

Bequests, Inter Vivos Transfers, and Wealth Distribution¹

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This paper constructs a heterogeneous agent overlapping generations model with bequests and inter vivos transfers. In the model, households in the same family line behave strategically to determine their consumption, working hours, gifts, and savings. Calibrating the model to the U.S. economy, the paper measures time preference and parental altruism consistent with the economy's capital-output ratio and the size of intergenerational transfers. The model with intergenerational transfers better explains, although not fully, the wealth distribution of the United States. The paper also analyzes the effects of government policy changes on wealth accumulation, distribution, and social welfare. *Journal of Economic Literature* Classification Numbers: D31, D64, D91, H31. © 2002 Elsevier Science (USA)

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1. INTRODUCTION

Macroeconomic analyses usually rely on either an infinite horizon model or an overlapping generations (OLG) model. Those analyses implicitly assume a household either perfectly altruistic toward its descendants or completely selfish. But, when economists evaluate fiscal policies that involve income redistribution among generations, the policy implication depends critically on the extent to which the Ricardian equivalence proposition holds.

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In Nishiyama (2000), I developed a heterogeneous agent overlapping generations model with altruistic and accidental bequests. The model assumes both imperfect altruism and lifetime uncertainty, and it captures the strategic behavior between a parent household and its adult child households. However, several panel data sets show a significant number of inter vivos transfers between a parent household and its child households, which the previous model does not consider (e.g., Gale and Scholz, 1994). This simplification is justified if the capital market is perfect. But, if borrowing constraints exist, it is also beneficial for an altruistic parent household to make transfers before it ceases to exist.

How will the economy change if we relax the model to allow parent households to make inter vivos transfers when the borrowing constraint of their child households is binding? More specifically, this paper answers the following questions: Can the model equipped with inter vivos transfers, as well as altruistic and accidental bequests, replicate the wealth distribution of the United States? If not, to what extent will the introduction of bequests and inter vivos transfers improve the model in explaining the skewed wealth distribution? The paper also analyzes how fiscal policy changes, such as estate tax repeal or a federal income tax cut, will affect national wealth, inequality, and social welfare.

To answer these questions, this study extends a heterogeneous agent overlapping generations model by adding one-sided altruism, lifetime uncertainty, and borrowing constraints, and it measures the degrees of time preference and parental altruism through the calibration of the model to the U.S. economy.² One of the main features of this extended model is that it involves both a dynasty economy (with one-sided altruism and borrowing constraint) and a pure life-cycle economy as two opposite cases. It is likely that the economy has imperfectly altruistic households, and it can be shown as an economy located between those two extremes.

The main parameters—time preference and parental altruism—are obtained simultaneously through the calibration of the model so that the steady-state equilibrium is consistent with the key statistics observed in the United States: capital-output ratio and the relative size of intergenerational transfers. For the steady-state economy to be consistent, a parent household would have to consider the utility of each adult child household 37 to 49% less than it considers its own utility.³

² The model was initially constructed as a two-sided altruism model in which child households could also make some gifts to their parents. However, the degree of child altruism implied by the model turns out to be negligible because the size of financial transfers from children to parents is very small.

³ The implied discount rate (the degree of altruism) depends on the coefficient of relative risk aversion as well as the wealth distribution in the steady-state equilibrium.

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