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# **Inequality and Optimal Redistribution**

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## INEQUALITY AND OPTIMAL REDISTRIBUTION

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# Inequality and Optimal Redistribution

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**Abstract:** From the 1980s onwards income inequality has reversed course and increased in many advanced countries. Moreover, top income shares have increased, and top tax rates on upper-income earners have declined significantly in many Organisation for Economic Co-operation and Development (OECD) countries during this period. It is very difficult to account for the rise in income inequality using the standard labour supply/demand explanation. Hence, the role of redistributive taxation should not be dismissed in these discussions. Fiscal redistribution has become less effective in compensating for increasing inequalities since the 1990s. Some of the basic features of redistribution can be explained through the optimal tax framework developed by J. A. Mirrlees (1971). We survey some of the earlier results in linear and nonlinear taxation and produce some new numerical results both in the standard Mirrlees model and in its extensions. Given the key role of capital income in overall income inequality, we also consider the optimal taxation of capital income. We also examine empirically the relationship between the extent of redistribution and the components of the Mirrlees framework, including measures for inherent inequality and the government's redistributive preferences. We analyse briefly the redistributive role of factors such as publicly provided private goods, public employment, endogenous wages in the overlapping generations (OLG) model and income uncertainty that are missing in the standard model.

**Keywords:** inequality, redistribution, optimal taxation

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