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THE GREEK EFFORT TOWARDS ECONOMIC CONVERGENCE THROUGH A NEW FISCAL POLICY*

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PLAN

ABSTRACT

The Greek economy is subject to a level of public revenue whose share in the country's GDP ranks among the lowest in the EEC, as well as to an extremely high tax burden on wage earners as a share in total direct taxation. Due to this is the emergence of large public deficits and the inability to cope with them.

The long term inefficiency of the income tax in Greece, due to its specific structural particularities, seems to point in favour of adopting a system of direct consumption taxation combined with a higher taxation of luxury goods and services as well as with taxation of capital.

The shift of Greece, from the income tax to the direct consumption tax promises its convergence to the average Community level, in terms of fiscal discipline, as well as, more importantly, in economic terms, with a far higher degree of success in comparison to the actual prevailing tax system. This achievement will result through the elimination of tax evasion, the suppression of the hidden economy and the controlling of macroeconomic disequilibria.

The deficiency of public revenue which clearly represents a structural phenomenon, is to blame for both the emergence of large public deficits as well as for the inability to cope with them. In fact, the Greek economy is subject to a level of public revenue whose share in the country's GDP ranks among the lowest in the EEC as well as to an extremely high tax burden on wage earners as a share in total direct taxation (Negreponti-Delivanis and Delivanis, 1991, p. 63). The large and constantly growing discrepancy between the contribution of wage earners to the total burden of direct taxation and their share in both total employment and total income has brought them to their limit of tax endurance without, however, contributing to a significant increase of public revenue.

Therefore what is currently even more important than answering the question whether the size of the Greek public sector is too large (Georgakopoulos, 1989) or too small (Negreponti-Delivanis and Delivanis, 1991, p. 63) or just about right, is the adoption of a tax system that will increase public revenue. The immediate need for convergence of the Greek economy towards the Community average both in terms of fiscal discipline as well as in more general economic terms requires a drastic tidying-up of existing structural disequilibria. The prevailing tax system, including its recent additional modifications, emphasizes the particularities of the Greek economy which could be summarised in an increasing ratio of hidden to officially earned incomes and results in a growing substitution of domestically produced goods by imported ones, in the discouragement of productive investment activities, in the inability to pursue an effective income policy, in a lower degree of tax consciousness and in a general shift of economic resources and factors of production towards low productivity economic activities.

The choice of a tax system obviously meeting certain basic requirements such as neutrality, social equity, efficiency and relatively simple procedures of tax collection, should be a function of the particular structure of each economy and of the nature of its primary and secondary goals at each point in time. Despite the fact that there is no consensus, on the theoretical level, as to the pros and cons of the income tax and the direct consumption tax respectively (Bradford, 1986, Sinn, 1987, McLure, Mutti, Thuronyi and Zodrow, 1989), the long term inefficiency of the income tax in Greece, which was linked to an abnormally high ratio of indirect to direct taxes, seems to point in favour of adopting a system of direct consumption taxation. Naturally the aforementioned consumption tax should be combined with a higher taxation of luxury goods and services (Kaldor, 1955 and Negreponti-Delivanis, 1966) as well as with taxation of capital. On the way to the realisation of the Maastricht treaty, the convergence of the Greek economy would benefit enormously from the imposition of an additional tax on imported luxury goods, within the frame of a direct consumption tax. The latter represents an immediate necessity for a period of at least five years and, in the interest of the Greek economy, it should be communicated to the Community as soon as possible.

Part I of the present paper will concentrate on the structural particularities of the Greek economy which point in favour of the adoption of the direct consumption tax. Part II will deal with the expected results of substituting the income tax by a direct consumption tax.

The working hypothesis will rely on the estimation that the tax revenue should increase by approximately 2 trillion drs. These, however, as well as the rest, will be distributed according to the ratio of the average per capita income of wage earners and their share in total employment, while the contribution of the other socio-professional groups will be (approximately) as follows: 32% for wage earners, 18% to farmers and 50% to all the rest (Negreponti-Delivanis, 1992).

