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Tax evasion in Greece In flagrante

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"If I could get everyone in this room to pay their taxes, I wouldn't need to be here." So muttered a member of the troika last year, in a room filled with Greece's great and good. The problem of tax evasion in Greece has been pointed out many times during the debt crisis: Christine Lagarde, the head of the IMF, got into hot water over the summer with her comments that she felt more sympathy with children in Africa than tax evaders in Greece. But eradicating a culture of tax evasion is no small task, as a new [paper \(http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2109500\)](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2109500) by Nikolaos Artavanis of Virginia Tech and Adair Morse and Margarita Tsoutsoura of the University of Chicago Booth School of Business underlines.

The trio use a novel technique to calculate levels of tax evasion in Greece. The authors look at a dataset from a large Greek bank, which contains information on individual borrowers' credit applications between 2003 and 2010. Taken at face value, the data for self-employed borrowers make no sense. On average, self-employed Greeks spend 82% of their monthly reported income—ie, the amount they declare to the tax office—on servicing debt payments. Some

professions, like lawyers and doctors, appear to spend more than 100% of their income on debt servicing.

That cannot be right: a rough rule of thumb is that a third of income should go on debt payments. Banks would not lend at these steeping debt-to-income ratios. Weirder still, the delinquency rates on loans do not seem to vary in line with these ratios: self-employed Greek doctors are both the most indebted profession and the one with the lowest delinquency probabilities.

The explanation, confirmed by bankers in statements to the authors, is that Greek banks have adapted their credit models to adjust borrowers' reported incomes up to a best guess of their actual incomes. Lenders assume that self-employed borrowers in certain occupations are under-reporting, in other words, and plug this assumption into their decision-making processes. Tax evasion is less an under-the-radar activity, more a social norm.

From this starting-point, the authors also make an estimate of how much tax is being evaded in Greece. The debt-to-income ratio for wage-earners in a particular profession ought to provide a guide (though not a precise one) to the debt-to-income ratio that banks are comfortable with for self-employed borrowers in the same profession. That assumption enables the authors to work out what multiples banks are applying to reported incomes in various industries; how much taxable income is not being reported; and how much tax is being evaded (see table). At an aggregate level, the authors calculate that the self-employed in 2009 dodged taxes on at least €28 billion of unreported income, enough to fill 31% of the Greek budget deficit that year.

The
paper

	Mean Tax Evasion (Euros)	Income Multiplier
Doctors & Medicine	29,343	2.45
Engineering & Science	28,625	2.40
Education	24,742	2.55
Accounting & Financial Services	24,573	2.22
Law	24,032	2.24
Fabrication	22,598	2.26
Media & Art	18,360	2.22
Lodging & Restaurants	15,884	1.99
Construction	13,919	1.85
Business Services	9,438	1.67

Business Services	9,730	1.51
Transport	9,320	1.51
Agriculture	9,288	1.75
Personal Services & Pharmacy	7,531	1.49
Retail	5,215	1.27
Others	3,370	1.22

concludes with some theories on why levels of evasion differ across industries. One hypothesis is that people in industries which generate a bigger "paper trail"—because they use more intermediate goods as inputs, for example—are at greater risk of being caught and therefore evade tax less. The authors do indeed find that industries that generate lots of traceable information have lower levels of evasion. But they also find another interesting correlation, between the professional backgrounds of Greek parliamentarians and the industries with high levels of tax evasion. Stripping out lawyers, who have a disproportionately nasty habit of becoming politicians, the three most tax-dodging professions account for about half the votes among Greek MPs. That, the authors say, might explain a lack of political willpower on the issue of tax evasion.

Greek tax evasion is an emotive subject. There is evidence that self-employed people tend to underreport their income everywhere, not just in southern Europe. The paper suggests that the most egregious behaviour happens higher up the wealth ladder, so ordinary Greeks may be more deserving of Ms Lagarde's sympathy. Things might have got better since the data in this paper were collected. But if the authors are close to being accurate in their estimates of the scale and institutionalisation of tax evasion, no wonder patience with Greece is so frayed.

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