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How Greek tax evasion helped sink the global economy

By Brad Plumer , Updated: July 9, 2012

The euro crisis first started roaring in late 2009, when auditors inside the newly elected Greek government discovered that the country had a much—much—bigger deficit than anyone realized. That, in turn, inflamed fears that Greece couldn't wiggle its way out of its debt trap so long as it was tethered to the euro. It also exposed structural problems within Europe's currency union. Worries soon spread to Ireland, Portugal, and eventually Italy and Spain. Now the entire global economy is on edge.

But why did Greece have such a massive budget deficit in the first place? One factor (among many) was rampant tax evasion, which had starved the Greek government of funds. As it turns out, this was a very big deal indeed. The Wall Street Journal's Justin Lahart points to a new paper (pdf) by three economists who estimate that the size of Greek tax evasion accounted for roughly half the country's budget shortfall in 2008 and one-third in 2009.

How is it even possible to estimate taxes that aren't ever paid? The economists, Nikolaos Artavanis, Adair Morse and Margarita Tsoutsoura, cleverly exploit a discrepancy. Few people in Greece want to report their real income to the government, since that would mean paying more taxes. But Greek *banks* have very solid estimates for how much income people are actually raking in — the banks need this info to make loans or to issue mortgages.

Comparing bank data with government data, the authors found that the true income of the average Greek person is about 1.92 times larger than what's actually reported to the government. In 2009, that shrunk the tax base by about $34 billion. Assuming that money was taxed at a 40 percent rate, that's 31 percent of the country's budget deficit in 2009 right there. As Lahart notes, "If Greece's government was as adept as its banks at figuring out what its citizens earn, the world might be a very different place."

Below is a map showing the top zip codes that avoid taxes in Greece. Note that it's not just limited to Athens; the authors found that Greek tax evasion is rampant everywhere, and prevalent across all income groups. (The circled area is Larissa, which, depending on what hearsay you believe, may or may not have a suspiciously high number of Porsche Cayennes registered.)

A bigger question is why Greece hasn't been able to crack down on tax evasion. The authors note that Greek officials seem to have a very good idea of who's avoiding taxes: In 2010, the parliament took up a bill that specifically targeted doctors, dentists, lawyers, architects, engineers and so forth. As the authors note, these are precisely the groups evading the most taxes (largely because they receive much of their income in bribes). But the crackdown bill failed — possibly because, as the authors discover, these are the professions best represented within the Greek parliament.

In any case, this is hardly the *only* reason that the euro is now stuck in a crisis. As Paul Krugman explains in this lecture, the euro zone has long had all sorts of deep structural flaws that were bound to combust sooner or later. It just so happened that the spark, in this case, appears to have been Greek tax evasion.