

**SHADOW ECONOMY AND CORRUPTION IN GREECE:
RECOMMENDATIONS FOR A MICROECONOMIC SURVEY**



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ABSTRACT¹

The paper discusses the determinants of shadow economic activities and corruption in Greece as indicated (or insinuated) by relevant studies. The concepts of tax evasion and informal labour (or undeclared work) are explored respectively. Our final aim is to build on the discussion so far in order to propose a questionnaire approach for the collection of primary data that will reflect the typology of the Greek taxpayer and to designate orientations for the econometric analysis of the data.

1. INTRODUCTION

Drawing from a discussion about the alternative methods adopted by researches, the paper aims to introduce a multifaceted approach and research methodology in the assessment of shadow economy and corruption in Greece. A strong advantage of direct (microeconomic) measurement over indirect (macroeconomic) approaches is in their ability to highlight directly the motives of engaging in shadow economic activities and to reveal the supply, demand and remuneration of informal labour and moreover, to depict more accurately tax evasion across industries and income groups.

The next section focuses on the size and determinants of the shadow economy in Greece. Section 2 briefly discusses the determinants of shadow economic activities and corruption in Greece as indicated by relevant studies. Sections 3 and 4 discuss tax evasion and informal labour (or undeclared work), respectively. Finally, section 5 builds on the discussion so far in order to propose a questionnaire methodology for the collection of primary data and to designate orientations for the econometric analysis of the data. The conclusions are summarized in the last section.

2. SIZE AND DETERMINANTS OF THE GREEK SHADOW ECONOMY

An early study concerning the determinants of tax evasion in Greece concludes that widespread tax evasion is largely due to the historical mistrust between the Greek state and its citizens (Ballas and Tsoukas, 1998), and can be even historically traced back to behaviors formulated according to our view even in the long period under the ottoman rule. Over a decade later and despite the positive externalities of the euro experience to European integration, low tax morale (distrust in public institutions) is still a major cause for the inability of fiscal authorities to meet projected tax receipts goals (Kaplanoglou and Rapanos, 2013). However, references are also made to another dimension of tax morale in Greece that is not related to trust in public institutions. This form of tax morale, which has been frequently termed by the Greek media as the “sport of tax evasion”, describes the norm of evading taxes for personal gain, and can be understood through the absence of the “social norm” of tax compliance (Alm and Torgler, 2011).

Furthermore, the tax burden has also been considered of equal importance. An empirical study focusing on Greek data from the previous century indicates that the shadow economy responds symmetrically to both direct and indirect tax changes and that individuals move into the shadow economy as quickly as they move out of it when taxes decrease (Christopoulos, 2003). Moreover, a non-empirical but more comprehensive approach to the determinants of the Greek shadow economy highlights the tax and social security contribution burdens and moreover, the intensity of the related regulations, as the major determinants (Katsios, 2006).

Another non-empirical study asserts that Greece's relatively high unemployment rate and the non-stop (geographically influenced) provision of undocumented immigrant workers encourage shadow economic activities (Danopoulos and Znidaric, 2007). The same study concludes that the relatively high Greek shadow economy is influenced by the relatively high poverty levels in Greece. This conclusion has also some empirical support as it has been indicated that the poorest regions in the EU tend to exhibit the highest shadow economy quotas (Tafenu et al., 2010).

All the macroeconomic studies that estimate the size of the Greek shadow economy and were not published in Greek, examine the country as a part of a broader (more than two digits) sample and underline in general, the determinants depicted in the findings of MIMIC approaches (Schneider et al., 2010): tax and social security burden, self-employment, unemployment and regulations. A study on the determinants of the shadow economy in OECD countries during the nineties (Bovi, 2003) that was based on previous estimations for its data set formulation, indicates that the Greek shadow economy was more institutional-pushed and points to the relatively high levels of corruption, the weakness of the legal system and strict labor market regulations. Based on a smaller sample Dell'Anno et al. (2007) indicate that unemployment, social security contributions and self-employment are the main determinants of the size of the Greek shadow economy. The studies of Dell'Anno et al. (2007), Schneider2 and the studies published in Greek depicted in Table I (Buehn and Schneider, 2012, Pavlopoulos, 1987, Vavouras et al., 1990, Negreponi-Delivani, 1991, Kanellopoulos, et al, 1995, Tatsos, 2001) are empirical studies that indicate the size of the Greek shadow economy. All of them are macroeconomic approaches (except from Kanellopoulos, et al, 1995) and emphasize on the determinants usually explored by the MIMIC approach.

