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Tax and Trust: The Fiscal Crisis in Greece

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They say that the only things certain in life are death and taxes. But in Greece, it seems, only the former is a certainty for many of its citizens. The result is a sovereign-debt crisis that has both reflected and contributed to the current instability in the Eurozone.

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http://www.tandfonline.com/doi/full/10.1080/13608746.2012.723327

In order to understand how Greece came to be in such a perilous fiscal state, two economists from the University of Athens have been looking at their tax system for clues. In an extensive study published in South European Society and Politics, G. Kaplanoglou and V.T. Rapanos highlight a number of shortcomings in the design and enforcement of the Greek tax system. They argue that the current crisis is the result not only of inappropriate fiscal policies, but also of poor domestic fiscal governance and weak fiscal institutions. In short, failures in the tax system have contributed substantially to Greece's catastrophic public deficit.

Through detailed international comparisons, the authors first reveal that Greece's tax-to-GDP ratio is particularly low, and out of pace with its level of economic development. The structure of its revenues, with a strong reliance on consumption taxes, resembles that of developing, rather than developed countries, which usually rely more on income tax as prosperity grows.

Professors Kaplanoglou and Rapanos then investigate what are in their view the longstanding failures of formal institutions, which led to such a disastrous state of affairs. They note that 'all indicators point to the fact that low and unfairly distributed tax yield is primarily due to the poor functioning of the tax administration, lax tax enforcement, inefficiency of tax collection and the lack of effective dispute mechanisms.' To illustrate their point, they note that over 150,000 cases are currently pending before the tax courts, with each case taking on average seven to ten years to resolve. Moreover, Greek tax amnesties – as frequently as every three to five years – effectively punish the honest taxpayer. The authors conclude that failures such as these 'result in high tax evasion and a thriving underground economy', as well as what they calculate as forgone VAT revenues of an astonishing 3.3% of GDP.

Believing strongly that 'tax evasion should be treated not only as a pure economic but also a social phenomenon,' the authors examine the social side of paying, or, rather, avoiding tax. They emphasise the important role that personal norms (one's own convictions about what is right) and social norms (evolving rules of behavior formed and accepted by groups) as well as trust in government/state institutions play in taxpayers' decisions. Put bluntly, 'people who believe that others do not comply with the tax rules will try to avoid paying their own taxes.' Conversely, if someone believes that the government spends tax revenues in a fair and efficient way, then he or she will be more wiling to pay. Worryingly, they also conclude that 'the unwillingness of Greeks to pay taxes is linked to low levels of perceived fairness and a high level of perceived corruption.' The structure of the Greek economy itself further contributes to the problem, with an 'abnormally high number of self-employed and very small businesses' making effective auditing a challenge.

The authors conclude that tinkering with tax codes, fines and laws will not solve the Greek fiscal crisis. They write that: 'Meaningful and long-lasting improvement has to emerge from a change in the way Greeks view public and societal institutions and from fostering higher levels of trust in the government.' The vital message to Greek policymakers in this essential article is that enhancing the efficiency of tax administration is just one step on the road to restoring confidence in Greek public institutions and with it, rescuing Greece's dire economy.

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