PART I. STRUCTURAL PARTICULARITIES

Among the numerous patricularities of the Greek economy were selected those which seem to impose the adoption of a direct consumption tax in Greece. The latter are so obvious that, despite any possible disadvantages this kind of tax system might imply, as well as the fact that the empirical investigation of these two tax systems did not allow any clear-cut conclusions about the supremacy of either one of them (Atkinson and Sandmo, 1980), the adoption of the direct consumption tax, in Greece, is of paramount importance if the objective is its economic convergence with Community:

a) Hidden economic activities (Negreponti-Delivanis, 1991)

In an economy like the Greek one, with such a high level of hidden economic activities, whose share in the country's official GDP was estimated at 50%, (according to my estimations in a recent study of mine, a significant increase was recorded in 1989 while there was a slight drop in 1991), the income tax cannot possibly be efficient in terms of tax revenue or as a means to control public deficits, and in fact, this is the case in Greece. Efficiency of the income tax implies an effective suppression of hidden economic activities and tax evasion, which represents a difficult, long term and possibly dangerous project, under the present conditions of extremely unstable economic equilibrium of the economy. However, fiscal convergence must be realised within the very narrow time limits of the Maastricht treaty. This is exactly where adoption of the direct consumption tax is expected to yield immediate results and to contribute significantly to the automatic conception of hidden economic activities and tax evasion.

b) Significant divergence between declared incomes and consumption

Obviously, such a significant divergence is a strong indication of tax evasion and hidden economic activities. Such a divergence was actually estimated by the Greek National Statistics Service, for 1981-82 (See Table I: Negreponti-Delivanis, 1986, p. 278).

The divergence between declared incomes and actual consumption, on a yearly basis, was found to be equal to 27,8% for the economy as a whole, in 1982. As one would expect, the divergence was larger in the case of self-employed and smaller in the case of wage-earners. On the basis of our estimations as to the level of hidden economic activities in Greece, the latter has a rising tendency after 1981, which implies larger potential margins for the application of a direct consumption tax, since.

c) Existence of strong lobbies

The failure of all Greek governments, during the last two decades, to apply an equitable and efficient tax system, is a function of the increasing power of the various socio-professional groups which manage to impose their own interests and, in so doing, counteract any attempt at economic recovery. The suppression of such lobbies is an extremely hard task in a parliamentary democracy and given that its success is largely dependent on the evolution of socio-economic institutions, it cannot be considered as a task for a single government. The substitution of an income tax by a direct consumption tax, would be a way, a priori, to bypass this problem.

d) Percentage share of the self-employed in total civil employment

The fact that after 1983, Greece represents the only OECD country with an income tax share in GDP that is lower than 5% (Table II) should definitely be related to the fact that, the country presents the highest share of self-employment within its total civil employment in the OECD countries (Table III). It has been observed that a high share of self-employment within total employment represents excellent ground for the development of hidden economic activities and tax evasion (Negreponti-Delivanis, 1991, p. 71). However, the conclusions of recent studies indicate that a rising number of self-employed has a negative impact on income taxation (Renaud and Van Winden, 1988). Therefore, given this particular aspect of its socio-economic structure, Greece should shift to a direct consumption tax system.

e) Stagflation

Despite the fact that the actual development stage of the Greek economy does not justify such phenomena of economic maturity as stagflation, the country is nevetheless subject to it, at least during the last fifteen years. The direct consumption tax system does not necessitate re-adjustments of the tax base as a consequence on inflation (McLure, 1988). Apart from that, however, it is believed that the generalised direct tax on consumption would be in a better position to promote an increased economic activity (Bird, 1988) that the income tax because the former is neutral as to the choice between actual and future consumption and, therefore, favours savings.

The main conclusion to be derived from Part I of the present paper is that, the specific structural particularitites of the Greek economy, combined with the very low share of the income tax within the country's GDP, necessitate the immediate adoption of a general direct consumption tax system.

PART II. EXPECTED RESULTS

There are many chances that the process of convergence of the Greek economy to the average Community level, imposed by the Maastricht treaty, may start and continue, through a radical reform of its prevailing tax system: that is, through the abolition of the income tax and the adoption of a direct consumption tax, combined with increased taxation on consumption of luxury goods and services, as well as with a tax on capital.

