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Policy Brief

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Tax Evasion: Greece's Jigsaw Puzzle

Vasilis Karakasis

Introduction

Seven months ago a staff team of the IMF published a policy paper explaining how the tax system operates in Greece and how it encourages the Greek citizens to avoid paying taxes for the sake of their own survival. This report lists certain procedures and practices, dominant in the tax system, that justify the Greeks' option to withhold their real income, depriving thus the national treasury from an important amount of revenues. It clearly states, that in Greece *"the benefits of evasion are comparatively high and the costs are comparatively low"* (IMF June 2013; 23). To get this straight, the report claims that paying your taxes in Greece is irrational (in the most lenient terms).

Drawing upon this assumption, the central aim of the paper is to analyze the reasons why paying taxes in Greece makes someone an "irrational" actor. In alignment with this

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position, it presents certain incentives that encourage tax evasion in the country. The first part will briefly document the level of tax evasion in Greece. The second part will list all the stimulants that have prompted the phenomenon of tax evasion in the country. Finally, the report will comment on the words of Greece's Finance Minister, according to which *"Greeks are not overtaxed".*[1]

1. Documenting the level of tax evasion in Greece

Several attempts have been made to properly document the level of tax evasion in Greece. An innovative research to this direction was undertaken by three professors of Chicago University. Instead of looking at tax records to identify the trends, economists Nikolaos Artavanis, Adair Morse and Margarita Tsoutsoura (2012) had recourse to a rather novel approach by investigating the bank records(one of the ten largest in Greece) to operationalize the role of tax evasion in the Greek debt crisis. They embraced the same method that banks use to determine one's "true income" before approving loans and credit cards. This enabled them to obtain an access to a rich set of hard and soft information that another survey would be hard to capture. That way is considered to be more accurate and reliable than looking at tax records. Having drawn a comparison between bank data and government data, the authors found that the true income of the average Greek person is about 1.92 times larger than generally reported (Artavanis N. et. al 2012)

The findings of these professors are more than significant. They claim that in 2009 tax evaders failed to report 28 billion euros which, at a tax rate of 40%, accounted for nearly a third of the country's deficit (approximately 11bn euros). Who are the people that withhold their real income?

According to Harry Theocharis, General Secretary of Information Systems in the Ministry of Finance of the Hellenic Republic, 5.5 million out of 8.2 million salary people[2] cannot easily hide since their salary taxes are automatically withdrawn from their paycheck. On the other hand some self-employed people as well as entrepreneurs with small companies have increased ability to hide (CNBC 16.6.2012).

[1] This is what he claimed in a TV interview, 25.11.2013

[2] A number that includes that includes civil servants, pensioners, a significant proportion of employers and employees in the private sector along with some self employed

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2. Tax evasion as a jigsaw puzzle

The challenge for Greece to cope efficiently with the crisis depends, among other factors, on its ability to extract tax revenue from its economy. Nevertheless, the prognosis, as regards this ability, does not seem good. An interplay between structural, institutional, societal factors and norms has contributed in making tax evasion endemic in the Greek economy. These factors, among important other, are:

- **nature and size of the market**: Greek economy seems a tailor made environment for underground activity since it is mainly based on small and medium sized enterprises (Danopoulos and Znidaric 2007). According to Eurostat (2010 cited in Kaplanoglou&Rapanos 2013), Greece displays the highest proportion of the non-financial business economy workforce (58%) that is employed in very small businesses (employing 1-9 people) across the EU-27 (30%).

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Some cultural aspects could partially explain this "path dependence".[3] A diachronic low future orientation, as regards the prospects of Greece's economy, has traditionally (even before the crisis) discouraged entrepreneurs from long-term resource commitment. Moreover, Petrakis (2012; 153) underlines the denial of institutional collectivism, the reduced trust towards institutions and the dominance of in-group collectivism (family-immediate environment) as certain factors in explaining this *modus operandi*.

The control of the small businesses' activities and trade turnover is really complicated. It is much harder to control hundreds of thousands enterprises than one thousand companies. After a certain point the cost of exercising any control becomes higher than the profits themselves. These companies maintain rudimentary and not optimally trained office. This means that the accurate record keeping cannot be flagged as their highest priority (Danopoulos and Znidaric 2007). Besides this, it cannot be neglected that the owners of these enterprises represent a noticeable political constituency whose influence cannot be ignored by every politician. The almost 800.000 small businessmen numbered more than 10% of the voters during the last elections. This means that every candidate should estimate the political cost of initiating a non-tolerance bill targeted on these groups (Mandravelis 7.10.2012).

