Optimal fiscal policy in a second-best climate economy model with heterogeneous agents

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Abstract

This paper studies optimal fiscal policy in a climate economy model with heterogeneous agents and distortionary taxes on labor and capital income. We derive optimal tax rules and show how they are modified relative to first-best and relative to the case without heterogeneity. We also explore quantitatively the role of heterogeneity for optimal carbon taxation in a version of the model that is calibrated to the US economy.

JEL classification: E62, H21, H23, Q5

Keywords: Climate policy; Carbon taxes; Optimal taxation; Heterogeneous agents.

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