

EXPLORING THE IMPACT OF TAXATION ON THE INFORMAL ECONOMY

Leila Adim

Faculty of Law, University of Barcelona (SPAIN)

Abstract

Taxation is generally considered as a factor motivating people to carry out informal economic activities as wage workers or self-employed, however there is no evidence confirming, in absolute terms, the existence of a causal nexus, nor of a direct proportion, between tax increase and informal economy's growth. The analysis of elements strictly related to the informality, such as tax noncompliance and institutional conflict between tax rules and individuals' perception, is also unable to lead to the result that taxation is a cause of the informal economy unless in the cases in which avoiding tax payments is the main reason for working informally. Nevertheless, a causal nexus may arise by considering taxation as an impulse to the effective formalisation and by identifying its presence in all those tax measures which contribute to the restoration of the confidence towards the governing system and encourage the shift to the formal economy.

Keywords: informal economy, taxation, institutionalism, tax morale, formalisation, tax measures

Introduction

During the 45 years which followed the first attempt to analyse and understand the informal economy¹, considerable progress has been made and the constant effort of scholars from various academic fields has helped to define some of its aspects, but others are still difficult to explain.

The issue's complexity does not concern specific features of the informal economy nor its effects; it regards, above all, the causes leading to its proliferation. As a matter of fact, the informal economy consists only in the set of economic activities which are lawful by nature, but performed without complying with specific legal requirements and it has been widely acknowledged that its impact on both economy and society is far from being very positive². The informal economy's negative effects include, among many others, erosion of labour and social security rights, barriers to personal and professional development, hindrance to domestic resource mobilisation and economic growth, while the positive ones can mainly be attributed to its aptitude to confer precarious livelihood to people in need. The comparison between pros and cons has led to the legitimate and general conviction that the informal economy represents a problem not only for those working irregularly, but also for the public management of numerous states.

The mentioned deleterious effects are similar in all the territories in which there is an appreciable share of informal economy, whether they are developed or developing countries, and almost everyone of them is taking action by issuing policies aimed at reducing its negative consequences or at eliminating the causes which provoke the increase in informal economy. While the first approach leads to provisional remedies and is conceived for alleviating the problem, the causal approach is used in order to reach definitive solutions and represents the most effective way to face the informal economy. However, as said, identifying the causes of the informal economy is not an easy task, because they depend on economic and social factors which tend to vary according to different contexts and their incorrect analysis cannot lead to any effective solution. Additionally, the coexistence of multiple variables tends to hinder the possibility to elaborate, through a causal approach, solutions which could be effective in every time and place³.

¹ In 1972, the British anthropologist Keith Hart addressed for the first time the matter during a study on the Ghanaian urban economy. On that occasion, he noticed that most of the Accra's labour force was working in a context which was parallel to that regulated by the state and coined the term "informal sector". In the same year, the International Labour Office, used the same term during its "Employment Mission to Kenya", to define those employees who carried out their activities without complying with state's regulations. On the issue, see Keith Hart, "Informal Income Urban Ghana Opportunities," *The Journal of Modern African Studies* 11, no. 1 (1973): 61–89; ILO, "Employment, Incomes and Equality. A Strategy for Increasing Productive Employment in Kenya" (Geneva, 1972).

² See Jan L. Losby et al., "Informal Economy Literature Review," *ISED and Aspen Institute*, vol. 44 Suppl 1, 2002, doi:10.1002/hast.259; Dan Andrews, Aida C. Sánchez, and Åsa Johansson, "Towards a Better Understanding of the Informal Economy," *OECD Economics Department Working Papers* (OECD Publishing, 2011), doi:10.1787/5kgb1mf88x28-en; Martha Alter Chen, "The Informal Economy: Definitions, Theories and Policies," *WIEGO Working Paper*, vol. 1, 2012.

³ Ibid.; Rosalind Copisarow and Aaron Barbour, "Self-Employed People in the Informal Economy – Cheats or Contributors? Evidence, Implications and Policy Recommendations," *Street(UK), Social Enterprise Zone(SEZ)*, 2004.

