

# Optimal human capital policies under the endogenous choice of educational types\*

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## Abstract

This paper examines optimal human capital policies under nonlinear labor income taxes in the presence of non-pecuniary benefits of education. We show that when individuals can choose educational types differing in the relative importance of consumption value (non-monetary benefit) and production value (monetary benefit), education subsidies for low-type individuals should not be equal to an efficient level that offsets distortions induced by redistributive taxes. Our findings implies that education policy does not restore the efficiency, i.e., the Diamond-Mirrlees production efficiency theorem fails. Moreover, we suggest the case in which education should be taxed.

**JEL Classification:** H21, I28, J24

**Keywords:** Human capital, Education subsidies, Optimal income taxation, Non-pecuniary benefits of education

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