Only two of the aforementioned studies that explore the size and determinants of the Greek shadow economy discuss the interaction of the shadow economy with the formal economy over the business cycle and the relation between corruption and the shadow economy. Dell'Anno et al. (2007) indicate that an inverse relationship prevails between the official GDP growth rate and that of the shadow economy and Katsios (2006) argues that there is a complementary relationship between corruption and the shadow economy. Moreover, an earlier study (which, however, focuses on tax evasion for the period 1987-1996) also reaches the same conclusions and indicates that recession encouraged the level of tax evasion in Greece, and institutional quality and the tax burden were its primary determinants (Agapetos, 1999). This complementary relationship is rooted to the phenomena of clientelism and rent-seeking (see Mitsopoulos and Pelagidis, 2009, Katsimi and Moutos, 2010, Lyrantzis, 2011). For studies about the incidence of corruption with an (or based on) empirical nature, the reader should turn to indirect inferences made by the findings of studies about the "restricted" access (i.e. protracted access to treatment) to public health, which has led Greece to generate the highest out-of-pocket health expenditure in the EU (Siskou et al., 2009, Matsaganis et al., 2009).

The Greek health care system, where patients frequently find themselves making "under-the-table" payments to access public services that are supposed to be free, is an ideal case study of the links between shadow economy and corruption in Greece. The inequities in access, supply and quality of services is caused by providers who have little incentive to improve productivity and rely on informal payments (Mossialos et al., 2005).

As a result, the socio-economic factors (such as low average household income, high unemployment, obligatory and full coverage by social insurance) that make individuals reluctant to pay for private insurance do not affect the preference to pay a doctor or hospital directly or under-the-table (Siskou et al., 2009). More specifically, a study measuring and analyzing the size and nature of informal payments by households in Greek public hospitals (Liaropoulos et al., 2008) indicates that 36% of the sample has made an informal payment to a doctor irrespectively of their socio-economic characteristics, either due to lack of confidence in the service received (e.g. receiving sub-standard care) or for receiving the service (e.g. doctor's demands, avoiding the queue).

Table 1. Indirect estimates of the Greek shadow economy

Study	Method	Size of the Greek shadow economy (% of GDP)
Schneider and Buehn (2012) provide estimates for the size of the shadow economy in 39 OECD countries (estimates for 1999-2010).	MIMIC approach	26% in 2008 (27.4% is the average value for 1999-2008)
Schneider <i>et al.</i> (2010) provide estimates for the size of the shadow economy in 162 countries (1999-2007).	MIMIC approach	26.5% in 2007 (27.5% is the average value for 1999-2007)
Dell'Anno <i>et al.</i> (2007) provide estimates for the size of the shadow economy in France, Spain and Greece (1968-2002).	MIMIC approach	Approximately 28% in 2002
Tatsos (2001) provides estimates for the size of the shadow economy in Greece (1967-1997).	Currency demand approach	36.7% in 1997 (30.1% is the average value for 1967-1997)
Kanellopoulos <i>et al.</i> (1995) provide estimates for the size of the shadow economy in Greece (1982 & 1988).	Comparative data ^a	27.6% in 1982 and 34.6% in 1988
Negreponi-Delivani (1991) provides estimates for the size of the shadow economy in Greece (1970-1985).	Currency demand approach	18.9% in 1984 (11% is the average value for 1958-1988)
Vavouras <i>et al.</i> (1990) provide estimates for the size of the shadow economy in Greece (1958-1988).	Currency demand approach	31.6% in 1988 (26.6% is the average value for 1958-1988)
Pavlopoulos (1987) provides estimates for the size of the shadow economy in Greece (1984).	Macro assumptions ^b	28.6% in 1984

Notes: ^a Comparison of data from the Household Budget Survey with private consumption as registered in the National Accounts; ^b Assuming for discrepancies on the macro level: i.e. accounting for underestimation of value added activities.

Finally, it should be noted at this point, also with reference to our research project THALES, that our aim is to research and measure all the various aspects of shadow economy in Greece, including corruption, tax evasion, tax avoidance, social contribution avoidance, undeclared and illegal work, self-consumption, tax morale level, tax compliance level, illegal and criminal acts (black or underground economy, money-laundering, human and drug trafficking, briberies). It covers all economic agents in Greece, such as citizens and corporations (e.g. public servants and private individuals, companies and all professional categories, etc.) The research is also performed at sector levels. It does not aim to the precise percentage regarding the measurement of Greek shadow economy but aims to the qualitative analysis of questionnaire results and the comprehension of the problem. The implementation of our interviews, scientific games and economic experiments (tax compliance games) involves at least 2,000 individuals and business owners (in majority small businesses). The project aims to achieve numerous objectives, among which the development of a relevant theoretical background, and perform cross-country comparisons at regional level, but also with country groups with advanced taxation systems.

