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Welfare and Society

Working Papers
2/2015

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ISSN: 2241-8717

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ISSN | 2241-8717

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Tax policy in Greece during the economic crisis

Nikos Tatsos[1]

1. The economic background

Until the outbreak of the financial and economic crisis, the Greek economy appeared to be performing fairly well with an average GDP growth of 4% from 2000 to 2008, double that of the euro area. However, this notable performance was mainly due to domestic consumption, with the country running at the same time large and increasing fiscal and external deficits. That is, on average, current account deficits were close to 10% of GDP and public deficits double the maximum level imposed by the Stability and Growth Pact.

In 2009 public deficit jumped to over 15% of GDP, public debt increased to almost 140% of GDP and the country started losing credibility. In conjunction with the global financial crisis, Greek spreads increased enormously and access to financial markets was in effect closed. Financing the public debt was not possible, measures were needed to reverse the debt build-up, to establish conditions for sustainable growth and to regain access to international capital markets and, in May 2010, the country embarked upon a European Union/European Central Bank/International Monetary Fund ("*troika*") economic adjustment program.

The adjustment program implemented under the supervision, the technical assistance and the financial support of the *troika* was aimed at restoring sustainable public finances and the foundations for sustainable growth. It envisaged an ambitious fiscal consolidation, substantial cuts in wages and a wide spectrum of structural reforms in the public and the private sectors that aimed – provided that the underlying assumptions were fulfilled – at boosting potential growth. The program however was deemed from the outset ambitious and a number of scholars and economic observers were quite skeptical about it.

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Challenging and quite similar consolidation efforts - though under more favorable circumstances - had been attempted in the past in other European countries and there was the experience and the expertise required for trying it in Greece too. However, it seems that the instigators of the program failed to realize that the conditions prevailing in Greece and in the global economy were not similar to those faced in the past. In addition, as was recognized later by one of the *troika* partners[2], there was a mistake in a key underlying assumption, namely the size of the multiplier.

The implementation of the reforms was also not easy in practice, as it faced high political risks. The authorities implemented substantial fiscal consolidation and the primary deficit was reduced by about 5% of GDP in 2010, which is remarkable given the difficult economic context with no precedence in the EU or in the OECD. However, the strong fiscal contraction and the other austerity measures reduced domestic demand more than expected, output started to decline and the unemployment rate to increase. Confidence was reduced as markets and an ever increasing number of people doubted the ability of the program to deliver sustainable fiscal consolidation and growth, which together with fiscal austerity and the inability of the banking sector to provide adequate liquidity, created the conditions for a negative growth spiral. Since then Greece has been in recession with both sides, having a share in the failure. The Greek side for not fully implementing the program and the "troika" side for proposing an ambitious program resulting in a much deeper recession than anticipated.

In the following pages we shall catch a glimpse of the main changes in the Greek tax system after the outbreak of the economic crisis, comment on some tax areas which although they require radical reform have remained untouched and highlight the political challenges and restrictions that the Greek government has been facing in attempting tax reform.

[2] International Monetary Fund (2013): "Country Report No 13/156", June. See also http://www.thetoc.gr/eng/politics.

2. The main areas of reform

Greece is not the only country which has implemented tax measures and reforms to alleviate the impact of the economic crisis and despite the differences in the specific conditions prevailing within each country and in the tax measures that have been taken, the aim of the measures was to stimulate spending and support private sector liquidity. Policy makers in Greece, facing huge fiscal imbalances and with no access to international capital markets were forced to do the opposite.

Table 1. Tax receipts from main categories of taxes (in million €)

Taxes	**2008**	**2010**	**2012**	**2014***	**%14/08**
I. Direct taxes	20,863	20,224	21,097	21,396	2,6
Personal income tax	10,816	9,398	9,970	8,224	-24.0
Corporate income tax	4,211	3,167	1,715	2,806	-33,4
Property taxes	486	487	2,857	3,432	606.2
Other direct taxes	5,350	7,171	6,555	6,934	29,6
II. Indirect taxes	30,222	31,042	26,083	24,228	-19,8
Value added tax	18,243	17,374	14,956	13,892	-23,9
Excise tax on energy	2,299	2,653	2,567	2,276	-1,0
Other indirect taxes	9,680	11,015	8,560	8,060	-16,7
TAX REVENUE(I+II)	51,085	51,266	47,179	45,624	-10,7

* Budget estimates

Source: State Budget, various years

The significant fiscal consolidation which was needed was attempted through across-the board tax increases with detrimental effects on economic activity, growth and finally on tax revenues (Table 1). In addition, although the measures taken had some role to play in the first place, they did not provide a long lasting solution and in effect they prevented policy makers from taking the measures that were necessary for enhancing the efficiency of the tax system. Moreover, they had harmful effects on social and equity grounds.

2.1 The personal income tax

Personal income tax in Greece is clearly underperforming. Tax receipts as a percentage of GDP are more than five points lower than the OECD average, largely due to widespread tax evasion and special tax regimes. In addition, the tax free level has been high[3], both in absolute terms and as a percentage of the "typical" wage level (OECD, 2010b) inducing almost 70% of the self-employed in 2009 to report income lower than this level. However, lowering the tax free level has been considered by policy makers inconceivable and an action of very high political risk.