Part II of the present paper will mainly deal with the expected results of such a radical reform of the tax system on the process of economic convergence in terms of fiscal discipline as well as in terms of controlling our macro-economic disequilibria.

A. Fiscal convergence

Fiscal discipline, expressed mainly as a necessity to control the country's enormous public deficits and debts, could certainly be achieved, in Greece, through the adoption of the direct consumption tax. In fact, such a shift should normally result in the following:

a) Automatic enlargement of the tax base

The narrow tax base, in Greece, which concerns mainly (by 70%) wage-earners who, however, only represent 46% of total employment, will be automatically enlarged to include the total, that is, all consumers. The 2 or even 3 trillion drs which are considered necessary in order to start coping with the enormous public deficits, will begin to flow freely, as if by magic. Furthermore, all vain attempts to capture tax-evasion will cease, since they will no longer be necessary.

On the other hand, the distribution of the total tax burden, which will be a function of the level of consumption as well as of the nature of the latter in each socio-professional group, is expected to be more equitable. Despite all the various arguments in favour or against the consumption tax, in terms of the latter's progressiveness, horizontal or vertical equity (Zodrow, 1990), etc., our view is that this disagreement in no way concerns the Greek case. The main reason is that during many decades, the Greek tax system was extremely inefficient and inequitable and, most important, acted against the country's main economic potential and counteracted any possibility for an efficient governmental intervention. It is our belief that any disadvantages which the direct consumption tax may have in relation to the income tax, will be counteracted, in the very particular case of Greece, by its numerous and very obvious advantages. A general adoption of the direct consumption tax will imply that all those socio-professional groups which are currently contributing marginally or not at all to the total tax receipts, will do so, according to their level of consumption. In comparison to the actual tax system, the shift of the tax burden away from the wage-earners, will be more than obvious.

b) Improvement of the Balance of Payments

We believe that the generalised adoption of the direct consumption tax, in Greece, combined with increased taxation for luxury goods and services, will have a positive effect on the balance of payments, as well as, indirectly, on the substitution of domestically produced goods by imported ones. Despite the fact that official Greek statistics do not allow for a detailed distinction of consumption patterns for the various income brackets nor for the estimation of the propensity to import characterising each one of them, we have attempted an indicative approximation of both, in Tables IV, V, and VI.

In Table V, we have grouped (according to average spending for consumption purposes) the eight existing categories of households, into three. The first one includes the three official categories with the lowest spending on consumption. The second one includes the three intermediate categories and the third includes the two highest ones.

On the basis of the above distinction and in combination with the data presented in Table IV, we have pinpointed the main groups of imported goods as well as those income groups which create the structural problem of the balance of payments deficit.

On the other hand, in Table VI we have estimated the income elasticity to import for the whole of the economy, based on the following formula:

AM/M/AY/Y, where: M=Imports and Y=GDP.

In order to estimate the separate propensities to import for self-employed and wage-earners, instead of Y we used earnings and incomes. We then multiplied the derived elasticity of the self-employed with the ratio of their per capita income over the corresponding one for the wage-earners. We then estimated the level of total imports corresponding to the self-employed and wage-earners and divided it by their total number in order to derive the per capita imports and the ratio of per capita imports of wage-earners to per capita imports of self-employed. Despite the fact that the estimation period is slightly outdated and that the ratio in question has an upward trend, we believe that the results are rather indicative. After 1980, the level of the hidden economy, in Greece, rises very fast and if one adds the estimated incomes earned by hidden economic activities to the official incomes of the self-employed, the ratio of per capita imports of wage -earners to those of self-employed registers a sharp drop. Therefore, the imposition of a direct consumption tax with increased taxation of imported luxury goods, is obviously expected to control imports.