3. SIZE AND DETERMINANTS OF TAX EVASION IN GREECE

The shadow economy is comprised by productive (thus value-adding) activities, which as a result, may be directly compared or added to GDP, and moreover, the economic agents engaging in shadow economic activities (except from illegal or household activities), do so in order to evade taxes. Tax evasion does not describe a value-adding activity and is the outcome of a financial transaction with the objective to conceal income (Schneider and Enste, 2002). Since shadow economic activities and tax evasion are related but not identical, tax evasion has become a research area of its own.

Although tax evasion in Greece raises average disposable income, its consequences are tremendous as it reduces the tax yield, makes income distribution more unequal, and renders the tax system considerably more regressive (Matsaganis et al., 2012). Moreover, an increase in tax revenues, which requires a great deal of progress both in the efficiency of collection and in combating tax evasion, is necessary for the consolidation needed to place the public finances back on a sustainable path. It is estimated that foregone government revenues due to tax evasion amount to 31% of the deficit for 2009 (Artavanis et al., 2012).

Early estimations of tax evasion in Greece were about 4% of GDP [29] and approximately 45% of VAT revenues (Agapetos, 1999). Another early estimation focusing on companies listed on the Athens Stock Exchange is 13% of total confirmed taxes (Kanellopoulos, 2002). A more recent study considering indirect taxation as the driving force of tax evasion (and making some “bold” assumptions) estimates tax evasion in Greece at 1.5% of GDP for 2010 and at 1.8% of GDP on average for 1999-2010 (Buehn and Schneider, 2012). A study that makes less assumptions and compares the levels and effect of tax evasion before and during the Greek crisis (Matsaganis et al., 2012) estimates that an average rate of under-reporting in 2006 at 11.8% (of total tax reports) resulted in a shortfall in tax receipts of 27.8% (of total tax receipts) and moreover, that an average rate of under-reporting in 2010 at 12% resulted in a shortfall in tax receipts of 30.3%.

And who participates most in tax evasion? The literature points towards firms and the self-employed,³ leaving thus salary employment to comply with the burden of government liabilities. There were arguments in the early noughties that the self-employed are more likely to participate in unregistered activities that remain invisible to the tax authorities (Tatsos, 2001). The highest estimates (from an empirical evaluation based on data for 2004-2005) of the aggregate rates of income under-reporting for the purpose of tax evasion were 24% for self-employment and 53% for farming (Matsaganis and Flevotomou, 2010). A recent evaluation indicates that the pattern of income under-reporting by income class is U-shaped and that income from farming and self-employment earnings account for the bulk of tax evasion in Greece (Matsaganis et al., 2012). Moreover, it is also reported that top tax evaders are professionals (with politicians protecting their own occupations), while paper trails are critical for industries (Artavanis et al., 2012).

The abovementioned can be an explanation for the large preference for self-employment in Greece relative to the respective in the EU. Although administrative barriers to entry make self-employment in Greece unattractive, the advantages of the potential benefit of tax evasion and the savings from the social security payments (which effectively increase for higher incomes) become a forceful motive to prefer it from salaried full-time or part-time employment (Mitsopoulos and Pelagidis, 2011).

Further, in the Greek corporate sector, as an example, many are those who argue that tax revenues of hundreds millions of euro a year are lost by the Greek government from illegal activity such as in fuel trading, arguing that tax evasion and fraud affect both public revenues and healthy companies. Experts say that specifically fraud, piracy,

incomplete deliveries to consumers, lack of transparency, the limited fraud inspections, delays in sentencing, fictitious exports, the lack of controls for maintaining buffer stocks substantially all arise from the lack of proper control mechanisms set by public authorities. Further, it is noted that the existing institutional framework is inadequate to eliminate the barriers in competition and healthy functioning of the market and achieve consumer protection (Bitzenis and Kontakos, 2014).

Particularly, smuggling in shipping oil sector remains important. Tax-exempted allocation of shipping fuels is required by the provisions of Articles 15 and 23 of Law 2127/93 and Law 603/77. The supply of passenger and cargo ships is carried out by tank cars, transporting untaxed fuel (transit). The smuggling process is based on the so called "slepia", i.e. small tankers which load the marine fuel from refineries, in customs' presence, stating that the amounts are intended for the refueling of ships. The surveillance mechanism of this activity on the part of state authorities remains inadequate and important measures remain to be undertaken in this direction. Overall, in a single market, like the Greek one, within a globalised economy, national mismatches and loopholes are too easily exploited by those that seek to escape taxation (Bitzenis and Kontakos, 2014).

