Capital Income Taxation, Stock Market Participation and Economic Growth[1]

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Abstract

We examine the effect of capital income tax cut on individuals' stock market participation and economic growth. Specifically, we construct an endogenous growth model in which individuals choose one of two types of savings (i.e., physical capital, which yields higher returns for individuals with higher financial literacy; and bank deposits, which require no financial literacy but the return rate is lower), and banks allocate deposits to physical capital investments and non-productive lending to individuals. We show that the capital income tax cut can raise both individuals' stock market participation and economic growth.

Keywords: limited asset market participation, capital taxation, endogenous growth, overlapping generations

JEL classification: E 13, E 62, G 51

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