Accepted Manuscript

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PII: S0047-2727(17)30100-7
DOI: doi:10.1016/j.jpubeco.2017.06.008
Reference: PUBEC 3784

To appear in: *Journal of Public Economics*

Received date: 13 May 2013
Revised date: 23 June 2017
Accepted date: 26 June 2017

Factor Income Taxation in a Horizontal Innovation Model*

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June 2017

Abstract

We consider the optimal factor income taxation in a standard *R&D* model with technical change represented by an increase in the variety of intermediate goods. In the model there are externalities both to working and to saving, due to market power by firms, incomplete appropriability of the benefits of inventions and the cost of economic activity in terms of public expenditures. Redistributing the tax burden from labor to capital will increase employment but, in most cases, reduce the rate of growth, with conflicting effects on the deadweight loss from the externalities. Under plausible calibrations of the model, the optimal tax rate on capital will be sizable.

Keywords: *Capital Income Taxes, R&D, Growth Effect, Welfare Effect.*
JEL classification: *E62, H21, O41*

*We are grateful to three anonymous referees for their guidance in improving the paper. We wish to thank Barbara Annicchiarico, Costas Azariadis, Thomas Davoine, Lei Ji, Pietro Peretto, Xavier Sala-i Martin, Marika Santoro, Pedro Teles, Robert Waldmann, Joseph Zeira and participants in seminars and presentations (Asset 2014 Aix-en-Provence, Manchester 2014, Sophia Antipolis 2013, Barcelona 2013, Padua 2011, LAGV Marseille 2011, DEGIT Frankfurt 2010, SIE Catania 2010 and RCEA Rimini 2009) for comments received on previous versions of the paper. The first was titled "Welfare Improving Taxation on Saving in a Growth Model" (University of Teramo, Department of Communication, WP 71, 2011).

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