Nevertheless, the fact that some causes appear in diverse contexts allows the identification of recurrent determinants of the informal economy and the development of policies which can be adopted in more than a country. According to the most influent literature⁴, unemployment and tax issues repeatedly appear among the common causes, but unlike the first determinant, the presence of taxation in this main group of causes does not look properly justified. In fact, if it is impossible to deny that the inability of the formal labour market to absorb most of the labour force tends to increase its migration to the informal economy, it is not that clear how tax issues can lead to the informal economy.

The purpose of this article is defining which are the real links that connect the realm of taxation with that of the informal economy. Hence, revealing if there is a direct proportion between tax increase and informal economy's growth, identifying if alleged causal nexuses may arise from objective data or subjective considerations and if other kinds of connection between tax issues and the informal economy can be found by considering taxation as something different from a cause of informality.

1- Taxation as a cause of the informal economy: first considerations on objective data

Over the last decade, tax issues have appeared increasingly often among the motivations driving millions of individuals to carry out informal economic activities as wage workers or self-employed. Although scholars, due to the detriment that such declaration may bring to many tax systems, tend to be cautious in openly mentioning taxation as a cause of the informal economy, there is an overwhelming evidence confirming that, conversely, the public opinion considers the high tax burden as one of the main reasons leading to the informality. This affirmation is reflected in reliable surveys and, in particular, in those of the Eurobarometer which take into account the undeclared work in the European Union. Accordingly, in 2007, 13% of people surveyed answered that high taxes and social security contributions were a cause of the informal economy and in 2014 the percentage increased by three points, turning taxation into the third major reason driving to informality⁵.

The grounds on which the assumption that taxation is a causal factor of the informal economy are rooted in the convergence of the concepts of informality and tax noncompliance, hence, on the idea that carrying out informal economic activities and evading taxes are almost the same thing. Such an equation is based on the conviction that undertaking informal economic activities implies noncompliance with tax obligations and, for this reason, it is assumed that to a growing necessity or interest in evading taxes would also correspond an increase in informal economy. Following the same reasoning, when the tax burden is high, the level of informality would be high too, while in the reverse case, there would be less informal economy.

⁴ See Friedrich Schneider and Dominik H. Enste, "Shadow Economies: Size, Causes, and Consequences.," *Journal of Economic Literature* XXXVIII, no. March (2000): 77-114; Kristina Flodman Becker, "The Informal Economy," 2004.

⁵ TNS opinion & social at the request of the European Commission, "Special Eurobarometer 284/Wave 67.3 'Undeclared Work in the European Union,'" 2007; TNS opinion & social at the request of the European Commission, "Special Eurobarometer 402 'Undeclared Work in the European Union,'" 2014, doi:10.2767/37041.

From a purely theoretical point of view, even acknowledging that the causal nexus between taxation and the informal economy is not direct, but derived from the link connecting informal economic activities with tax noncompliance, nothing would apparently preclude to hypothesise the existence of a direct proportion between tax increase and rise in informal economy.

However, this thesis cannot be empirically confirmed. By examining - even superficially - some concrete examples, it seems that the absence of such a direct proportion looks immediately clear. In fact, in many territories in which the informal economy involves 70% of the labour force, as in some countries of the Sub-Saharan Africa, income taxes and social security contributions are very low or non-existent, thus taxation cannot be considered a cause of the informal economy. The same conclusion can be reached by taking into account that in some countries in which income taxes and social security contributions are very high, as in the United States or in Japan, the size of informal economy is not large⁶. Similar results arise if, instead of investigating on the existence of a direct proportion between increment in taxation and informal economy's growth, the attention is shifted to tax noncompliance, in order to prove if high tax burden may lead to an increased tax evasion, thus, to a factor which is strictly connected to the raise in informal economy. In fact, in Scandinavian countries, where income taxes and social security contribution are among the highest in the world, the level of tax evasion is low, as well as that of the informal economy⁷.