A major step aimed at broadening the tax base as well as curbing income tax (and VAT) evasion was made in 2010, when taxpayers were required, in order to qualify for the tax free level, to keep the receipts for their purchases. However, when it was first introduced, the measure was too generous[4], had an inverse effect on tax revenues and although it has been changed a few times since then and become successively less generous, there is much doubt as to its final net effect on tax evasion. This is because, when the method became less generous, an incentive was created for tax payers not to insist on a receipt so as to obtain better prices. Thus, while before the introduction of the measure the proposition of two different prices – one with and another (lower) without the issuance of the relevant receipt – was

[3] In 2009, the tax free level in Greece was €12,000, i.e. 65.5% of the "typical" annual wage level in the country. The respective percentages were only 17.3 % in France, 14.5% in Belgium, 35.7%in Austria, etc, while a number of countries have no tax free level at all (OECD, 2010b).

[4] Actually, when first introduced, instead of curbing tax fraud the measure was in effect subsidizing tax evaders. By establishing an open-ended system of tax refunds, the larger the amount proven by the receipts collected by taxpayers as a percentage of income declared, the higher were the tax benefits accrued, thus favoring more taxpayers who declared low income and high expenditures, i.e. in most tax evaders

made by the sellers, after the reduction of the tax refund and in conjunction with the austerity measures, the request for a lower price without the issuance of a receipt comes also from the buyers, who are much greater in number than the sellers.

Another step towards the rationalization of personal income tax was the introduction in 2010 of a single rate scale applicable to all main sources of income, instead of the two rate scales that had been applied until then[5]. However, three years later, another change was made in the opposite direction, when the number of rate scales was increased to three[6] and it has been announced that in 2016 the number of rate scales will be reduced again to one or two. The instability in personal income tax has been further accentuated by the fact that from 2008 onwards, the income tax scale(s) has been changed every year. Another notable change in personal income tax has been the abolition of almost all tax allowances (including child allowances).

Lack of stability also characterizes the so called "extraordinary levy" which was deemed to be temporary in nature but has not proven to be as temporary as originally thought. An extraordinary levy was first imposed in 2009 retroactively to incomes exceeding €60,000 which were earned in the year 2007. The threshold level was increased to €100.000 in 2010 and then reduced drastically to €12,000 in 2011. The income base upon which the above levy is imposed has also been changed a number of times since 2009[7]. This levy was intended to terminate in 2014, but since its termination would have had adverse effects on tax revenues, it was prolonged in 2015. Furthermore, the third Memorandum of Understanding between Greece and its creditors provides for an increase in tax rates with a retroactive effect from 1 January 2015 and its incorporation in 2016 with the income tax scale(s). Thus, the extraordinary levy introduced an additional

[5] One rate scale was for wage earners and pensioners and the second for all other taxpayers.

[6] One rate scale for wage earners and pensioners, the second for all the other taxpayers and the third for income received from the leasing of real property.

[7] Laws 4024/2011, 4052/2012, 4093/2093/2012, 4041/2013, 4254/2014 etc.

element of uncertainty and instability in the way personal income is taxed in Greece. And certainly, the imposition of extraordinary levies is not the best way for extracting additional revenues in a country with widespread tax evasion, since extraordinary levies hurt those already paying taxes, as compared to tax evaders. These levies also affect tax progressivity, tax compliance and economic planning, especially when they have retroactive effects.

The instability in the way income is taxed in Greece is also reflected in the capital gains tax which was imposed in 2008, abolished in 2010, reintroduced in 2012 and postponed in 2014.

The above rather abrupt and unsystematic changes in personal income taxation show that there has been no sound plan for reform and that the motive of the above mentioned changes has not been the rationalization of the tax system but purely an increase in tax revenues. However, the above measures, by exerting additional recessionary pressures on the economy, were self-defeating. They failed to deliver the revenues expected (Table 1) and made the distribution of the tax burden more uneven (Giannitsis and Zografakis, 2015).

2.2 The taxation of profits

The statutory corporate income tax rate has also demonstrated noticeable volatility over time, while similar volatility can be noted in the rate of withholding tax on profit distributions (Table 2). That is, there has been a major change in tax law almost every year (some with retroactive effect), which exerts harmful effects on investment decisions and risk taking. It is also worth noting that at the time other countries were reducing corporate income tax rates as a stimulus for the recovery of their economies, policy makers in Greece were in the awkward position of doing the opposite. Thus, in order to attain the fiscal targets agreed upon, they imposed an extraordinary levy on profits in 2009 and 2011, a levy on economic activity in 2011[8] and they increased the corporate income tax rate in 2013 from

[8] The levy on economic activity was retroactively increased in 2013.

20% to 26% (EU average 20,5%[9]) and then to 29% in 2015. That is, they adopted recessionary measures in a country already suffering from deep recession. There have been also tax increases and frequent changes in the withholding tax on profits distribution.

Table 2 . Taxation of profits: Main changes in the tax rates

Tax Law	Date in effect	Corporate income tax on undistributed profits (%)	Corporate income tax on distributed profits (%)	Withholding tax on dividends (%)	Extraordinary levy
3697/2008	1.1.2009 1.1.2010 1.1.2011 1.1.2012 1.1.2013 1.1.2014	25 24 23 22 21 20	25 24 23 22 21 20	10 10 10 10 10 10	
3808/2009	1.1.2009				5%-10%, profits>5m
3842/10	1.1.2010	24	40		
3845/10	1.1.2011				4%-10%, taxable profits> 100.000
3943/2011	1.1.2010 1.1.2011	24 20	24 20	21 25	
4038/2012	1.1.2010	20	20		
4110/2013	1.1.2013	26	20	10	
4334/2015	1.1.2015	29	20	10	

[9] KPMG (2011): "Corporate and Indirect tax Survey, 2011", in www.kpmg.com

As in the case of personal income tax, these changes do not reflect a plan for reform but rather are changes aimed at fulfilling short term needs and balances.