c) Controlling the inflation rate

The general price level will certainly increase as a consequence of the direct consumption tax. However, where inflation is concerned, what is important is not the price level itself, but its rate of increase or its stability. There will be a tendency for price stability because consumption will drop and the ratio of hidden economic incomes to official ones will decrease. The drop in total consumption will mainly concern the wage-earners who (we assume) spend all of their income on consumption. However, in the particular case of the Greek economy, the drop in consumption is expected to appear after the incomes of wage-earners have increased and those of all the other socio-professional groups have dropped, thanks to a more equitable distribution of the total tax burden. Hopefully, the suppression of tax evasion and hidden economic activities which will result from the adoption of the new tax system, will contribute to eliminate the sources of inflation in Greece.

d) Possibility to suppress the level of interest rates

The drastic suppression of public deficits and of the inflation rate will create the necessary conditions for the possibility to suppress interest rates. This, will in turn limit the burden of servicing the public deficit and, in case the propensity to invest is ecouraged as a consequence of the lower interest rates (which, however, according to the econometric investigation is statistically non-significant), the result will be an increased investment activity.

B. Convergence through controlling macro-economic equilibria

The existence of significant macro-economic disequilibria is, mainly, a consequence of the primary importance of hidden economic activities and tax evasion. The latter, in turn, act upon the main macro-economic indicators, affecting the interdependencies between them and disorganising the operation of the economic system which is increasingly shifting towards low productivity activities. The imposition of restrictive economic policies intensifies the above dangers as long as only the official incomes are controlled in this way, while the hidden ones remain free to increase their relative importance in the economy.

I will indicatively mention two features of the econometric investigation which remains unchanged through all modifications of the models and which I believe are extremely important for the interpretation of the unorthodox performance of the Greek economy: In the first place, private consumption is negatively related to the level of the public deficit. Therefore, restrictive economic policies which result in decreasing the level of private consumption in the hope of controlling public deficits, are clearly misconceived. Limiting private consumption through a suppression of wages and pensions, increases the public deficit, precisely because the macro-economic disequilibria are intensified. In the second place, the level of the public deficit is positively correlated with increased private investment in manufacturing. Therefore, under the prevailing stagflation and the divergence, after 1986, of the Greek economy from the average development level of the Community one would be absolutely justified in questioning the fact that limiting the public debt is put forward as the primary economic goal and preferred over the encouragement of private investment in manufacturing. Indeed, is it necessary to promote fiscal convergence, at this stage, given the prevailing conditions in Greece, over convergence in economic terms?

Adoption of the direct consumption tax will result in the elimination of tax evasion and the effective suppression of the level of the hidden economy. Furthermore, the correct estimation of the main economic variables will be made possible, which is now obviously not the case, and economic, monetary and fiscal policies will be effective. Under the assumption that the proposed new tax system will be in a better position in relation to the actual one, to fill the requirements of "neutrality", "simplified tax collection procedures", "social equity" and "efficiency' it will have the possibility to:

- limit the tendency of the Greek economy for fast and easy profits
- discourage social upheavals
- shift the economy towards higher productivity activities.

As far as the extent of hidden economic activities and fast rates of economic growth are concerned, the direct consumption tax may prove to be extremely effective, under the following assumptions and conditions:

- if it encourages the demand for domestically produced manufactured goods
- if it increases the propensity to save, through the suppression of consumption of, mainly, imported goods
- if it facilitates the gradual conversion of hidden economic activities to official ones
- if it achieves social peace and increased productivity
- if it contributes to the awakening of the private sector and turns the latter towards activities that belong to it.

The kind of tax proposed here, has quite a lot of chances to achieve all of the above goals.

Therefore, the general conclusion to be derived from the above analysis, is that it is necessary to the Greek economy to shift from the income tax to the direct consumption tax. Given the particular structures of the economy, the direct consumption tax promises convergence of Greece to the average Community level, in terms of fiscal discipline, as well as, more importantly, economic terms, with a far higher degree of success in comparison to the actual prevailing tax system.

