

Accepted Manuscript

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PII: S0304-3878(18)30356-0

DOI: [10.1016/j.jdeveco.2018.04.003](https://doi.org/10.1016/j.jdeveco.2018.04.003)

Reference: DEVEC 2221

To appear in: *Journal of Development Economics*

Received Date: 21 February 2017

Revised Date: 27 March 2018

Accepted Date: 4 April 2018

Please cite this article as: Rocha, R., Ulyssea, G., Rachter, Laí., Do lower taxes reduce informality? Evidence from Brazil, *Journal of Development Economics* (2018), doi: 10.1016/j.jdeveco.2018.04.003.

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Do Lower Taxes Reduce Informality? Evidence from Brazil*

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April 6, 2018

Abstract

We exploit a unique, large-scale formalization program in Brazil to estimate the effects of reducing the costs of formality on firm formalization. We rely on both firm-level administrative data and individual panel data to show that reducing taxes once registration costs have already been eliminated reduces firm informality. This effect comes from the formalization of existing informal firms, and not from the creation of new formal businesses nor greater formal firm survival. The implied formalization elasticity is otherwise low, and our cost-benefit analysis indicates that the program led to net losses in tax revenues.

Key words: Taxes, informality, firm creation.

JEL code: O17, H32, H26.

*We would like to thank Mariano Bosch, Carlos Henrique Corseuil, Claudio Ferraz, Miguel Foguel, David McKenzie, and Joana Monteiro for comments and helpful discussions. We are also thankful to seminar participants at Yale, IDB, UFRJ, USP/FEARP, PUC-Rio, INSPER, FGV-EBAPE, FGV-EESP, FGV-EPGE, IPEA, BNDES, PUC-Chile, LACEA Labor Network Meeting (Cartagena), SOLE-EALE (Montreal), and Brazilian Econometric Society Meeting for helpful comments. We are extremely thankful to Dimitri Szerman, who generously shared his knowledge about the RAIS data. All remaining errors are ours. Corresponding author, Rudi Rocha: São Paulo School of Business Administration, Fundação Getúlio Vargas - FGV EAESP, e-mail: rudi.rocha@fgv.br. Gabriel Ulyssea: Department of Economics, University of Oxford, e-mail: gabriel.ulysea@economics.ox.ac.uk. Laísa Rachter: Brazilian School of Economics and Finance, Fundação Getúlio Vargas - FGV EPGE, e-mail: laisarachter@gmail.com.

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