

[Paolo Di Caro, Agnese Sacchi, 2020. The heterogeneous effects of labor informality on VAT revenues: Evidence on a developed country. Journal of Macroeconomics.](#)

Do labor informality and its changes have consequences on the collection of VAT revenues?

The value-added tax (VAT) is widely spread in many advanced and developing countries primarily because it allows rising public revenues by preserving production efficiency and promoting compliance through self-enforcing mechanisms. International organizations often suggest switching tax revenues from distortionary income and trade taxes to commodity taxation for sustaining long-run economic growth without discouraging saving, investment and labor supply. However, its revenue performance can be undermined in the presence of informality.

In a recently published paper in the **Journal of Macroeconomics**, *The heterogeneous effects of labor informality on VAT revenues: Evidence on a developed country*, Paolo Di Caro and Agnese Sacchi aim at investigating the consequences of labor informality on VAT revenues in Italy.

Italy is a good candidate for this analysis for different reasons. It is a developed country where the size of the shadow economy, 211 billion euro (about 12% of the Italian GDP), and the VAT gap, 34 billion euro (about one-third of the VAT revenues), both referring to the year 2017, are the highest among the advanced economies. In Italy, the regional distribution of VAT revenues and informality is highly heterogeneous following the very different economic conditions and industrial structures across regions. In this country, the regional shadow economy labor markets are different in size, characteristics, and economic implications. In the North, informal occupations are mostly made up of secondary jobs and moonlighting activities, while in the South informal workers, which are concentrated in agriculture, building and private services, are the by-product of weak labor markets, low productivity, and high unemployment levels. The maps in Fig. 1 illustrate the distribution of total VAT (a) and labor informality (b) across Italy. High (low) VAT revenues (labor informality) are registered in the Central and Northern regions; the opposite is true in the Southern regions.

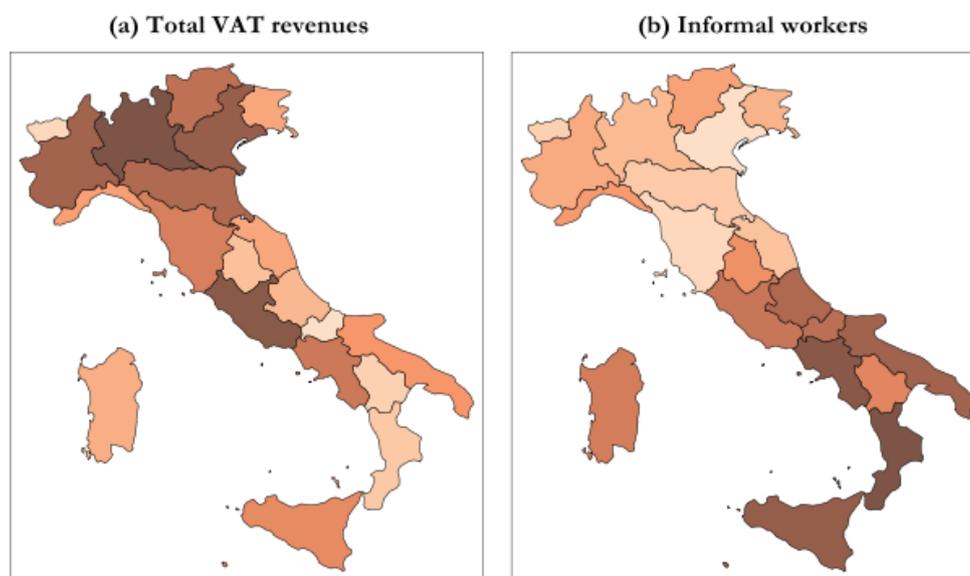


Fig. 1. Regional distribution of VAT revenues and labor informality. Note: Data on total VAT revenues (log) are from the Italian Ministry of Economy and Finance, data on informal workers (log) are from the Italian National Institute of Statistics; variables refer to the average over the years 2009–2017.

Fig. 2 gives a preliminary view of the connections among labor informality, labor productivity, and unemployment: high levels of informality are registered in the regions having low productivity and high unemployment.

the theoretical predictions of macro, general equilibrium models and some recent evidence pointing out the mixed effects of the informal economy on welfare. Moreover, they show that the relation between labor informality and VAT collection is heterogeneous and depends on the size of informality, by approximating an inverted U-curve.

Some policy implications can be derived, possibly of interest for other countries characterized by internal variability in the extent of labor informality. First of all, this study might raise the necessity of incorporating aggregate, general equilibrium considerations, which imply looking at the production and demand side of the economy empirically, when analyzing the effects of informality on tax revenues. More specifically, considerations on the informal economy are crucial when assessing the VAT performance and, in particular, the VAT collection following VAT reforms. Indeed, a rise of tax rates can produce lower additional revenues than expected, when labor informality increases and reduces the VAT self-enforcing mechanism. Lastly, policies aimed at reducing labor informality need to necessarily take into account the possible, asymmetric consequences of a reduction of informal jobs on VAT collection, across regions and sectors. In this contest, the Italian government has just approved a new law on this issue. The legalisation of a large number of (mainly low-skilled) natives and immigrant workers in certain sectors (e.g., agriculture, domestic work, family assistance) would increase public revenues as newly legalised workers will sustain VAT self-enforcing mechanisms and VAT collection. However, the choice of limiting the regularization of those workers employed only in some sectors is not justified by economic reasons and reduces the possible positive effects in terms of public revenues.