Lastly, with the aim of identifying the way to prove, albeit only partially, the opinion according to which the tax noncompliance deriving from informal economy is caused by the high tax burden, the discourse can be expanded to completely include the standard theory on tax evasion developed by Allingham and Sandmo. According to this thesis high taxes are not the only factors related to taxation which contribute to the increase in tax evasion; sanctions for tax noncompliance and likelihood of being detected also play a leading role⁸. However, once again, the assertion can be rebutted by the empirical analysis, in particular, by the Italian example. Since 1982, sanctions for tax evaders and number of controls on tax compliance have been repeatedly increased, but Italy is still among the European countries with the highest levels of tax evasion and informal economy⁹.

These first considerations eliminate every possibility of identifying a causal nexus between taxation and the informal economy through the evaluation of objective data deriving from economic estimations. The noteworthy studies of the authors who have been cited in reference to every example confirm that there is no evidence proving that taxation is a cause of the informal economy and that

⁶ On the size of the informal economy in developing and developed countries see Friedrich Schneider, "The Shadow Economy and Shadow Economy Labor Force: What Do We (Not) Know?," *Institute for Study of Labor IZA*, vol. 5769, 2011.

⁷ For a complete overview see Henrik Jacobsen Kleven, "How Can Scandinavians Tax So Much?," *Journal of Economic Perspectives* 28, no. 4 (2014): 77-98, doi:10.1257/jep.28.4.77.

⁸ See Michael G. Allingham and Agnar Sandmo, "Income Tax Evasion: A Theoretical Analysis," *Journal of Public Economics* 1 (1972): 323-38.

⁹ See Giovanni Castaldi, "Gli Obblighi Antiriciclaggio e il contrasto dell' Evasione Fiscale," in *Lotta all' Evasione Fiscale: Economie Sommerse e Difesa Dello Sviluppo Legale* (Naples, 2012), 1-16.

there is no direct proportion between tax increase and informal economy's growth even when informality is conceived as tax noncompliance. This means that the analysis on the economic variables connected to the informal economy is far from confirming the existence of the mentioned causal nexus, but the thesis cannot be definitively excluded without taking into account other types of variables and, in particular, those related to subjective and social factors.

2- Institutional conflict as a cause of the informal economy: considerations on the tax morale

The reasons leading to consider different approaches for verifying if taxation can be a cause of the informal economy are rooted in the current universally-shared opinion that economic and social dynamics are strictly connected and that the society always influences economic cycles. This vision of an economy embedded in the society derives from the substantivist theories of Polanyi and Granovetter and represents a dogma for the institutionalism, the orientation which introduces, among the aspects to be included in the analysis of economic phenomena, the impacts of institutions on the economy¹⁰.

According to the institutionalism, individuals' conducts are regulated by two types of institutions: the formal and the informal ones. Formal institutions are "openly codified rules, in the sense that they are established and communicated through channels that are widely accepted as official", while informal institutions are "socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels"¹¹. These institutions can interact "positively" or "negatively" between them, influencing individuals' behaviour in different ways. There is a positive interaction when formal and informal institutions coincide; in this case due conducts and conventional conducts are the same and their overall impact tends to be constructive, because both institutions would contribute to achieve a climate of stability, to foster growth and development. An opposite situation occurs when informal and formal institutions differ, since there is a confrontation between two opposed normative systems: one official and the other unofficial. It should be pointed out, in fact, that both institutions are independent and that each of them is supported by regulations whose noncompliance is punished through sanctioning measures. Informal institutions, lacking of solemnity due to their unofficial nature, are legitimated by people's acceptance and strengthen their power through imitative mechanisms and reputational sanctions. In such a way they would compete with formal institutions, embodying the alternative to the established and official legal system. The

¹⁰ On the issue see Karl Polanyi, "The Economy as Instituted Process," in *Trade and Markets in the Early Empires. Economies in History and Theory*, ed. Karl Polanyi, Conrad M. Arensberg, and Harry W. Pearson (Glencoe, Illinois: The Falcon's Wing Press, 1957), 243–69; M. Granovetter, "Economic Action and Social Structure: The Problem of Embeddedness," *American Journal of Sociology* 91, no. 3 (1985): 481–510; Douglass C. North, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, 1990.

