

Optimal taxation and monitoring in an economy with matching frictions and underground activities

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Abstract

This short paper shows the interdependence of taxation and monitoring policy in a search and matching model of equilibrium unemployment with an underground sector. More precisely, from a social welfare standpoint, two options are available to the policy maker: she/he may either substitute a tighter monitoring with a higher penalty or enforce both a higher taxation and an increased monitoring.

Key words: optimal taxation, tax evasion, underground economy, job search theory

JEL Classification: E26, H21, H26, J64

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