2.3 Real property tax

Property taxes are particularly challenging to amend and their reforms have often proven difficult to carry out successfully. This has been confirmed in the case of Greece too. In fact, in addition to the obvious political challenges concerning the reform of the property tax in Greece, some of the measures that have been taken to overcome various difficulties have been problematic themselves and instead of working towards the imposition of a good and efficient tax they have in practice distorted the efforts of the reform.

However, before commenting on the major changes made in real property taxation, it would be useful to point out that a noticeable feature of property taxation in Greece has been the high reliance on taxes based on property transactions. That is, while in other countries most revenues from property taxes arise from recurrent taxes on property ownership, in Greece the contribution of these taxes to property taxes in 2009 was only 11.4%. Since then, new taxes have been imposed on real property and the receipts from taxing property ownership have been increased by more than 600% (Figure 1). At the same time, due to the economic recession, transactions on real property and consequently transaction taxes on real property have fallen dramatically. Thus, the contribution of real property taxes to total property taxes increased from 11.4% in 2009 to 96.9% in 2014 and Greece now has the highest recurrent taxes on property as a share of GDP in the EU.

The first major reform of property taxation was implemented in 2008 when the existing progressive real property tax (FAP) was replaced by a flat rate tax on all real properties without exemptions. In 2010 this tax was abolished and a progressive tax on "large real property" (FMAP), similar to the one imposed prior to

2008, was introduced which, in contrast to the 2008 tax, was based on the property right holdings of individuals, rather than on properties. It took some time for "large real property" to be defined and when it was realized that the expected revenues from such a tax would not be as much as required, the untaxed amount was dramatically reduced. A year later (2011), a new recurrent area-based property tax was applied which was levied on the occupants of residential and commercial buildings that are connected to electricity and the tax was administered and collected through the public electricity company.. This area-based tax was calculated by multiplying the size of the real property in square meters (actually, the size of the lighted area) times a multiplier that decreased with the age of the property and times a zone rate which reflects the location of the property. The burden of this tax on poorer taxpayers has been estimated to be almost four times the average burden on all households (Giannitsis, T and Zographakis, S., 2015) and since the tax was considered from the outset to be very unpopular, the government announced that it would be temporary. The most recent reform was undertaken in 2013 with the replacement of the two property taxes (the FMAP tax and the PPC tax) by a unified property tax (ENFIA), first applied in 2014. The new tax was originally thought to tax properties, not individuals, and to have a much broader base including all types of real properties. However, mainly due to administrative problems, the tax was subsequently changed considerably and the tax base became narrower. In addition, a progressive surcharge was imposed on property holdings exceeding €300,000.

Again, it is obvious that the above, almost yearly, changes in the structure of the real property tax do not constitute part of a plan for tax rationalization but rather they are fragmentary changes aimed solely at ensuring additional tax revenues. Furthermore, apart from the absence of a reform plan, there are also other reasons that have made the imposition of the real property tax difficult and unpopular in Greece.

First, despite long established property taxes in Greece, there is no complete official record of real property holdings that would make it possible to identify their ownership, location, dimensions and the other information required to efficiently impose a property tax. That is to say, there is no data that can be used to prepare a cadastre for tax or other purposes and for determining the value of real property holdings (especially land parcels) equitably, ensuring that all property holdings are covered and identifying the persons that are liable for the tax. For that reason, a "fiscal cadastre" was prepared based on self-assessment with all the disputes, legal problems and other difficulties such a procedure may have.

Second, in order to collect the revenues required for attaining fiscal consolidation targets, the government based and imposed the above mentioned taxes on out-of-date (2007) real property values. That is, on property values existing before the economic crisis, which in the meantime have fallen by over 40% resulting to over-taxation.

Third, the timing of the imposition of the real property taxation on all real property owners coincided with a period of drastic income reductions, other tax increases, mass vacancies of buildings, a considerable decline in real property values, a freezing of real property transactions, a rapid increase in unemployment rates, etc, making income and liquidity restrictions of taxpayers much more apparent in fulfilling their property tax obligations. It is worth noting too that the ratio of owner occupied housing in Greece is approximately 80% relative to an unweighted EU-19 average of approximately 68%[10] and that due to very low pension levels in Greece real property rent income has traditionally been considered a necessary "supplement" to the pension system. And since the fact that the smaller the total property a taxpayer holds, the larger the fraction of real property is very apparent in Greece, the imposition of a real property tax is much more challenging than it otherwise would be.

[10] OECD Country Surveys (2014): The data collected by the OECD refers to different years for the countries analysed.

In short, the Greek government had to impose and amend real property taxes without having a cadastre, on inflated values that prevailed prior to the crisis and at a very inappropriate momentum. In this respect the argument that the property tax is a "tax everyone loves to hate" (Rosengard, 2012) could not be more justified than in the case of Greece. And certainly, all the above "reforms" in property taxation will make a proper reform much more difficult to accomplish in the future.

