Redistributive Capital Taxation Revisited

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This paper shows that capital-skill complementarity provides a quantitatively significant rationale to tax capital for redistributive governments. The optimal capital income tax rate is 60%, which is significantly higher than the optimal rate of 48% in an identically calibrated model without capital-skill complementarity. The skill premium falls from 1.9 to 1.67 along the transition following the optimal reform in the capital-skill complementarity model, implying substantial indirect redistribution from skilled to unskilled workers. These results show that a government that cares about redistribution should take into account capital-skill complementarity in production when setting the tax rate on capital income.

JEL classification: E25, J31.

Keywords: Capital taxation, capital-skill complementarity, inequality, redistribution.

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