¹¹ Gretchen Helmke and Steven Levitsky, "Informal Institutions and Comparative Politics: A Research Agenda," *Perspectives on Politics* 2, no. 4 (2004): p.727, doi:10.1017/S1537592704040472.

negative interaction between institutions creates instability, uncertainty and may slow down economic and social improvements¹².

The research on the informal economy which has been carried out during the last 15 years is characterised by a strong adhesion to the institutionalism and its causal analysis has been significantly influenced by the idea that institutional interactions may have different impacts on the informal economy. Starting from the conviction that formal institutions normally prohibit to carry out economic activities which do not comply with some legal requirements, while informal institutions can either discourage or not the resort to the informal economy; when there is a positive interaction between institutions people tend to reject informality because it is conceived as a bad practice by official and unofficial regulations, while in the reverse case part of the population would consider itself legitimate to carry out informal economic activities by those informal institutions which are in contradiction with formal rules. Hence, the positive interaction between institutions would distance people from the informal economy, conversely, the institutional conflict may lead to the informality¹³.

A similar logic has been applied in order to find the existence of a causal nexus between informality and taxation, by investigating if increases or decreases in informal economy are caused by informal institutions acting against or in favour of the formal institutions which compose the tax system. These studies identify the tax morale as the informal institution that, depending on its conformity or nonconformity with official tax rules, may have a different impact on the informal economy. In particular, the tax morale, namely “moral principles or values that individuals hold about paying their tax”¹⁴, in some circumstances is conceived not only as a determinant of tax noncompliance, but also - and consequently - as a cause of the informal economy. In point of fact, the tax morale “is likely to be influenced by such factors as perceptions of fairness, trust in the institutions of government, the nature of the fiscal exchange between taxpayers and government, and a range of individual characteristics”¹⁵ and the negative opinion regarding these issues determines also the negative interaction of the tax morale with formal institutions. Accordingly, the literature recognises that perceiving the legal system as unfair, the law enforcement as unequal, autocracy and corruption as limitless may lead to the aversion against formal institutions and to a conflict between these and the tax morale with a consequent increment of tax noncompliance and informal economy¹⁶.

¹² On the issue see Adalgisio Amendola and Roberto Dell’Anno, “Istituzioni, Diseguaglianza ed Economia Sommersa: Quale Relazione?,” *Dipartimento Di Scienze Economiche, Matematiche E Statistiche, Università Degli Studi Di Foggia* 24 (2008): 1–21.

¹³ See N.V Loayza, A.M. Oviedo, and L. Servén, “The Impact of Regulation on Growth and Informality: Cross-Country Evidence in Guha,” *Oxford University Press.*, 2005.

¹⁴ James Alm and Benno Torgler, “Culture Differences and Tax Morale in the United States and in Europe,” *Journal of Economic Psychology* 27, no. 2 (2006): p.27, doi:10.1016/j.joep.2005.09.002.

¹⁵ Ibid.

¹⁶ On the issue see Eric Friedman et al., “Dodging the Grabbing Hand: The Determinants of Unofficial Activity in 69 Countries,” *Journal of Public Economics* 76, no. 3 (2000): 459–93, doi:10.1016/S0047-2727(99)00093-6; James Alm and Benno Torgler, “Do Ethics Matter? Tax Compliance and Morality,” *Journal of Business Ethics* 101, no. 4 (2011): 635–51,

Again, tax noncompliance and informal economy are jointly regarded as if they were the same phenomenon and the thesis which have been rebutted in the first empirical observations, now seems to be confirmed by using the tax morale as a factor able to justify the existence of a causal nexus between taxation and the informality¹⁷. In other words, it is argued that unfairness turns the tax morale into aversion against formal institutions and into an alternative regulatory system that legitimate the recourse to tax noncompliance and to the informal economy. The perceived unfairness regards not only taxation, the entire governing system is blamed, because it is not considered able to repay for the contributory efforts to the public expenditure with the provision of wellbeing for all¹⁸.