2.4 Indirect taxes

Long standing problems of inefficiency can also be noted in the system of indirect taxation. Around 30% of the VAT due is not collected, as compared to approximately 12% EU average, while the VAT efficiency rate in Greece is 0.51 as compared to 0.71 OECD average (OECD, 2011).

To fulfill fiscal consolidation targets, VAT rates were raised three times from March 2010 to January 2011. The standard rate was raised from 19% to 23%, exceeding the average standard rate in the EU by 1.5 percentage points, the reduced rate was increased from 9% to 13% and the super-reduced rates were increased to 6.5%. The VAT tax base was also broadened to cover legal and notarary services, previously exempt, while a number of products and services were transferred from the reduced VAT rate to the standard rate. However, despite the fact that the reduced and the super-reduced tax rates were increased by 44%, the standard tax rate was increased by 22%, the tax base was broadened and the other measures aimed at increasing tax revenues, VAT revenues decreased between 2008 and 2014 by 45 billion (almost 24%) due to the economic recession and the impetus to the tax evasion caused by the above tax increases. Despite this, the third Memorandum of Understanding agreed upon with the creditors in July 2015 provides for further VAT increases. Excise tax rates have increased as well. The excise tax rate on alcohol was increased by 124.7%, the tobacco tax rate by 16.7%, the tax rate on gasoline 91.4%, the tax rate on heating oil 1,471.4%, etc. However, as in the case of VAT, despite the remarkable rate increases, excise tax revenues were lower in 2014 than in 2008.

2.5 Tax debt

While statutory tax rates have been higher in Greece than in other countries (OECD, 2011) the effective tax rate[11] up to 2012 was well below the OECD average due to high tax debt and widespread tax evasion.

Table 3. Undisputed tax debt as a % of net revenue collection (Year 2010)

Country	%	Country	%
Greece	89.5	Lithuania	10.0
Slovak Rep.	63.9	Finland	8.0
Cyprus	35.8	France	6.8
Malta	30.9	United Kingdom	6.5
Hungary	24.6	Estonia	5.2
Bulgaria	24.3	Slovenia	5.2
Portugal	22.5	Ireland	4.4
Latvia	21.8	Netherlands	4.0
Poland	17.9	Sweden	2.9
Luxemburg	15.9	Austria	2.5
Czech Rep.	12.8	Denmark	2.3
Spain	10.4	Germany	2.3
Belgium	10.4		

Source: OECD (2013)

As in other countries, the tax administrations in Greece include a specialised department responsible for all activities relating to arrears collection and the related function of securing overdue tax payments. However, despite the impor-

[11] The amount of taxes collected in relation to GDP

tance of collection enforcement and the specialised skills it involves, the relevant collection enforcement department has been neither properly structured nor well staffed. As a consequence the collection enforcement programs of the tax administration have been highly ineffective (Table 3) having more than €33 billion in tax arrears at the beginning of 2010, which represents 14% of GDP.

The ineffectiveness of the tax administration in enforcing debt collection in Greece is also to a large extent due to the continued application of deferred payment schemes and to tax amnesties, practices which may have a positive effect on tax receipts temporarily, but at the same time encourages people not to pay taxes. And while during the implementation of the economic adjustment program the tax administration has made much progress in the development of means to better target debt cases warranting closer attention, it seems that the successive governments, in attempting to implement the economic adjustment program, have been involved in the situation of a "tax collection trap". That is, by being pressed at times of deep recession and tough austerity programs to fulfill revenue targets and to restore fiscal balances within tight time limits, the governments have been offering ever more generous tax deferrals and tax amnesty programs. However, while these tax deferrals and tax amnesties are aimed at increasing receipts from back taxes, at the same time they are making it more difficult to collect current accruals. Thus, in effect they shift the growing problem of inadequate tax collection to the next administrations. And as the economic crisis and the prolonged austerity programs cause the number of taxpayers unable to meet their obligations to increase continuously, the situation is becoming worse year by year. So, while the tax debt was €33 billion at the end of 2009, it increased to over €80 billion in the third quarter of 2015, showing that Greece has been involved in a self-reinforcing condition of persistent and increasing under-collection of tax revenues. That is, an ever increasing portion of the assessed taxes is not collected, the burden is shifted to the taxpayers who are still able to fulfill their tax obligations, with the latter group being constantly reduced.

2.6 Tax evasion

Tax evasion has been an endemic problem in Greece for decades[12] and despite the important measures that were taken during the implementation of the economic adjustment program there is no evidence suggesting that it has been reduced.

