

Inequality-aware Market Design Seminar Series

Arpad Abraham: Tax Wedges, Financial Frictions and Misallocation (special in-person talk)

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Details

When: 30 Nov 2022 @ 17:00 GMT+2

Where: GRAPE

Speaker this week

[Arpad Abraham ↗](#)

University of Bristol

Arpad Abraham is a Professor of Economics and Co-Director of Research at the University of Bristol. His research interests include macroeconomics, dynamic contracts, incomplete markets and quantitative methods.

Abstract: We revisit the classical result that in a closed economy the incidence of corporate taxes on labor is approximately zero. We consider a rich general equilibrium framework, where agents differ in the level of their wealth as well as in their managerial and working ability. Potential entrepreneurs go through all the key decisions affected by corporate tax changes: the choice of (i) occupation, (ii) organizational form, (iii) investment, and (iv) financing structure. We allow both for the presence of financial frictions and the traditional tax advantage of debt over corporate equity, which jointly generate misallocation of capital and talent. In this environment we characterize the effects of increasing corporate taxes both analytically and for a calibrated version of the model. We show that this tax increase reallocates production from C corporations to pass-through businesses. Since, due to distorted prices, the latter have higher capital-labor ratios, this reallocation generates a reduction in labor productivity and wages. Furthermore, the corporate tax increase induces some C corporations to reorganize as pass-throughs, which implies more restricted access to external funds and thus a socially inefficient downsizing of production in these firms. Finally, the tax increase causes further misallocation of talent by inducing agents with low wealth relative to their managerial talent to switch from entrepreneurship to being workers, while the reverse happens for agents with higher wealth and lower managerial skills. Overall, we find that both labor and capital bear a large share of the corporate tax incidence, while entrepreneurs are net beneficiaries of the tax change. Find the paper [here ↗](#).

Should you have any queries please contact the seminar organizers at IMD@grape.org.pl.

