

Abstract

economy with observable human capital accumulation. We show that under plausible conditions the marginal schooling subsidies are positive and that they are zero at both endpoints of the skill distribution.

We compute the optimal policies and evaluate their impact over the transition and at the steady state. We find that the optimal schooling policies are significantly smaller than the optimal marginal income taxes. If optimal schooling policies are introduced jointly with optimal income taxes then their welfare and aggregate effects are small. However, if income taxes are not set optimally then the optimal schooling policies have significant welfare and aggregate effects.

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