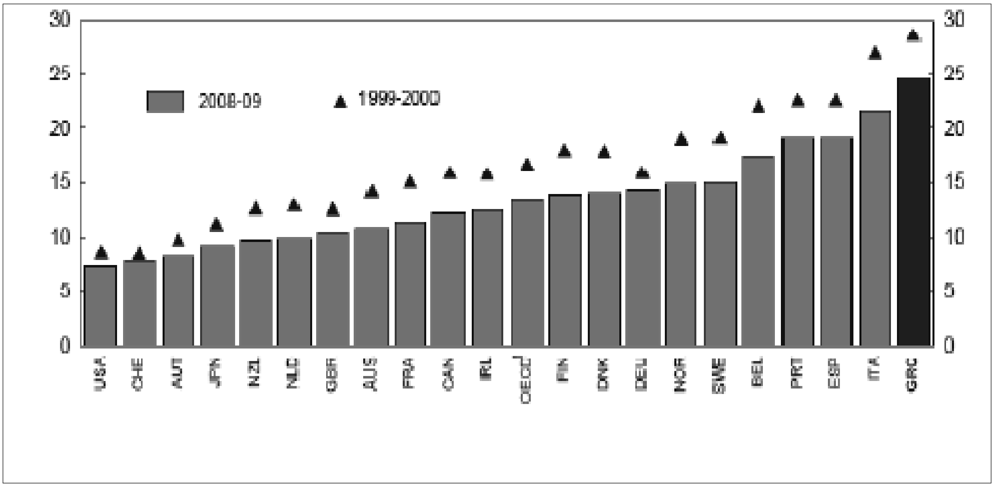
However, since all taxpayers are not willing or able to evade taxes, the combination of high statutory tax rates and low effective tax rates in Greece implies that a part of the population is paying less taxes than it should be paying and another part is being overtaxed. This, in turn, suggests that the tax reform measures needed in Greece in order to bring the effective tax rate in 2012 in line with the OECD average[13] should aim at eliminating tax evasion and reducing nominal tax rates and not the other way round. And although a number of important measures have been taken in recent years aimed at curtailing tax evasion (better access to bank accounts, third party information, indirect methods for estimating taxable income, better international cooperation, crosschecking of statistical information, etc), it seems that there are issues that have been underestimated or neglected.

According to a theory which attempts to explain tax evasion and which has been adopted by many scholars, people will always try to evade taxes if they are given the chance, and the only thing that prevents them from doing so is the threat of being caught and fined (Allingham and Sandmo, 1972). That is, tax evasion is driven by costs and benefits and rational individuals weigh the benefits they expect to have from evading taxes against the prospect of being caught and punished and they act accordingly.

[12] See Tatsos, N. (2001).

[13] In 2007 the effective tax rate in Greece was 30.9% while the OECD average 34.2%. In 2012, the effective tax rate in Greece was in line with the OECD average (33,7%).

Figure 1 . Shadow economy as a % of GDP

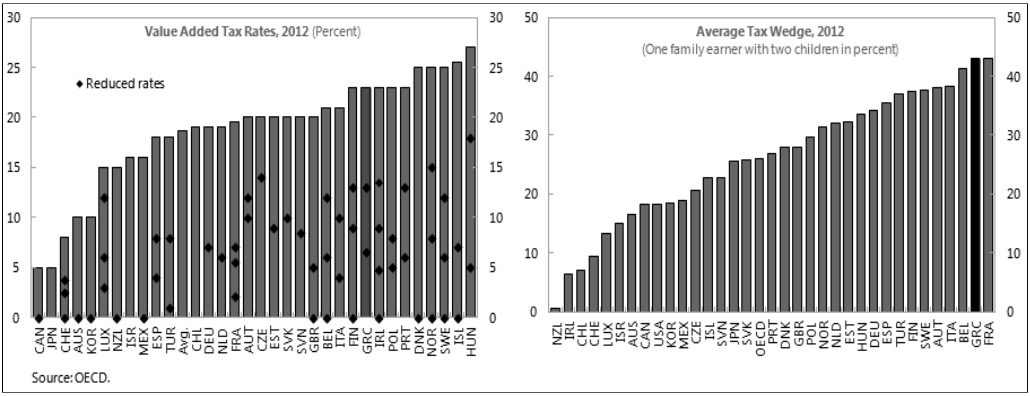


Source: OECD (2012); Schneider, F. (2009)

As to the benefit side, the higher the tax rates, the higher the benefits from not paying taxes and therefore the higher the tendency towards tax evasion. The tax rates in Greece are considered by the OECD and the IMF as high and stand at the top of those of the OECD member countries[14]. Thus, the tax wedge of salaried employees in Greece is 43% as compared with an OECD average of 26%, the standard VAT rate in Greece is 23%, placing Greece among the countries with the highest VAT rates (Figure 2), as seen above the corporate income tax is much higher than the EU average, etc. In this respect, the tax rate increases implemented in order to attain fiscal consolidation have amplified the expected benefits from tax evasion and have induced taxpayers to join the shadow economy which was already significant in Greece (Figure 1). Furthermore, the economic recession and the tough austerity measures that were taken during the implementation of the economic adjustment program have made the economic situation of most businesses and individuals very difficult, putting additional pressure on them to evade taxes in order to survive.

[14] OECD (2011 and IMF (2013)

Figure 2 . Value added tax rates and average tax wedge in OECD countries



As to the cost side of tax evasion, the main determinants are the probability of being caught and the penalties imposed. As far as the imposition of severe penalties is concerned, there are severe limits in their use as a means for curtailing tax evasion. First, because penalties are already high in Greece and there might be risks to increasing them further while the country is in deep recession. Second, a prerequisite for having very severe penalties is for the tax code to be clear and fair, with easily understood and undisputable rules, which certainly is not the case in Greece. On the contrary, Greece is a classic example of a country with an extremely complicated tax system, with myriads of tax regulations scattered among thousands of laws[15], which are often not well harmonized (if not in conflict). And as described above, the plethora of changes in the tax laws that have since the outbreak of the economic crisis, been made, designed and implemented in haste and often rescinded have made the situation worse and the imposition of more severe penalties much more risky.