Once clarified the motivations leading to take into account the tax morale for identifying the mentioned causal nexus, it remains to be seen how taxation and the informal economy are linked. First of all, it should be pointed out that, according to the literature on the matter, it is not taxation, but the negative perception about it - the “negative” tax morale – the determinant of the informal economy. The tax morale is the individuals’ attitude towards the payment of taxes¹⁹ and it is negative when the deriving conduct is not in compliance with formal institutions. Thus, saying that the “negative” tax morale may lead to the informality means: if people consider paying taxes as unfair and unnecessary they do not want to comply with tax duties and tend to carry out informal economic activities. Such a consideration denotes the existence of a causal nexus between taxation and the informal economy based on the individuals’ perception rather than on economic evaluations, however it seems quite simplistic, because it is grounded on the idea that people carrying out informal economic activities have voluntarily chosen to be informal for avoiding tax payments. Undoubtedly, people decide whether or not paying taxes and their perception about formal institutions influences their choice to be compliant or not with tax rules, but this decision does not always include the intention to carry out informal economic activities for one main reason: most of the times resorting to the informal economy is the only available option for earning money. This means that generally people do not work informally in order to avoid taxation and such an assumption is widely endorsed by most of the causal theories, because the informal economy’s detriment to the individual tends to be greater than the benefit deriving from tax savings²⁰. As a matter of fact, it is fanciful to think that millions of people

doi:10.1007/s10551-011-0761-9; Stephen Dobson and Carlyn Ramlogan-Dobson, “Inequality, Corruption and the Informal Sector,” *Economics Letters* 115, no. 1 (2012): 104–7, doi:10.1016/j.econlet.2011.11.034.

¹⁷ See Benno Torgler, “Tax Morale in Latin America,” *Public Choice* 122, no. 1–2 (2005): 133–57, doi:10.1007/s11127-005-5790-4; A Chong and M. Gradstein, “Inequality and Informality,” *Journal of Public Economics*, no. 91 (2007): 159–79.

¹⁸ See Gebhard Kirchgässner, “Tax Morale, Tax Evasion and the Shadow Economy,” *Handbook on the Shadow Economy* 17 (2011): 347–74.

¹⁹ For an outstanding literature review on the definition of tax morale see the Tulio Rosembuj, *Tax Morale* (Barcelona: El Fisco, 2016).

²⁰ Although the voluntarists affirm that people choose the informal economy because, after having evaluated its benefits and costs, it represents the best option, none of the other schools of thought agree on this point and conceive informality as a form of exclusion rather than as way to escape. On the issue see Guillermo E. Perry et al., “Informalidad: Escape Y Exclusión,” *The World Bank*, 2007; Hart, “Informal Income Urban Ghana Opportunities”; Hernando De Soto, *The Other Path. The Invisible Revolution in the Third World*. (New York: Harper and Row, 1989); Alejandro Portes, Manuel Castells, and Lauren A. Benton, *The Informal Economy: Studies in Advanced and Less Developed Countries*. (Baltimore and London: Johns Hopkins University Press, 1989).

would prefer avoiding tax payments and social security contributions rather than, for example, being safeguarded by labour rights or entitled to receive a pension and, for this reason, it cannot be affirmed in absolute terms that the “negative” tax morale leads to the informal economy’s growth. Nevertheless, it can be said that a causal nexus is likely to exist whenever the two related elements involve on the one hand the perception and, on the other, some kinds of voluntary decision. Thus, the “negative” tax morale can be a determinant of tax noncompliance as well as a cause of the informal economy, but only when individuals voluntarily choose to carry out informal economic activities with the aim of avoiding taxation. In all the other circumstances, the “negative” tax morale - and consequently, taxation - cannot be considered as a cause of the informal economy.

However, it is undeniable that, even if such a causal nexus appears in few occasions and the determinants of the greatest part of the informal economy are other than the influence of the “negative” tax morale, individuals’ perception of tax unfairness creates a climate of distrust towards formal institutions able to keep informal workers and self-employed far from the formalisation. Hence, in those circumstances in which the “negative” tax morale is not among the main causes leading to the informality, it may influence individuals’ attitude towards formalisation by providing reasons for remaining in the informal economy. Therefore, it seems that the “negative” tax morale is rather a cause of non-formalisation, because when it does not increase the size of the informal economy, it may hamper the decrease in informality. The discourse achieves particular importance in reference to the policy-making processes aimed at countering the informal economy.