- the effectiveness of the tax system: The Greek tax bureaucratic structure, with special reference to the tax law enforcement agencies, lacks the proper technical knowledge and stellar reputation to deal with tax evasion (Danopoulos and Znidaric 2007). In several land registries there is no sufficient personnel to adequately meet the requirements of the tax offices. Their archives have not been sufficiently computerized. Thus, if a tax officer seeks to search for the real property of a tax payer, he has to spend too much time to reach his data. In many cases has to conduct a research in the 270 land registries to find out the real property of the tax payer. In addition, the latter's profile should be mainly searched into the basements of tax offices and land registries where there are many documents and archives non-digitalized and non-computerized, often hand-written and fragmentary. If a tax auditor

[3]The economic concept of path dependence explains how the set of decisions one encounters in any given circumstance is constrained by the decisions one has made in the past, although past circumstances may no longer be relevant.

seeks to exercise an integrated control of a person that has changed his living address or his job address, he has to resort to all the relevant tax offices in order to receive the proper files. This problematic tax administration system and its lack of database allow certain citizens not to declare their real property withholding their assets (Neoi Fakeloi 23.1.2012).

The enforcement mechanisms seem particularly weak as well. One of the dominant manifestations of this weakness is that tax arrears -at the end of 2010- had reached 14.5% of GDP and that another 13.2% of GDP of assessed tax revenue was disputed in courts (Kaplanoglou & Rapanos 2013; 292). Additionally, the lack of an effective dispute resolution mechanism is indicated by the fact that over 150.000 cases are pending before tax courts, with each case taking seven to ten years, on average, to reach a final verdict (ibid.).

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Furthermore, tax audits are sparse, leading to an accumulation of unaudited tax returns. In dealing with this issue, the government resorts to tax amnesties every three to five years.[4] It periodically provides the businesses with the opportunity to "close" past declarations to any audits, for a fee which is to be paid for each tax year in case a business would like to exempt from possible audits. This "window of opportunity" can be viewed as a middle ground: it encourages an entity to cover-up past transgressions, at some cost, but it also enables the government to collect some tax revenue. Nevertheless, the outcome is that the revenue collected from these cases is much less than what is properly owed (Goumagias et al 2012; 76).

Additionally, the tax overregulation, which is accompanied by successive amendments and manifested through several circulars of the Ministry of Finance[5]have brought well-intended and punctual taxpayers into a deadlock situation. Their deficient revenues, as an impact of the austerity-driven policies on their properties and economic activities as well as the continuous fear for not meeting the strict deadlines -set by the state- to pay their duties have played a catalytic role in this perspective. Moreover, citizens with insufficient income resources, have to resort to their bank deposits in order to fulfill their obligations towards the state. This outflow of deposits damages inevitably the stocks and the functioning of the banks as well.

- the scarcity of employment opportunities: This parameter often urges job seekers to comply with black market offers that do not provide them with a fixed minimum wage or health insurance benefits. This unregistered employment might be beneficial for many employers but it damages the nation's nearly bankrupt pension system and facilitates the augmenting erosion of the personal income. Even before the outburst of the crisis, the Eurobarometer (2007) conveyed that the Greeks reported the highest number of undeclared work and at the same time the lowest percentage of those expecting a sanction to be a fine or prison (Kaplanoglou & Rapanos 2013; 292).

[4]It should there are many cases of businessmen and entrepreneurs that are called by the state authorities to pay immediately their obligations to the state although the state itself has not fulfilled its obligations towards them, has not provided them with any tax clearance and has refused to come up with any kind of clearing.
[5]Whose contents are often contradictory to each other.

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- the level of tax burden: In the pre-EMU accession phase and under the dictum of the Maastricht criteria, calling for constrained budget deficits, the threat of exclusion for Greece forced the government to fix its fiscal imbalances. The hard-conditionality of this pre-accession period paved its way to a soft-conditionality of the EMU period that allowed Greece -in a similar way with other governments, Germany's included- to breach both the letter and the spirit of the pact (van Hagen 2005). As Katsimi and Moutos (2010) claim, an important disadvantage of the Maastricht criteria is relying upon its concentration on numerical targets without addressing the *modality* of the fiscal adjustment.

The Greek case reflected this ephemeral character of adjustment whose tax increases constitutes the main pillar. In the "soft conditionality" period of the EMU (Katsimi and Moutos 2010) and before the shadows of the global crisis appeared, tax revenues in the Greek state showed a declining trend (from 42.9% in 2000 to 39,6% in 2007). When the crisis erupted and the budget deficit had reached a double-digit magnitude, overall taxation was considered the "safe-net" to bring Greek economy back on the track.

