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Tax evasion and the crisis in Greece

A government's inability to collect tax is damaging to its long-term prospects

JEEVAN DEOL

Much of the comment on Greece's problems has focused on debt and spending. It is true that Greece's use of short-term borrowing to support a bloated civil service, overgenerous pensions and reckless infrastructure expenditure has been the most immediate cause of it's problems. But there is a deeper, underlying issue that constrains the government's ability to find a solution to the crisis: Greece's inability to collect tax revenue.

Economists estimate that Greece loses up to 15 billion euros a year through tax avoidance by individuals and small businesses, with over a quarter of Greek economic activity taking place in an unaccounted 'shadow economy'. More than half of Greeks declare an incredibly low income of less than 12,000 euros per year on their tax returns and many small businesses don't use cash registers or issue receipts. The usual way of solving a serious tax dispute in Greece is to apply the 'rule of thirds': one-third of the tax bill to the government, one-third in the tax inspector's pocket and one-third saved by the taxpayer. None of these practices is unknown in India.

Of course, it is not only Greece and India that have problems with tax collection. Between 10-15% of activity in most western European countries takes place in the shadow economy and the UK alone loses up to £4 billion per year in excise tax. Corporate tax evasion is equally widespread.

But the strikingly similar ways that individual Greeks and Indians seek to avoid paying tax on a large scale raises concerns about integration into rule-bound financial systems and structural problems. Although India has not come close to matching Greece's large-scale infrastructure spending, government policies have created high fixed costs that may become difficult to service over time. Fuel, fertiliser and petroleum subsidies have tended towards 10% of total government expenditure. Lost tax revenues on subsidised fuel, further energy subsidies at the state level and rising energy prices will increase the burden unless subsidies are phased out. Equally, new rights such as the right to education (and to food) will create underlying salary and subsidy expenditures that will essentially become fixed costs at the Centre. And as overall costs in the economy rise, the relatively low retirement age for government employees will create an increasing squeeze on central spending as civil service pensions become more expensive.

None of this means that India is in danger of going bust. But without a more concerted approach to tax collection—and more responsible tax payments—it will become increasingly difficult for the state to fund social and infrastructure expenditure at precisely the moment when India's growth depends on rising spending. The introduction of VAT and abolition of local taxes such as octroi have reduced opportunities for tax avoidance, but the essential problem is the same in India as in Greece. Not enough people pay income tax, too many who pay are able to cheat, and too much of the trade in goods and services takes place in the black economy.

The problem is social and political as much as it is economic. Not enough Indians believe that responsible citizenship means ensuring the conditions necessary for the prosperity and security of all. To some extent, this reflects the post-Independence Indian state's failure to construct a comprehensive ideal of citizenship and belonging. But new rights are changing the contract between citizens, as well as the relationship between individuals and the state. The other side of this new equation is the responsibility to distribute opportunity and prosperity in an increasingly prosperous society. India's super-rich have already started to understand this, even if much of their giving is by necessity directed towards correcting government's failures. But the merely rich, the well-connected, the political classes and the middle classes have yet to follow suit. Only when more Indians buy in to the notion of limited redistribution through taxes will the country truly be in the hands of its citizens.

No one likes paying taxes, in any economy. If the Indian state succeeds in collecting more tax, it will be due to the types of changes that made taxation work in the West: automatic payroll deduction, simple tax structures, harmonisation of excise duties and strong enforcement. But India's social contract is shifting in wider ways, and already the clever use of RTI has forced politicians, civil servants and judges to publicly declare personal assets and income. If the well-connected do not choose to lead the way in paying taxes, the new political reality looks set to force them to do so anyway. The social and political changes that are giving Indians more rights and increasing prosperity bring with them a greater responsibility. Whether or not that comes to include paying taxes may be critical for India's economic future.

The author is a researcher in the Faculty of Asian and Middle Eastern Studies at the University of Cambridge