3- Taxation as a solution for the informal economy: the alternative causal nexus

The tax morale represents an important indicator for assessing the impact that specific policies may have on the society and, as a matter of course, on the economy. In this respect, special mention is deserved by tax measures designed for different purposes and, among them, those aimed at the formalisation.

The ambit of such measures includes both taxation and informal economy in a relationship of causality which is different from that already analysed; it involves a causal nexus arising when the decrease in informal economy is achieved through tax measures.

Nowadays, many policies aimed at countering the informal economy provide for tax measures such as tax amnesties, tax exemptions, tax deductions and tax credits, but none of them can effectively solve the problem of the informal economy without taking into account the impact of the tax morale on the individuals’ choice. As a matter of fact, the functioning of these tax measures depends on the decision of formalising an employment relationship or a self-employed economic activity as well as complying with - future - tax duties, and such a decision is inevitably influenced by the tax morale. If it is “positive”, tax measures are welcomed and their probability of success is high, while, in the presence

of “negative” tax morale, people tend to exclude that formal institutions can bring better opportunities and those working informally may reject the possibility to shift to the formal economy. Thus, the effectiveness of policies aimed at reducing the informal economy is strictly related to the absence of institutional conflict and even the most daring political efforts may be in vain when the “negative” tax morale prevails²¹.

It seems, therefore, that tax measures cannot lead to a decrease in informal economy when there is a negative attitude towards formal institutions and that no causal nexus between taxation and formalisation exists if those carrying out informal economic activities are not convinced that switching to the formal economy is the best option. However, the obstacles set by the “negative” tax morale can be overcome and the solution may reside in the tax measure itself. In these adverse circumstances the only available way to address the problem is encouraging the shift to the “positive” tax morale and building trust in formal institutions through specific policies or by including in the tax measure some incentives to formalisation.

On this last point it should be said that there are various types of incentives to formalisation, but few of them are able to positively influence the tax morale for a long time and turn the tax measure into an effective solution to the problem of the informal economy. The successful formula must provide for a concrete benefit for the individual participating in the informal economy and demonstrate a never-wavering commitment to fairness and non-discrimination. For this purpose, the tax measure has to contribute to the restoration of the confidence towards the tax system by demonstrating that it is consistent with the main objectives of taxation: collecting resources in order to provide for the common wellbeing and redistributing wealth among taxpayers. Tax measures aimed at satisfying people’s needs and at achieving the distributive justice, represent effective and long-term solutions for countering the informal economy and not only, because they encourage a shift of tax morale which has a positive impact in many other issues related to taxation.

Undeniably, among the most significant examples of this kind of tax measures there are the Monotax adopted by Uruguay and the French tax credit for household services. The first one is a simplified tax and social security scheme introduced in 2001 in order to reduce the informality in small and family-round businesses of all kinds, from street vendors to gardeners. It provides the worker-entrepreneur and his/her family with health and social security protection, reduces the costs of formality and the payment to tax authorities are gradually increased during the first 3 years of activity²². Conversely, the tax credit for household services introduced in France is a tax measure implying the refund, to the employer - or user -, of half of the costs incurred for paying domestic workers. The measure is

²¹Similar conclusions appear in Friedrich Schneider and Benno Torgler, “The Impact of Tax Morale and Institutional Quality on the Shadow Economy,” *Department of Economics, Johannes Kepler University of Linz*, 2007.

²² See ILO Social Protection Department, “Monotax: Promoting Formalization and Protection of Independent Workers Uruguay Y Social Protection in Action,” vol. 2 (Geneva, 2014).

included in a broader strategy, the Borloo Plan, which provides for a voucher scheme aimed at simplifying the procedure for purchasing household services, employing domestic workers and paying for them without renouncing to confer to the employee full labour and social security rights²³.

Both measures tend to “include” those participating in the informal economy into the formal system by using tax rules and promote tax fairness through progressive tax rates and deductions aimed at reducing income inequalities. The concrete benefits provided by the tax measures consist in tax reliefs, such as tax deductions and tax credits, which incentivise the formalisation and at the same time contribute to make people feel that the formal economy is the best option.

