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# An examination of direct and indirect taxation in OECD countries and the case of Greece

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**Abstract:** This paper attempts to analyze and interpret the principles of direct and indirect taxation. Initially, a theoretical approach to the general concepts and principles governing tax law is presented. It is followed by a presentation of the Greek tax and financial system. The key points demonstrating the harmonization of tax legislation, in accordance with the OECD (Organization for Economic Cooperation and Development) guidelines so far are highlighted. Any future reform of the Greek national tax system should incorporate the fundamental principles of national tax policy. Additionally, it must be in line with OECD principles and guidelines. The further implementation of the Organization's recommendations will shift the balance between direct and indirect taxation, leading to strengthening the first and reducing the second. Over the last decades, the ratio of direct to indirect taxes has been on the increase, particularly in developed countries. The main reason is that direct taxation is socially just and effective. Direct taxation is attributed by the liable person, while indirect taxation is transferred according to the ability of each person to react to the relevant market. The OECD supports, for member countries, the strengthening of direct taxation, which takes into account income and other social criteria and satisfies both the criterion of efficiency and the criterion of fair distribution of economic burdens. On the contrary, indirect taxation is reduced to inversely progressive taxation in terms of the income of consumers and is not consistent with the OECD principles of socially just and effective taxation in economically developed countries. The taxation of the citizens in general follows the principle of the citizens contributing to the public burdens according to their powers, for there is nothing more unjust than to treat unequal men as equals. From this proportional treatment of the taxing units, the constitutional principle of equality is also satisfied by reflection.

***Keywords:*** *Balance, Direct, Indirect, OECD, Tax policy, Tax, Taxation.*

## 1. Introduction

Taxation is a primary tool used by governments to generate revenue, redistribute income, and influence economic behavior. Taxes are broadly categorized into direct and indirect taxes, each with distinct characteristics, effects, and implications for economic efficiency and equity. Direct Taxes: These are levied directly on individuals or organizations. They include income taxes (personal and corporate), property taxes, and estate taxes. Direct taxes are typically based on the taxpayer's ability to pay, making them potentially more progressive. Indirect Taxes: These are levied on goods and services rather than on income or wealth. Common examples include value-added tax (VAT), sales tax, and excise duties. Indirect taxes are often regressive, impacting lower-income individuals more heavily as they spend a higher proportion of their income on taxed goods and services.

Efficiency and Equity: Musgrave and Musgrave (1989) argue that direct taxes are generally more progressive and can be designed to align with the principle of ability to pay, whereas indirect taxes, being consumption-based, are less aligned with this principle and can be regressive. Slemrod (1990)


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discusses the trade-offs between direct and indirect taxes, highlighting that while direct taxes can be more equitable, they often involve higher administrative costs and economic distortions. Indirect taxes, on the other hand, are generally easier to administer and can be less distortive but may lead to regressive impacts.

The rule of legality of the tax is established by the Constitution and specifically by article 78 paragraph 1. "No tax is imposed, nor collected without a formal law that determines the subject of taxation and the income, the type of property, the expenses and the transactions or their categories, to which the tax refers'. This means that for a tax to be levied and then collected, it must be provided for by law. The law must be formal, i.e., passed by the Parliament and not a rule of law, by legislative authorization (Michailidis, 2006).

Optimal Taxation Theory: Diamond and Saez (2011) explore optimal taxation theory, emphasizing that a combination of direct and indirect taxes can achieve a balance between efficiency and equity. Their model suggests that direct taxes on high incomes can be progressive, while indirect taxes can be used to broaden the tax base and reduce economic distortions.

Behavioral Responses: Chetty, Friedman and Saez (2013) examine how individuals' behavioral responses to taxation can affect the efficiency of both direct and indirect taxes. They find that tax avoidance and evasion behaviors are significant in the context of direct taxes, while indirect taxes can influence consumption patterns and savings behavior.

Revenue Generation and Economic Impact: OECD (2020) reports that in many OECD countries, indirect taxes are a significant source of revenue, with VAT being a major component. The shift towards indirect taxation is often driven by the need for stable revenue streams and the administrative simplicity of VAT systems. Myles (2009) notes that while indirect taxes are less distortive compared to direct taxes, they can lead to higher costs of living and disproportionately affect lower-income households, necessitating compensatory measures such as targeted subsidies or social welfare programs.

