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# Fiscal consolidation and tax compliance

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## Abstract

Relying on a novel measure of VAT compliance in a panel of 35 countries, we document a robust negative association between changes in tax compliance and tax rates. In order to rationalize this finding, we develop a theoretical framework where heterogeneous firms adjust the share of declared activity. We calibrate the model using firm-level data in Greece, and find large leakages following the recent fiscal consolidation. We then show how differences in financial development and the size of economic activity at the margin of informality are able to explain the heterogeneous response of tax compliance to tax rates across countries.

**Keywords:** both

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