4. UNDECLARED WORK IN GREECE

According to the definition used by the European Commission since 1998 "undeclared work is defined as "paid activities that are lawful as regards their nature but not declared to public authorities, taking into account differences in the regulatory system of Member States". Particularly, the definition excludes criminal activities which are treated in national law (European Commission, 2014).

The resort to such work has been explained by the growing demand for domestic services, the trend towards more flexible working relationships, the growth of self-employment, disguised self-employment, sub-contracting, and the ease of setting-up group of enterprises that operate across borders.

Economic activities which arise from undeclared work tend to generate significant costs on various levels: they undermine the revenues (e.g. income and value added taxes) collected by the tax authorities; the same applies with the contributions aimed to social security institutions, whereas regular/fully secured employment is inhibited by the existence of undeclared activities. Moreover, the financing of social services is put at risk, poor working conditions are associated and little social protection, undeclared workers tend to have a lack of representation, sets the financial sustainability of social protection systems at risk, the establishment of competitive business environment is distorted (Voss, 2009) and the value of social justice is undermined.

Undeclared work is diverse in nature but explicitly hidden type and multi-faceted. Its level of acceptance by the general public and the specific forms that can take varies among the different societies. It ranges, for example, "from occasional baby-sitting to the construction of entire buildings with professionally organized networks of undeclared workers" (European Commission, 2014).

Accordingly, a wide array of methods has been developed to evaluate and understand the dimensions and causes of the phenomenon of undeclared work, particularly in the past three decades. These can be roughly grouped under two approaches: indirect and direct methods of measurement. Both approaches have their specific pros and cons.

Indirect methods are mainly intended at evaluating or estimating the size of undeclared work. The real meaning of these methods is that they construe observable phenomena as signs of the unseen part of the economy. The most famous are discrepancy methods based on data comparisons, e.g. between labour force surveys and business statistics, as well as monetary methods (Schneider and Enste, 2000).

Direct methods of measurement refer to survey-based methods that depend on information directly retrieved by the population. Their main contribution is that they can measure not only the size but also the structure and motivations of the participants involved in undeclared work. Such methods have been applied in a number of countries in recent years.

The reliability and validity of some indirect methods (particularly Schneider's monetary model calculations) has been criticized for measuring unrealistically high rates of undeclared work (Pedersen, 2003, Renooy et al., 2004). On the other side, direct surveys tend to measure only the lower limit of the phenomenon since the participants during the conduct of a survey are usually unwilling to (fully) disclose their own relation with undeclared work, but also due to the difficulty of covering undeclared work by illegal immigrants in surveys.

According to a Eurobarometer Survey, which was carried out in the 27 Member States of the European Union during the second quarter of 2013, countries with particularly high proportions of respondents who have purchased undeclared goods or services in the past year are Greece (30%), the Netherlands (29%), Latvia (28%), Denmark and Malta (23% in each) and Slovenia (22%) Further, whilst the level of participation in buying goods or services which

might involve undeclared work is relatively low overall in European Union, it shows no sign of shrinking. There is significant variation between Member States, with as many as three in ten participating in Greece and as few as one in twenty in Poland and whilst, in most countries the number of people involved in purchasing these goods and services remains similar to that reported in 2007, there have been notable increases in a few countries, particularly Greece and Cyprus (European Commission, 2014).

It has been put forward that the size of undeclared work ranges from one quarter to one third of the size of the shadow economy estimates derived from the MIMIC model. The application of this method indicates that undeclared work in Greece was at 6.8% of GDP in 2010, with an average of 8.1% for 1999-2010 (Buehn and Schneider, 2012). However, these indirect estimations seem to differ greatly from actual numbers. For example, 10% of all firms inspected by the Social Insurance Foundation in 2008 failed to pay social contributions, while 27% of their employees remained unregistered (Matsaganis and Flevotomou, 2010).

Katsios (2006) argues that shadow production in Greece is relatively labor-intensive and the most recent study (Kanellopoulos, 2012) that discusses the synthesis of undeclared work in Greece, indicates that the highest shares of undeclared work in 2010 belonged to immigrants (approximately 38%), individuals less than thirty years old (34%), family business assistants (approximately 21%) and part-time employees (31%). Moreover, the same study highlights that undeclared work is industry and occupation specific. The former concerns mostly the industries of “construction”, “hotels and tourism activities”, and “trade”, where employment has a temporary nature and the latter refers to occupations (such as household assistants) whose shadow economic activity is difficult to detect. In addition, the same study indicates that employment for extra income (i.e. second job holders or employed retirees) is mostly done in the shadows.