Tax Compliance and Administration: Slemrod and Bakija (2008) explore issues related to tax compliance, particularly in the context of direct taxes. They find that tax compliance is often influenced by the complexity of the tax system and the perceived fairness of tax policies. Keen and Mintz (2004) discuss the advantages of indirect taxes in terms of easier administration and enforcement, compared to the often complex and evasive nature of direct tax systems.

Regressivity and Equity Concerns: Deaton and Muellbauer (1980) analyze the regressive nature of indirect taxes, particularly VAT, and argue that lower-income households spend a larger proportion of their income on taxed goods, making them more adversely affected by these taxes. Piketty and Saez (2013) provide empirical evidence on income inequality and the role of progressive direct taxation in mitigating income disparities. They argue that progressive income taxes are crucial for addressing inequality, whereas indirect taxes often exacerbate it.

The Constitution includes a special provision (article 78 par. 4), in which the subject of taxation, the tax rate, the tax certification procedure and the exemptions or exemptions from taxation cannot be objects of legislative authorization (Barbas, Finokaliotis, 2011). Therefore, as long as it concerns these basic, explicitly defined, tax issues, a formal law is definitely required, while for other secondary tax issues it is not prohibited, as their regulation is done by a regulatory decree issued by legislative authorization (Michailidis, 2006).

The rule of universality of tax means that everyone is subject to tax. This rule can be considered as an extension of the rule of tax equality, because if it is assumed that a tax is imposed on certain persons, while others who are in similar circumstances are excluded, then the tax is not universal and therefore not equal either (Michailidis, 2006). The taxation systems of OECD countries generally consist of a mix of direct and indirect taxes, which play crucial roles in shaping economic outcomes, redistributing income, and funding public services. Direct taxes, such as personal income tax and corporate income tax, are levied directly on income, profits, and wealth. In contrast, indirect taxes, such as value-added tax (VAT) and excise duties, are imposed on goods and services and are typically passed on to consumers in the form of higher prices.

OECD Taxation Frameworks: Studies such as those by the OECD (2020) provide detailed insights into how OECD countries structure their tax systems, showing a diverse range of approaches depending on the economic, social, and political context of each country. The OECD's Revenue Statistics report highlights that in most OECD countries, indirect taxes like VAT are a significant source of revenue, often exceeding revenue from direct taxes. This is particularly evident in European countries where VAT rates are among the highest globally.

## 2. Tax Systems

Tax systems are called the set of principles on the basis of which the tax is determined or, in another sense, a terminological system is: the set of taxes that have been selected appropriately and are applied at a given time within a certain country. In other words, it is not enough to talk about a tax system, so that we simply have a sum of various ones constructed in such a way that they more fully serve the intended purposes. In another sense, a tax system is the complex of individual taxes, through which the state draws from the single tax source the revenue and which have been selected and constructed in such a way as to complement each other from the point of view of its various purposes tax for the fullest possible service of these purposes (Michailidis, 2006). The tax systems of the various countries, as well as of Greece, usually consist of income taxes, property taxes, transaction taxes, consumption taxes on domestic products, customs import duties, etc. (Barbas and Finokaliotis, 2011).

During the 18th century, the idea of a single tax was advocated, but it could not be put into practice. So, the physiocrats proposed the introduction of the uniform tax on land income. A flat tax on capital was later proposed by other publicists. Also, recently in France a single energy tax was proposed, which would replace other taxes (Barbas and Finokaliotis, 2011). Other writers and publicists have occasionally advocated the introduction of a flat income tax or a general consumption tax or a general tax on only consumed income and not on saved income. In Greece, as is known, there is a single income tax (natural persons on the one hand and legal persons on the other). However, this single tax does not have the meaning of the single tax under consideration, because there are other taxes in the Greek tax system (Barbas and Finokaliotis, 2011).

Despite the fact that the idea of a single (one) tax is very attractive because the tax legislation will be simpler, the revenue of certification and collection of the one tax will be smaller, the inconvenience to taxpayers will be less, etc. however, to be efficient in revenue this one tax would have to have a very high rate and would therefore be unaffordable. This is why the various states apply more than one tax, i.e. they apply a multiple taxation system. In this case, the taxes must have been well chosen, so that they form a harmonious whole, and according to a sound tax principle, there should not be a large number of taxes, but few and efficient ones, so that the saving is also served by the tax utilization of every element of tax capacity and the inconvenience to taxpayers to be as little as possible. But economic policy goals are also served through multiple taxation (Barbas and Finokaliotis, 2011). All taxes, even those that cause a decrease in private property, are paid from the net domestic product, that is, with all taxes, the state and other public financial institutions participate in the distribution of the net domestic product, as they receive a share of the total goods and services produced.