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[15] Over the last four decades 3,450 laws have been passed in Parliament containing taxregulations with 250 of these being purely tax laws. In the same period more than 11,000 Ministerial Decisions on tax matters have been issued while the relevant Interpretative Law Circulars are incalculable.

On the other hand, strengthening the enforcement of tax laws is not an easy option for Greece either. First, because this takes time and the time limits set in the economic adjustment program for attaining fiscal consolidation were too tight. Second, although some very useful measures that facilitate the enforcement of the tax laws have been taken, some other measures are contradictory and have undermined the attainment of the set targets. For instance, increasing the enforcement of the tax laws requires the expansion of the tax administration and the provision of incentives to tax auditors. However, as noted in an IMF report, while in other countries the remuneration of the tax auditors varies between 134% and 340% of per capita GDP, depending on their scale, tax auditors in Greece are paid significantly less—less than 50 percent of GDP per capita income, something that as pointed out in the report does not create sufficient incentives for the staff to perform complex tasks (IMF, 2013b). On the contrary, the Economic Adjustment Program provided for the abolishment of bonuses to tax auditors and a decrease in their total remunerations by up to 50%. Also, as noted in the aforementioned IMF report, more than 50% of the tax revenue staff in Greece are over 50 years of age, which means that the yearly rate of retirement is high. In addition, after the reduction in their remuneration levels and fearing that if they retire later they will receive reduced pensions, a great number of tax officials close to retirement age have chosen early retirement, thus amplifying the drainage rate of the most experienced personnel. And since there is a non-replacement clause in the agreed Memorandum of Understanding, these tax officers have not been, and will not be, replaced. Thus, while the curtailment of tax evasion has been a top priority in the economic adjustment program, the Greek tax authorities are facing the challenging situation of being expected to increase the enforcement of tax laws with much less staff, with less experienced staff and with remunerations levels almost halved, something which appears to undermine the attainment of the set objective.

Furthermore, the frequent use of amnesty schemes is another example of measures undermining tax compliance and efficiency in the collection of taxes.

This is because, asking taxpayers to pay an additional tax liability in exchange for not having the tax authorities audit their tax returns creates self-fulfilling expectations of more generous schemes in the future.

3. The untouched areas of reform

Many changes were made in the Greek tax system during the implementation of the economic adjustment program but they did not cover the whole tax system. They were confined to central government taxes, leaving some areas of the tax system untouched.

3.1 Taxes on behalf of third parties

A typical example, and one that constitutes a distinctive feature of the Greek tax system, is the large number of so called «taxes on behalf of third parties», that is levies whose revenues are assigned for particular purposes, such as financing certain pension funds, or funding spending agencies other than the central government or institutions not even falling within the public sector in general. Most of these taxes were introduced a long time ago – often in a not very transparent way - and are imposed as surcharges on existing taxes or as separate levies on a base that has been already taxed. That is, they are imposed: a) as a surcharges on an existing central government tax, i.e. as an additional tax imposed and collected at the same time as the main tax[16], b) as a surcharge on the tax , i.e. not on the tax base but on the amount of the tax, making the tax rates effectively imposed higher than those known as statutory tax rates, c) as predetermined fractions of the proceeds of a central government tax, and d) as levies imposed on the amounts of certain transactions.

[16] This means that a multiplicity of different levies may be imposed on the same tax base.

Some of the assigned levies are collected directly by the beneficiaries, others are collected by intermediaries (notaries, banks, public utilities, etc) and the receipts are transferred directly to the final beneficiaries while a small portion is collected by the central government and is then assigned to the beneficiaries. Surprising enough, it is only the last small portion - namely revenues assigned to Local Government – that is recorded in the state budget while the greater portion remains unknown and hidden in the extremely extensive, chaotic and non codified legislation. Thus, taking into account the huge number of these levies and the revenues they accrue, it is as if Greece has two budgets. An official one which is under regular parliamentary and administrative scrutiny and another one which is unknown and uncontrolled. This in turn means that the official statistics do not give a full picture of tax revenues or the tax effort.

In addition, taxes on behalf of third parties make the tax system more complicated, prevent rational choices among alternative programs and distort resource allocation. Furthermore, since they represent a significant transaction cost, they exert a negative effect on international competiveness and add an unnecessary workload to public administration. However, their lack of transparency has made them popular among pressure groups (and politicians) who believe that the revenues accrued to them are more secure if they are tied to a particular source of revenue than if they come to them as ordinary revenue from the general fund. Finally, since taxes on behalf of third parties constitute an explicit transfer from one group of taxpayers to another, they exert serious distributional effects.

Table 4 shows how the receipts from taxes on behalf of third parties are distributed among a sample of social security funds for which there are available data. As can be seen readily, the distribution which is highly unequal both in absolute terms and as a percentage of the contributions the final beneficiaries make to their social security funds. That is, there are professional groups whose social security benefits are mainly financed by their members, and other groups whose benefits are mainly financed by the rest of society. What is more striking is that the higher benefits, both in absolute terms and as a percentage of the final beneficiaries' own contributions, are assigned to professional groups which have considerable political power, such as people employed in the media and in the field of justice, as compared to other professional groups who are less privileged politically.

