Optimal Income Taxation, Public Good Provision and Informative Voting

We jointly address the problems of optimal income taxation and public good provision in a continuum economy. Individuals differ in both earning abilities and valuations of a public project. In a situation of large skill heterogeneity and uncertainty about the aggregate valuation, the relevant incentive constraints for information aggregation must ensure that individuals behave as if they engaged in informative voting over the decision on provision. Therefore, adjustments of the transfer system are needed to discourage the more (less) productive from exaggerating (understating) the desirability of public good provision. Relative to an optimal income tax, which focuses solely on earning ability, income transfers are increased whenever the public project is installed and are decreased otherwise.

**Keywords**: two-dimensional heterogeneity, aggregate uncertainty, optimal income taxation, public good provision, informative voting

**JEL**: H41, H21, D82, D72