

Investment Subsidies and Redistributive Capital Income Taxation in a Neoclassical Growth Model*

- Preliminary version -

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Abstract

In this paper it is analyzed how investment subsidies bear on pure redistribution when coupled with capital income taxes. In a heterogeneous-agent, neoclassical growth framework it is found that in the short run and absent optimizing behaviour investment subsidies are good for growth but bad for redistribution. They may, however, stabilize the investment return in a recession. But when the agents and the government act optimally for the long run the investment subsidies should be such that the tax scheme does not distort accumulation anymore. This holds regardless of social preferences. I find that redistribution and so capital income taxes may be nonzero in the long run optimum, depending on the social weight of those who receive redistributive transfers, the distribution of pre-tax factor incomes, and the intertemporal elasticity of substitution. It is argued that investment subsidies may be an important indirect tool for redistribution.

KEYWORDS: Growth, Redistribution, Investment Subsidies, Capital Income Taxes

JEL classification: O41, H21, D33

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