Nevertheless, the vast figures of undeclared work in Greece (approximately 30% in 2011 and significantly higher than the respective figures of other euro-area countries), are not only the outcome of employed or retirees seeking extra income, but also of unemployed workers that substitute into the shadow economy amid economic depression (Foundation for Economic & Industrial Research, 2012).

5. PROPOSED ECONOMETRIC METHOD AND QUESTIONNAIRE DESIGN FOR ACCESSING THE INCIDENCE OF SHADOW ECONOMIC ACTIVITIES AND CORRUPTION IN GREECE

The discussion thus far indicates that the exploration of the primary data can be through a logit or probit analysis. The findings would be indicated by the marginal effects of predictors describing the socioeconomic background, employment status and type, etc. A proposed innovation for accessing the incidence of shadow economic activities and corruption in Greece would be through propensity score matching. Propensity score matching would correct for sample selection bias due to observable differences between groups in terms of i.e. corruption victimization, long-term unemployment, tax morale, etc.

Therefore, the analysis should be based on predictors of the incidence of shadow economic activities after matching for corruption victimization, long-term unemployment, tax morale, etc. Exact reference to the predictors or to the variables on which the matching would be based cannot take place before the collection of the primary data. A proposed questionnaire for the collection of the data has been developed by the authors of the paper based on the aforementioned grounds. It is not included in the Appendix, but is available in case that is requested. The questionnaire accounts for all the discussion thus far and questions about the incidence of shadow economic activities take place in the end.

This aforementioned questionnaire approach has been employed in the pilot tests conducted by the authors, which ultimately aims to involve more than 2,000 individuals and business owners.

6. CONCLUSION

The paper discusses the determinants of shadow economic activities and corruption in Greece as indicated by relevant studies. The early studies concerning the determinants of tax evasion in Greece conclude that widespread tax evasion is largely due to the historical mistrust between the Greek state and its citizens, whereas other non-empirical studies assert that the relatively high unemployment, low tax morale (distrust in public institutions), and the tax burden are considered of equal importance.

The macroeconomic approaches (emphasize on the determinants usually explored by the MIMIC approach) consider the tax and social security burden, self-employment, unemployment and regulations are the main

determinants of the size of the Greek shadow economy. The interaction of the shadow economy with the formal economy over the business cycle (inverse) has been also explored.

According to the most recent MIMIC estimates of Greek shadow economy as percentage of GDP has been estimated between 26 to 28 percent, whereas the currency demand approach followed mainly in the period 1984 to 1997 has produced estimates in the range of 19 to 37 percent.

The concepts of tax evasion and informal labour (or undeclared work) are explored respectively. In the case of tax evasion, the literature points towards firms and the self-employed, leaving thus salary employment to comply with the burden of government liabilities. The highest estimates (from an empirical evaluation based on data for 2004-2005) of the aggregate rates of income under-reporting for the purpose of tax evasion were 24% for self-employment and 53% for farming. The significance of tax evasion and fraud in the fuel trading and shipping oil sector were particularly highlighted by the authors.

According to a Eurobarometer Survey covering the period of the second quarter in 2013, Greece is the country countries with particularly high proportions of respondents who have purchased undeclared goods or services in the past year are Greece (30%). This is in line with estimates derived from the MIMIC model, according to which the size of undeclared work ranges from one quarter to one third of the size of the shadow economy. Nevertheless, the vast figures of undeclared work in Greece are not only the outcome of employed or retirees seeking extra income, but also of unemployed workers that substitute into the shadow economy amid economic depression.

As our final aim is to propose econometric method and questionnaire design for accessing the incidence of shadow economic activities and corruption in Greece and reflect the typology of the Greek, the discussion thus far indicated that the exploration of the primary data can be through a logit or probit analysis, based on predictors of the incidence of shadow economic activities and the use of propensity score matching.

ENDNOTES

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2. Some of which are co-authored. The most frequently referenced in this report is Schneider et al. (2010) and a more recent study (which indicates that the conclusions in Schneider's studies are more or less uniform) is Schneider and Buehn (2012) and Buehn and Schneider (2012).

3. For example, small business owners not only perceive more opportunities not to comply than employed taxpayers, but also render taxes as painful losses (Kamleitner et al., 2012).

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