Conclusions

By exploring the impact of taxation on the informal economy it has been found that the assumption that taxes contribute to the increase in informality is, under many points of view, false and misleading.

The analysis on objective data deriving from economic estimations on the level of taxation and the size of the informal economy has led to the conclusion that high taxes cannot be considered, in absolute terms, as a cause of informality, nor as a determinant of tax noncompliance, and that to the tax increase - or decrease - does not always correspond an increment - or decrement - of the informal economy.

After having excluded the possibility to identify a direct proportion between taxation and informal economy, it has been confirmed that the fact that carrying out informal economic activities implies the noncompliance with tax duties does not necessarily create a causal nexus between taxation and the informal economy, because most of the individuals participating in the informal economy are not motivated by the interest in evading taxes. In this respect, the discourse has been broadened in order to include an analysis based on the institutionalist principles and, in particular, on the role played by the tax morale in the decision of working informally.

Accordingly, it has been argued that when people perceive official rules as unfair, there is an institutional conflict able to distance the due conduct from the common conduct and if such a confrontation involves the field of taxation, the tax morale may lead to an increase in informal economy. Nevertheless, this situation occurs only when individuals choose the informality in order to avoid tax payment. In all the other cases, which are the vast majority, people do not even decide to carry out informal economic activities and participating in the informal economy is the only available option for satisfying their primary needs. Hence, the tax morale, being the individuals' attitude

²³ See Clément Carbonnier, “Réduction et Crédit d’impôt pour l’emploi d’un salarié à domicile, Conséquences Incitatives et Redistributives,” *Économie et Statistique*, no. 427–428 (2009): 67–100.

towards the payment of taxes, cannot turn taxation into a cause of the informal economy if among the main reason for working informally there is not the intention of avoiding taxes.

The analysis on the interactions between tax morale and informality, however, has led to find that not every causal nexus between taxation and the informal economy may be excluded. People perception about the tax system is relevant in all decisions involving - even indirectly - taxation, as a result, when they choose to formalise - or not - their employment relationship or their self-employed activity, the influence of the tax morale is significant. This means that, if on the one hand the tax morale does not always lead to an increase in informal economy, on the other, it is necessarily involved in the decision concerning formalisation. Thus, to a “positive” tax morale corresponds more formalisation, while in the presence of a “negative” tax morale people tend to remain within the informal economy because they do not trust that formal institutions are able to provide them with better opportunities.

Taking into account these findings is extremely important during the policy-making processes aimed at countering the informal economy. As a matter of fact, legislators should be conscious about the fact that applying measures when the “negative” tax morale prevails, can be useless and counterproductive. This is true in reference to every kind of formalisation policy, because all of them imply a commitment to comply with the tax duties derived from a formal occupation, and, in particular, those tax measures elaborated for favouring the shift to the formal economy. In these adverse conditions, the tax morale should be put in accordance with formal institutions for being sure that the tax measure will be effective and such an intervention can be done through *ad hoc* policies or by providing the tax measure with the necessary instruments for boosting trust towards the tax system. Tax measures able to effectively solve the problem of the informal economy, in fact, involve incentives to the formalisation characterised by the provision of a concrete benefits for those who choose to shift to the formal economy and the commitment to improving fairness through taxation.

Although at first sight taxes may represent a burden able to contribute to the increase in informality, it can be said that, by conferring effectiveness to formalisation policies, taxation also provides solution to the problem of the informal economy.

Therefore, according to the main findings, for tackling the informal economy, the tax morale should be taken into account especially during the policy-making processes aimed at encouraging the formalisation and taxation must be enabled to comply with its main purposes: collecting resources for providing for the common wellbeing and redistributing wealth among taxpayers.

Conceiving taxation, tax noncompliance and “negative” tax morale as causes of the informal economy may only lead to the elaboration of inappropriate policies which are likely to generate a decrease in tax rates without provoking a reduction of the informal economy and, most importantly, without

promoting a shift to the “positive” tax morale, because less taxation sometimes means investing less resources for providing common wellbeing and limited ability to redistribute wealth among taxpayers.

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