The Cost of Informality: A structural barrier to growth — United States

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∼7%	$1.4T+	∼600B
Informal economy as % of GDP	Estimated annual informal output (USD)	Estimated annual IRS tax gap (USD)

Sources: Medina & Schneider (IMF, 2018); World Economics QIES; national statistical agencies.

1 The Issue

The United States has the smallest informal economy as a share of GDP among CERI's three founding member states — approximately 5–8% depending on methodology. However, its absolute scale is extraordinary: with a GDP exceeding $27 trillion, even a 5% informal sector represents over $1.4 trillion in unrecorded economic activity, making the U.S. informal economy one of the largest in the world in dollar terms.

The IRS estimates the gross tax gap — the difference between taxes legally owed and taxes actually paid — at approximately $600 billion per year. This is the largest known tax gap of any individual country. Underreporting of income by self-employed individuals, cash businesses, and gig workers accounts for the largest share. Despite enforcement investment, the net tax gap (after late payments and enforcement) remains above $400 billion annually.

The rise of the gig economy has complicated the picture significantly. Workers classified as independent contractors — estimated at 15–20% of the U.S. workforce — operate in a regulatory gray zone. Many do not receive W-2s, do not contribute to Social Security or Medicare through employer withholding, and underreport self-employment income. This is not informality in the traditional sense, but it produces structurally similar outcomes: reduced social protection, reduced tax yield, and reduced labor market standards.

2 Key data by sector

Sector / Indicator	Estimated Rate	Key Impact
Gig & platform economy	∼15-20%	Tax underreporting; no employer contributions
Cash businesses (restaurants, retail)	∼10–15%	VAT/sales tax gap; wage theft
Undocumented labor (agriculture, construction)	∼5–7M workers	No labor protections; depresses wages
Domestic & childcare services	∼40–50%	'Nanny tax' non-compliance; gender impact
Cryptocurrency & unreported digital income	Growing; IRS est. $50B+ gap	Enforcement lag; international dimension

Table 1: Informality by Sector in the United States

3 Comparative Context

Informality is not unique to any single country, but its scale, drivers, and costs differ significantly. The table below places this brief in the context of CERI's three founding member countries.

Country	Informal Economy (% GDP)	Informal Workforce (%)	Est. Annual Tax Gap
Colombia	∼36%	∼58%	∼$10–14B USD
France	∼13%	∼11%	∼$80–100B EUR
USA	∼7%	∼7%	∼$600B+ USD

Table 2: Informality and Tax Gap: Cross-Country Comparison

4 Why it matters

The $600 billion annual tax gap has a direct and compounding impact on U.S. fiscal capacity. It constrains investment in public goods, forces higher marginal rates on compliant taxpayers, and contributes to deficit financing. The Congressional Budget Office projects federal debt will continue to rise as a share of GDP through the 2030s — a trajectory that informality-driven revenue losses accelerate.

Beyond fiscal arithmetic, U.S. informality reflects deep structural inequities. Undocumented workers — estimated at 5–7 million in agriculture, construction, and domestic services — contribute payroll taxes but receive no Social Security or Medicare benefits in return. Simultaneously, high-income informal activity (unreported investment income, cryptocurrency gains, and cash business profits) disproportionately benefits wealthier taxpayers. The result is a system where the compliance burden falls most heavily on wage earners, while informal activity is concentrated at both the bottom and top of the income distribution.

5 Policy Recommendations

- Stabilize and Target IRS Enforcement Capacity: IRS enforcement funding has faced significant legislative erosion since the Inflation Reduction Act's original $80 billion allocation, including rescissions and subsequent budget reductions. The policy priority is stabilizing remaining capacity and directing it toward high-yield noncompliance sectors rather than broad expansion.
- Enforce 1099-K Reporting Thresholds for Gig and Platform Workers: The IRS has delayed full implementation of lowered 1099-K reporting thresholds multiple times. Consistent enforcement of these requirements — without further deferral — is necessary to close the information gap on unreported self-employment income from platform work.
- Clarify and Enforce Independent Contractor Classification Standards: The DOL's 2024 independent contractor classification rule reestablished an economic reality test. Consistent enforcement of this framework is needed to ensure workers in functionally dependent relationships with platform companies receive formal employment status and associated legal protections.
- Operationalize Cryptocurrency Income Reporting: The 2021 Infrastructure Investment and Jobs Act established broker reporting requirements for crypto transactions. The priority is full IRS implementation of standardized 1099-DA issuance by exchanges and automated matching with tax filings.
- Expand EITC Outreach and Simplify Compliance for Informal Low-Income Workers: Targeted outreach and administrative simplification of the Earned Income Tax Credit for low-income informal workers creates an incentive-compatible pathway toward formalization, reducing the cost differential between formal and informal participation.

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