Table 4. Distributional aspects of revenues from taxes on behalf of third parties

Social Security (S.S.)Funds	As % of S.S. Contributions	€ per beneficiary
ETAA – Solicitors' insurance fund	73.45	2,895.45
ETAA - Athens/Thessaloniki's newspapers personnel pension fund	105.62	4,909.90
TV photographers and cameramen insurance fund	849.50	20,626.00
Public Corporation of Electricity Personnel's welfare fund	183.17	3,018.76
Journalist's Supplementary Insurance and medical treatment fund	641.92	6,547.83
ETAA- Pension and Insurance sector of health officers	0.002	0.11
ETAA- Chemist's Supplementary Insurance	0.14	1.49
Civil Servants' Supplementary Insurance	0,37	5.89
Heavy metal personnel's welfare fund	0.46	1.94
Self Employed Pension Fund	3.51	91.45

Source: Ministry of Labour and Social Security (2010).

An attempt to trace and record taxes on behalf of third parties in the abyss of Greek legislation as a first step towards their abolition was made in 1995[17] and the outcome was published as a supplement to the 1996 state budget. The findings were impressive: 655 levies on behalf of third parties were recorded, accruing benefits to 1,011 institutions. However, despite the fact that the abolition of taxes on behalf of third parties would constitute a major reform of the Greek tax system no further systematic action has been taken since then. The political risk of such a reform would be high and lacking in fast pay offs.

3.2 Tax decentralization

Another noticeable feature of the Greek tax system is that it is heavily reliant upon national taxes, which shows that the functions of government are highly centralized. Thus, local government taxes in 2010 accounted for only 1.1% of total tax revenue, relative to 11.8% on average in the OECD unitary states. However, the financial autonomy of local government in Greece is much lower than indicated by the above figure, since local authorities in Greece have very limited discretion over their tax sources, making them unable to raise own tax revenues, which implies closer control of their activities by the central government and less local accountability.

The highly centralized tax system in Greece was attributed in the past to the large number of local authorities and consequently their limited size. However, after the amalgamations of local authorities in 1997 and in 2010 and the reduction of their number from over 6,000 to 325 at the first layer of local government and from 57 to 13 at the second layer of local government, the concentration of taxing power at the central level is purely a political choice. This in turn means that local authorities' own tax revenues and tax policies are not taken into account

[17] The study was conducted by Panteion University, Athens, on behalf of the Greek Ministry of Finance.

in the allocation of government grants with all the relevant consequences this may have on efficiency, local accountability, local tax effort and fairness in local public finances. Moreover, since some taxes are more suitably imposed at the local level, there would be efficiency benefits if these taxes were administered by local government and if the central government focused on more complicated tax issues and on curbing tax evasion. In this respect, the decisions the real property tax and the tax on economic activity, which in other countries predominate at the local level, but in Greece were recently imposed by the central government, may not have been the best possible choice.

In brief, although major steps towards the rationalization in the geography of public finances have been made on the expenditure side through the amalgamation of local authorities and other measures aimed at increasing local discipline, no measures have been taken with regard to the way in which tax revenues and taxing power are shared between central and local government with the political system in Greece preferring to preserve the *status quo* in the financial (and political) control over local government rather than to pursue efficiency in public finances.

4. The lost opportunity for reform

The major characteristic of Greece over the last few decades is not the lack of adjustments in the tax system, but the nearly total absence of reform despite widespread acknowledgement of the deficiencies of the tax system and the need to reform it substantially. And although, up to a point, the weakness of the tax reform efforts is not surprising, since tax reforms are usually politically unpopular, the inefficiency, discretion and corruption that characterize the Greek tax system as well as the unequal distribution of the tax burden could reasonably be expected to generate incentives for at least moderate reform both for raising adequate revenue and for increasing the fairness of the tax system. Furthermore, although economic crises are expected to open a political window for substantial reforms, it seems that in the case of Greece, the economic crisis has not been a sufficient condition for tax reform and that there are other political and institutional factors that have influenced the result.

It should be noted in the first place the severe asymmetry between the factors that have caused fiscal destabilization in Greece and their contribution to restore fiscal balances. That is, while roughly 77% of the fiscal deterioration in Greece prior to the economic crisis[18] was due to primary current expenditure (Giannitsis and Zografakis, 2015), something that might indicate that the adjustment should be focused on the expenditure side of the budget, paradoxically enough, the adjustment attempted was the other way round. The decline of the deficit as a percentage of GDP by more than 13 percentage points between 2009 and 2013 was achieved mainly due to the increase of the revenue/GDP ratio by almost 10 percentage points, equaling 72.4% of the total fiscal adjustment and showing that the focus of the policy undertaken was on the revenue side. Moreover, the distributional effects of this asymmetry were not counterbalanced by other adjustments in the tax system. On the contrary, they were reinforced, since the changes made were bare tax increases in a rather "flat" way that had adverse distributional effects. As a consequence, the lower income taxpayers experienced an increase in their tax burden of 337.7%, while those in high income classes an increase of only 9%. Or, the share of the lower income groups to the tax-led adjustment increased from 2.5% to 9.4%, while that of the higher income groups decreased from 97.5% to 90.6%. (Giannitsis and Zografakis, 2015).

The choice to place the focus of the economic adjustment program on the revenue side was obviously a political decision based on the fact that increases in nominal tax rates, the abolishment of tax exemptions and the imposition of

[18] Increase in fiscal deficit as a percentage of GDP between 2006 and 2009

new taxes were considered easier than the curtailment of public expenditures. And something that probably counted most, increases in taxation could be made much faster than expenditure cuts, demonstrating to all internal and external actors that fiscal consolidation was on track. However, not all tax changes constitute a tax reform. Moreover, in order to be successful, a tax reform must fulfil certain conditions.

