Assuming that financial constraints are active in driving educational decisions (as Section 3 seems to show) the theoretical model of Section 4 predicts a lower ratio of educated individuals coming from non-educated families than from educated ones and affirms the existence of “misallocated individuals”.<sup>2</sup>

Nevertheless, the results cannot be easily generalized, because our theoretical model is based on some relevant assumptions:

- The utility function is separable in consumption, bequest and effort, namely it is logarithmic in consumption and bequest and linear in effort. This specification implies that the amount left to children does not depend on the bequest tax rate so that the deadweight loss is taken into account only through effects on effort.
- Altruism towards children and/or risk aversion should be sufficiently low.
- Individual talent is random and inheritance of talents does not exist.

One of the main findings of the model is that intergenerational redistribution via bequest taxation is desirable because helping children endowed with high ability and coming from poor families to circumvent financial constraints, it increases the average talent of skilled people, generating a better ability allocation and an efficiency gain measured in terms of average utility. These results emerge only in the case that fiscal yield coming from bequest taxation is redistributed throughout all the population and it does not emerge if it is used to finance education.

The paper is organized as follows. Section 2 reports a brief survey concerning intergenerational persistence in status inequality and the influence of bequest taxation on it. In Section 3 we examine the intergenerational transition matrices of Italy, the US and the UK, trying to study the relationship between the allocation of individuals in unskilled/skilled position, their talent and their family background. In Section 4 we present a theoretical model where an efficiency problem in talent allocation emerges and where both parents’ “bequest” and state redistribution are crucial in determining financing for schooling and attainment of education. Section 5 concludes.

## 2. Brief overview of the literature on intergenerational mobility and bequest

Although there are no doubts about the persistence of status inequality, there is no general agreement on the causal mechanisms behind it.<sup>3</sup> Focusing on differences in schooling decisions, two main theories have been developed and empirically checked by economists:<sup>4</sup>

- The most popular theory, started by [Becker and Tomes \(1979, 1986\)](#), emphasizes the role of “short-run” financial constraints, which make it difficult for low income families to enroll their children in higher education levels, even if children show high ability during compulsory school.<sup>5</sup>

<sup>2</sup> In the model people are assumed to be heterogeneous in their talents so that we refer to “misallocated individuals” as those whose position is dependent on the family: unskilled children of unskilled parents who would have been skilled and skilled children of skilled parents who would have been unskilled if the allocation in the skilled position were not dependent on social class but on individual’s talent alone.

<sup>3</sup> “Intergenerational wealth transfers make consumption and welfare more persistent across generations than labor earnings” [Piketty \(2000\)](#).

<sup>4</sup> [Cecchi \(2005\)](#) presents a complete survey of education related topics and shows some conclusions linked up with our issues.

<sup>5</sup> [Cecchi D. \(2003\)](#), with a cross country analysis, suggests that financial constraints limit access to secondary school. [Shea \(2000\)](#) empirical results are potentially consistent with the hypothesis that credit market imperfections constrain low income households to make suboptimal investments in their children; [Krueger \(2004\)](#) reviews various contributions supporting the view that financial constraints have a significant impact on educational attainment. See also [Kane \(1994\)](#), [Ellwood and Kane \(2000\)](#).

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