The tax mix adopted, however, conveys an even more puzzling picture. Most of the total tax revenue (around 60%) is covered by indirect taxes (VAT and other taxes on

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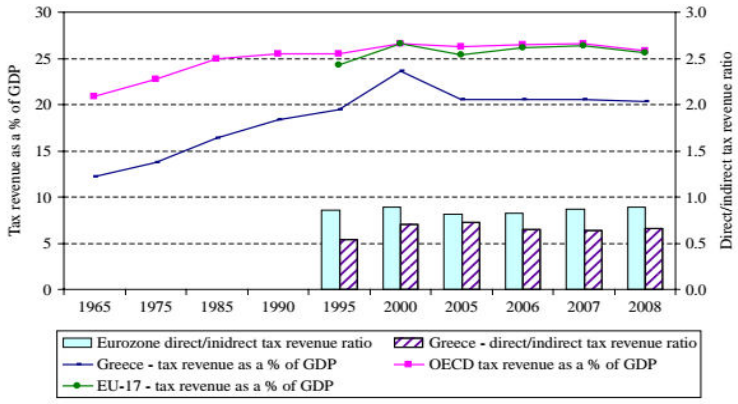
consumption and production). Due to this number, Greece –along with Portugal- has the lowest direct-indirect tax revenue ratio (0.64) within the Eurozone (Kaplanoglou & Rapanos 2013; 283).[6] This figure raises obvious questions of **social injustice**. In contrast to the progressive character of personal income tax, the cost of an increase in indirect taxation is shared by the majority of the consumers and taxpayers regardless of their economic status and their actual ability to pay taxes. As the poorest households generally spend most of their income on consumption, they are required to pay disproportionally high taxes compared to their actual-tax paying ability (Petrakis 2012; 182).

Figure 1 (cited in Kaplanoglou & Rapanos 2013 and European Commission 2012)



Why does this matter? We all know that the key objective of every tax system is mainly to redistribute income from the rich to the poor. This is done by collecting higher taxes from the rich and using the proceeds to provide public services that benefit rich and poor alike (Meghir et al 2010; 11). However, the predominance of indirect taxation burdens those with a lower average tax rate compared to individuals/households with higher incomes. This way, the progressive nature of the tax system is almost nullified (Petrakis 2012; 182).

- perceptions of economic fairness: The role of ethics related to tax evasion should be stressed. The term "ethics" is not referred to a branch of philosophy, but to the standards and values affecting the evader's behavior (Etzioni 1986). Values derived from the community are significant in determining people's compliance or non-compliance with tax

[6] See Figure 2

laws. When the distribution of wealth is not in conformity with the society's perception of social justice, then there are great chances for tax evasion to increase. This non-conformity seems to be dominant in the Greek society.

Conclusion

After four consecutive years of repeated hikes, tax has become one of the most sensitive issues in Greece. There are many competent analysts who could explore ways on how the Greek authorities could crack this phenomenon down. However, not being an expert in economics, I do not intend to stray into this territory. Troika has established a team meant to assist with the required internal changes. My hope is that after the current austerity measures, a more detailed and carefully designed technical assistance will pave the way for a strictly institutional (and not accounting) rationale.

However, I would like to conclude by raising the officials' awareness on another point. Two months ago, Greece's Finance Minister, Mr. Yannis Stournaras, made a claim in a TV interview, according to which the Greeks do not pay taxes as much as the citizens of their EU counter-partners. He insisted on this assertion when questioned about it in the

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following days. To justify this, he cited figures that show tax revenues accounted for 22.8% of Greece's GDP in 2012, while the Eurozone average was 25.7% (To Vima 26.11.2013).

Needless to say, that this insistence evoked a domestic outrage among the Greek citizens and drew criticism from his cabinet colleagues and the opposition parties. The Greek Administrative Reform Minister, Mr. Kyriakos Mitsotakis castigated Mr. Stournaras' remark, by claiming that "*those who pay*"[7] are overtaxed. He added that "*in Greece we are badly taxed. Despite the measures that Greek governments have taken all these years to make a fair distribution of the load to the taxpayers, every systematic effort towards this direction has failed its purpose*."

My opinion is that Mr. Stournaras should have been much more cautious with his words especially in a period during which the talks with troika are pending and the Greek society is at a very high risk of social unrest (Economist 23.12.2013). Statements that underestimate the honest taxpayers' sacrifices, in restoring Greece's public finances, increase the latters' mistrust towards the state institutions.

If the people do not conceive the institutions of an entity standing for each citizen,[8] no glimpse of hope can emerge. It will become extremely difficult to tame the pestiferous tax evasion, if the people think of an entity that solely rips off with cynicism and impudence the contributory pensions and salaries[9] and his representatives afterwards claim that "Greek people are not overtaxed". In the citizens' mind, the recent "hypertrophic austerity rationale" has already resulted into a grave violation of Greece's constitution (fundamental provisions and spirit) as well as of core European values and *acquis*, touching upon basic social rights and human dignity *per se*. Thus, if the authorities want to alarm the society on combatting tax evasion, the prerequisite for an **honest** explanation to the overtaxed citizens should be more than capital. Otherwise, the Greek society, which has already begun to suspect that the tax burden, that the people continue to carry on, is senseless, will be transmuted into a jungle of egocentric primitiveness for simple survival reasons. The sense

[7] The "usual suspects"
[8] According to Aristotle "Ηπόλις φύσειπρότερον ἢ ἕκαστος"
[9] which the state itself and the citizens have jointly agreed upon

of the social debt will disappear while many citizens, driven to desperation, will be transformed into risky predators.

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