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Eurobank Research issued today a Focus Note entitled **"Estimates of the size of the shadow economy in Greece and policy proposals"**. The authors of the note are Tasos Anastasatos, Michail Vassileiadis, Stylianos Gogos, Theodoros Rapanos and Theodoros Stamatiou.

Focus Note Summary

This note includes estimates regarding the size of the shadow economy in Greece and summarizes some of its implications for public finances and the country's productive model.

Various attempts have been made in the literature to estimate the size of the shadow economy or tax evasion in Greece, with results ranging between 20% to 30% of GDP. While the precise measurement of the tax evasion's extent is inherently difficult or even impossible, we can attempt an indirect estimation by observing its impact on other economic indicators.

Firstly, as mentioned by the Governor of the Bank of Greece, **the total income declared by households in their tax statements significantly falls short of their consumption** based on ELSTAT's national accounts data, with the discrepancy reaching approximately **€50 billion** in 2021 and possibly even more in 2022. Imputed rents, included by ELSTAT in final consumption, as well and the new arrears to the government which boost consumption despite being recorded as a liability, should be deducted from the above figure. **Based on these factors, a rough estimate of the size of the shadow economy amounts to around €40 billion annually.** Various interpretations have been offered to explain this difference between reported income and consumption, but some explanations, for example the conjecture that consumption is higher due to tourism (which, is however, recorded in exports) or that consumption is fueled by cash that had fled the banking system (but cash in circulation is at low levels compared to previous years), do not hold as true.

Another indication of the size of the shadow economy comes from labor market data, as there is a significant difference of about 17% between the level of employment as reflected in ELSTAT's labor force survey and the employment that would be consistent with GDP data. Additionally, **it is noteworthy that there is no strong correlation between declared incomes and fluctuations in economic activity. For example, in 2020, a year of significant recession due to the Covid-19 pandemic, €1.3 billion more in income was declared compared to 2019! Therefore, the size of declared incomes seems to be a mere reflection of the degrees of freedom that the legal framework allows for minimizing tax burden.**

There are significant reasons why the total shadow economy is likely to be much larger than the above calculations. **Firstly, these calculations do not include tax evasion and tax avoidance by legal entities**, an indication of which is provided by the increase in deposits by firms compared to their declared net profits. S**econdly, the size of the so-called "VAT gap"** indicator provided by the European Commission, which, despite decreasing significantly in the past decade, remains proportionally **the third highest in the eurozone** and more than twice the EU27 average. This, along with the large amount of inventories in the estimated GDP, indicate that there may be a systematic underestimation of consumption due to incomplete inclusion of tax evasion. **Thirdly, the arrears to the Greek**

tax authority (AADE), although not formally a part of the shadow economy, exacerbate its consequences.

The direct consequence of extensive tax evasion is the loss of revenue for the General Government: Even though public expenditures in Greece as a percentage of GDP exceed the respective EU27 average, tax revenues from direct taxes fall significantly behind. Equally important is the issue of tax fairness, meaning that to compensate for this shortfall, the state relies on extracting revenues from groups with limited tax avoidance options – primarily employees and pensioners. **Out of the €84 billion of income declared for the fiscal year 2021 by natural persons, €66 billion (78%) came from salaries and pensions, while only €4.3 billion (5%) came from business activities** (7% if agricultural business activities are included). This distortion leads to a **shift in the economy toward over-reliance on self-employment** (Greece ranks first in the OECD and EU27 in this regard) **and a large number of very small businesses, at the expense of wage labor and larger, more innovative enterprises** respectively. As the former invest significantly less compared to the latter and are less productive and less export-oriented, the economy falls into a self-sustaining trap of low productivity and low investment. The uncompetitive wages due to this distorted model deter brain regain, while more productive investments that would boost productivity and wages are delayed due to a lack of appropriate workforce and the competitive disadvantage faced by larger and more innovative firms.

Dealing with the issue of the shadow economy is therefore imperative, not only for fiscal consolidation and a fairer distribution of economic burdens in the Greek society but also for improving the country's growth dynamics and long-term sustainability. The study mentions some policy measures that have been proposed to keep the shadow economy in check. It concludes with the **policy proposal** that possible **revenues from reducing tax evasion should not be directed towards increasing public spending**, which already exceeds the eurozone average as a percentage of GDP, **but rather towards reducing the tax burden on wage labor, in order to incentivize a change in the growth model**.