First, a good tax reform takes time. It takes time to be designed, to be discussed within the governmental bodies and it also takes time for the government to decide on the proper moment for the announcement of the reform proposals to the public. In addition, it takes time for the enactment of the new measures as well as for the administration to prepare for the implementation of the reform. And as has been demonstrated, successful reforms require over two years to be prepared and adopted while the least successful attempts at reform are those that have been undertaken in haste, often in response to immediate pressure (Tompson and Price, 2009).

The economic crisis opened a political "window of opportunity" for tax reform in Greece, but the excessive haste with which this was implemented created problems and in many cases the end result was the opposite of what was expected. As shown above, the policy makers, irrespectively on whether the ownership of the relevant decisions belongs to internal or external actors, in order to restore fiscal balances were introduced successive "reforms", though not necessarily in the same direction, aimed at securing extra tax revenues in a rather "fast track" manner. Under these conditions, the outcome could not be satisfactory. One tax law succeeded the other, some tax laws were amended before or shortly after their implementation, or there were bare tax increases without any social or redistributional element in them. Thus, at the end "tax reforms" have been interpreted by the public as having a negative connotation, with all the detrimental effects this may have had on the acceptance of the measures and on any tax reform in the future.

Second, tax reforms need a favorable reform momentum. In this respect, it is believed that crises facilitate reforms (Schmidt, 2001) and that they make their implementation easier. However, in the case of Greece, the economic crisis has made tax reform more difficult to implement in many respects, not only because the reform was attempted under conditions of extreme haste, but also because of the economic crisis itself and its effects on the taxpayers and on the economy. More specifically, it is easier for a government to implement a tax reform when times are good, that is when there are budget surpluses that can be used to absorb revenue losses or to compensate the losers of the tax reform, which was certainly not the case in Greece. In addition, it is not easy for the taxpayers to respond positively to tax changes in a country suffering from deep recession, high unemployment rates, huge wage and pension reductions, substantial devaluation of property assets etc., especially if the proposed tax changes are aimed at increasing tax revenues.

Third, an essential requirement for successful tax reform is a strong will for reform from all the parties involved (the government, other political parties, social partners), something that can be facilitated if among the taxpayers/voters there are winners and losers as a result of the reform and if the proposed measures are socially acceptable. Also, voters are more willing to accept a tax reform if there are offsetting benefits through reforms in other policy areas, especially if the losers constitute a large part of the electorate. The situation in Greece was not favorable in this respect either. The tax measures imposed had losers only, since they were tax increases without notable distributional effects. They were also not accompanied by offsetting measures in other policy areas and from the outset they were considered unfair. Actually, those who were hit the most by other policy measures (income policy, labor market regulations etc) were those who were asked to bear most of the additional tax burden.

Fourth, the outcome of a reform is highly affected by the cohesion of the government with regard to the specific reform. If the messages received by the public show that the government is not united regarding the reform proposal, the reform will not be supported and its opponents will exploit the situation in order to reap political benefits. And, as has been argued (Tompson and Price, 2009), the cohesion of the government matters more than the government's parliamentary strength or the strength or the unity of the opposition parties.

This factor has not been favorable for tax reform in Greece either. The weak cohesion of the government with regard to the reform proposals is reflected in the fact that since 2009 there have been seven successive governments and ten Ministers of Finance. It is also worth noting that the reforms attempted in Greece under the economic adjustment program were "externally driven". That is, they were measures dictated, recommended or approved by the "troika", something that neither all the political parties, nor all the members of the political parties were equally ready to accept. And since the reforms: a) were all restrictive in nature, b) they covered a very wide spectrum of policy areas, and c) affected the everyday life and the standards of living of the population within a very limited period of time, they acted cumulatively on the cohesion of the government. It may be worth noting in this respect that the attempted reforms in Greece have been responsible for the splitting of all the political parties that have participated in the government since 2009.

Fifth, a successful reform requires persistence (Tompson and Price, 2009). However, as pointed out above, the amendments made in the Greek tax system during the implementation of the economic adjustment program were not made in the same direction. Moreover, due to the very limited time allowed for the economic adjustment program to be implemented, the amendments made in the tax system were neither well designed nor well implemented, which necessitated unprecedented "corrective interventions" at a later stage. Nor certainly have the successive changes of political parties in power and of Ministers of Finance created the conditions necessary for a successful tax reform.

Sixth, a key factor determining the success of a reform is the existence of an electoral mandate for reform, while it has been found that major reforms for which governments have not previously sought public approval may succeed only if they generate visible benefits very rapidly (Tompson and Price, 2009). As seen above, the problems of the Greek economy that emerged in 2009 required immediate measures and the country agreed with its creditors on an economic adjustment program without having an electoral mandate for the reforms. At some point, the voters realized that they were caught up in a vicious circle of successive income reductions and tax increases without any pay-offs, they punished all the political parties that had been in power since 2010 and had agreed on the "reforms" by not re-electing them, and in fact in all successive elections thereafter they voted for the parties that promised to take no further reforms.

Thus, none of the conditions for successful reform existed in Greece. And if one adopts the definition provided by Wikipedia that reform means "*the improvement or amendment of what is wrong,corrupt, unsatisfactory, etc*", then the amendments made in the Greek tax system during the implementation of the economic adjustment program can hardly been considered as constituting a tax reform either.

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