

Optimal Taxes and Transfers under Partial Information

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Summary

Effective from 2005, benefits for long-term unemployed have been reduced in Germany to the level of social assistance. This measure reflects the view that “all who are able to work, should work” – a view which makes sense only if the government can distinguish the disabled from the productive. In this paper we augment the standard model of optimal taxation, where the government has no information about individual productivities, by this very assumption: Partial information means that the government can distinguish the disabled from the productive, but cannot distinguish among the different productive types. An interesting proposition about the shape of optimal tax-transfer schemes under partial information is derived. Moreover, it is shown that unemployment on the side of the productive poor may still be optimal.

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