TABLE I

Average spending on consumption of households, according to profession 1981-82

	All Households		*Employer*		*Self-Employed*		*Wage-Earner*		*Unemployed*	
0.Food	10,202	21,4	12,149	16,8	10,043	22,6	11,458	20,4	8,428	23,9
1.Food	5,907	12,4	9,378	13,0	5,854	13,2	6,844	12,2	4,363	12,4
2.Alcohol, Tobacco	1,381	2,9	1,816	2,5	1,522	3,4	1,589	2,8	910	2,6
3.Clothing	6,253	13,1	9,916	13,7	6,370	14,3	7,259	13,0	4,189	11,9
4.Housing, Electricity etc.	5,513	11,6	7,436	10,3	4,360	9,8	6,677	11,9	4,771	13,5
5.Durable Goods	4,625	9,7	6,752	9,4	4,274	9,6	5,754	10,3	3,134	8,9
6.Health, Beauty products	3,025	6,4	4,952	6,9	2,711	6,1	3,299	5,9	2,666	7,6
7.Education	2,745	5,8	4,877	6,8	2,333	5,2	3,558	6,3	1,709	4,8
8.Transport, Communication	5,422	11,4	10,475	14,5	4,541	10,2	7,074	12,6	3,213	9,1
9.Various goods and services	2,486	5,2	4,415	6,1	2,467	5,5	2,698	4,8	1,860	5,3
TOTAL	47,579	100,0	72,166	100,0	44,475	100,0	56,010	100,0	35,243	100,0
	X12		X12		X12		X12		X12	
Yearly total (1)	570,948		865,992		533,700		672,120		422,916	
Average declared income 1982(2)	412,641		547,470		317,950		470,700			
(2) as % in (1)	72,2		63,2		59,6		70,0			

Source: GNS (ΕΣΥΕ), Personal Income Statistics

TABLE II

Income tax share in G.D.P.

	1965	*1970*	*1975*	*1976*	*1977*	*1978*	*1979*	*1980*	*1981*	*1982*	*1983*
Australia	8	9	13	13	13	12	13	13	14	14	13
Austria	7	7	8	8	9	10	9	10	10	10	9
Belgium	6	9	13	13	14	15	16	15	16	17	16
Canada	6	10	11	11	10	10	10	11	12	12	12
Denmark	12	20	23	22	22	22	23	24	24	24	24
Finland	11	13	17	19	18	16	15	15	16	16	16
France	4	4	5	5	5	5	5	5	6	6	6
Germany	8	9	11	11	12	11	11	11	11	11	11
Greece	2	2	2	2	3	3	3	4	4	5	4
Irlande	4	6	8	9	9	9	9	11	11	11	12
Italy	3	3	4	5	6	7	7	8	9	10	11
Japan	4	4	5	5	5	5	6	6	7	7	7
Luxenbourg	8	7	10	9	10	11	10	10	9	10	12
Holland	9	10	12	12	12	12	12	12	11	11	10
N. Zealand	10	11	16	16	19	18	18	19	20	20	19
Norway	13	14	14	15	14	15	14	13	13	12	12
Portugal	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Spain	2	2	3	3	3	4	4	5	5	5	6
Sweden	17	20	20	21	21	22	21	20	20	20	20
Switzerland	6	8	11	12	12	11	11	11	11	11	11
Turkey	4	5	7	7	8	9	9	9	10	9	8
G. B.	9	12	14	13	12	11	10	11	11	11	10
U.S.A.	8	10	10	10	10	10	11	11	12	12	11
Average non weighted	7	9	11	11	11	11	11	12	12	12	12

Source: Statistiques de recettes publiques des pays membres de l' OECD, 1965-1984 (OECD: 1985)

TABLE III

Percentage share of self-employment in total civil employment

Countries	*1969*	*1973*	*1979*	*1981*	*1984*
Australia	9.3	9.5	12.1	12.1	12.4
Austria (a)	13.1	11.7	8.9	8.6	7.9
Belgium	11.9(b)	11.0	11.2	11.5	12.3
Canada	-	5,8(c)	6.7	6.4	7.4
Denmark	-	9.7(c)	9.2	8.3	8.4(d)
Finland	-	-	-	-	6.9
France	-	9.7	8.7	8.7	9.1(d)
Germany	8.3	7.6	7.7	7.6	8.2
Greece	-	-	-	27.8	27.3
Ireland(a)	10.2	8.3	7.0	7.0	7.3(d)
Ireland	9.6(e)	10.1	10.4	9.6	11.4
Italy	-	17.8	18.7	19.6	20.6(d)
Japan	14.6	14.1	14.0	13.6	13.0
Netherlands	-	3.7 (c)	4.1	5.6	4.9(d)
New Zealand	7.5(e)	9.1(g)	-	8.4	-
Norway	7.6(f)	7.6	6.4	6.6	6.3
Portugal	-	11.5(h)	12.1	11.6	-
Spain	161(b)	16.3	15.9	16.3	17.9
Sweden	5.6(b)	4.8	4.5	4.6	4.6
Switzerland	7.6(b)	-	7.5(i)	-	-
Turkey	25.0(b)	25.0(g)	20.8	-	-
U. K.	6.5	7.3	6.6	7.9	9.6
U.S.A.	7.0	6.7	7.1	7.3	7.6
Unweighted average (k)	-	9.5	9.4	9.5	9.9
Change Coefficient (k)	-	40	4.2	42	44

(a) including working unpaid family members,
(b) 1970,
(c) 1975,
(d) 1983,
(e) 1971,
(f) 1976,
(g) 1972,
(h) 1974,
(i) 1980,
(k) non including Finland, Greece, Portugal, Switzerland, Turkey.

Sources: OECD Labour Force Statistics, Labour Force Survey, Greek National Statistics.

TABLE IV

Evolution of the structure of imports, by main groups, according to period average

	Including Fuel			Not Including Fuel*	
	1973-76	*1977-80*	*1981-84*	*1973-76*	*1981-84*
Food	13.0	11.1	12.3	15.6	17.5
Raw materials	18.2	16.9	14.3	21.7	20.5
Fuel	16.3	21.6	29.9	-	-
Capital goods	28.7	25.2	19.5	34.2	27.8
Consumer goods	23.2	24.6	23.5	27.7	33.6
Transportation costs	0.6	0.6	0.5	0.8	0.6
TOTAL	100.0	100.0	100.0	100.0	100.0

* In order to examine the evolution of imports free of oil prices.
Source: Epilogi, 9/85, p. 618.

TABLE V

Average spending on consumption of households, by total level of spending

	All House Holds	*Up to 29.999 (3 Lowest Groups)*		*30.000-69.999 (3 Intermediate Groups)*		*70.000 and up (2 Highest Groups)*	
Food	10,202	4,843	32.0	10,992	23.6	16,960	15.8
Food	5,907	2,349	15.0	6,168	13.3	11,189	10.4
Alcohol-Tobacco	1,381	627	4.0	1,499	3.2	2,321	2.2
Clothing-Footware	6,253	1,443	9.2	6,015	13.0	15,458	14.3
Housing-Electricity-Water	5,513	2,524	16.1	5,716	12.4	10,149	9.4
Health-Beauty Products	3,045	843	5.4	2,687	5.8	8,056	7.6
Education	2,754	466	3.0	2,481	5.4	7,576	7.0
Transport-Communication	5,422	886	5.7	4,530	9.8	16,115	15.0
Various Goods and Services	2,486	579	3.7	2,181	4.7	6,918	6.4
TOTAL SPENDING	47,579	15,640	100.0	46,210	100.0	107,147	100.0

Source: Same as for Table I.

TABLE VI

Ratio of imports of wage-earners to self-employed

	1968	*1972*	*1976*	*1980*
Income elasticity of imports	1.19	1.25	0.77	0.83
Income elasticity of imports: wage-earners	0.65	1.25	0.90	0.78
Income elasticity of imports: self-employed	0.65X1.83=1.19	0.83X1.76=1.46	0.53X1.52=0.81	0.63X1.20=0.75
Imports of wage-earners	14,659,000(35%)	32,372,000(46%)	118,275,000(53%)	230,969,000(51%)
Imports of self employed	27,172,000(65%)	38,001,000(54%)	104,885,000(47%)	221,912,000(49%)
Per capita imports of wage-earners	10,789	27,074	88,571	168,460
Per capita imports of self-employed	34,977	56,739	136,087	265,661
Ratio of imports of wage-earners to self-employed	0.31	0.48	0.65	0.63

Source: Negreponti-Delivanis (1986), p. 77 and Annex Tables I, II, IV.

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