Multiple taxation is the means by which the reconciliation of the conflicting purposes of the tax is achieved and the better service of each of these purposes. Multiple taxation achieves, among other things, the distribution of tax burdens in a way that responds to the principle of measurement. This happens to a limited extent for the reason that under the system of multiple taxation it becomes technically possible to tax small and large income earners and even to tax not only income earners, but also property owners in general to take into account the tax capacity of the each and its size. While under the single tax system some income classes would completely avoid taxation and others would suffer a small tax burden disproportionate to their tax capacity (Barbas, Finokaliotis, 2011).

The balance between direct and indirect taxes has been a subject of considerable academic debate. Proponents of direct taxation argue that it is more progressive, as it can be designed to tax higher incomes at higher rates, thereby reducing income inequality (Musgrave & Musgrave, 1989). However, direct taxes, particularly corporate and personal income taxes, can also have distortive effects on labor supply, investment decisions, and economic growth (Myles, 2009).

Indirect Taxes and Consumption: On the other hand, indirect taxes are often considered less distortive to economic behavior. According to Slemrod (1990), indirect taxes like VAT are more efficient in terms of administration and collection and can encourage savings and investment by taxing consumption rather than income. However, the regressive nature of indirect taxes, which tend to disproportionately affect lower-income households, raises concerns about equity.

The OECD Perspective: OECD analyses have shown that countries with higher reliance on indirect taxes often implement compensatory measures, such as targeted welfare programs, to mitigate the regressive effects. For example, in the Nordic countries, high VAT rates are offset by extensive social welfare programs that reduce overall inequality (OECD, 2018).

## 3. The Advantages of Multiple Taxation

As far as the saving function of taxes is concerned, this is served more fully through multiple taxation. The reasons that support this is that: Through multiple taxation, the tax utilization of all elements of tax-paying capacity becomes possible and the tax burden on everyone who has: tax-paying capacity. If e.g., there were no consumption taxes and transaction taxes in Greece but there was income tax as a single tax only a small percentage of the national income would be subject to taxation because this is subject to income tax. Also, multiple taxation serves the purpose of tax savings and for the reason that through it tax evasion in one tax (e.g., income tax) is neutralized with the simultaneous submission of the taxpayer to other taxes (consumption, luxury, transactions, etc. a.) or tax evasion in one tax with the parallel operation of another tax (e.g., income tax - wealth tax) is still controlled.

As far as the socio-economic function of the tax is concerned, it is served because: it makes it technically possible to serve more individual purposes of economic policy and it makes it possible to serve a given purpose more fully (Barbas, Finokaliotis, 2011). But as far as the socio-political function of multiple taxation is concerned: that is, the purpose of combating income inequality is more fully served when more taxes operate than when there is a single tax, e.g. the income tax, because with the coexistence of more taxes, you combat income inequality repressively and proactively, with multiple taxation, the subjective tax burden is reduced because: taxpayers are served because the subjective burden from taxation is lower when the number of taxes is greater and because it becomes financially easier to fulfill tax obligations (Barbas and Finokaliotis, 2011).

## 4. The Intention of the Tax Legislator

One of the criteria classifies taxes into direct and indirect. The distinction between direct and indirect taxes has prevailed in both theory and practice for a long time. However, the distinction is not always easy. The problem of discrimination exists especially if we adopt as a criterion of the above discrimination the possibility or not of the taxpayer, as he transfers to other individuals with whom he transacts, the tax burden for which he is liable. Based on this criterion, direct taxes are considered to be those taxes which the debtor cannot shift, such as personal income taxes that are withheld from his wages. On the contrary, indirect taxes, based on the above criterion, are characterized the taxes which the debtor has the possibility to pass on part or the whole amount to other individuals. An example is the imposition of a tax on cigarettes where the tobacco manufacturer can transfer to the consumer an equal increase in the price of cigarettes. However, the above criterion is not absolutely stable. The reason is that under certain conditions it is possible to transfer the considered as direct taxes, while the transfer of the considered as indirect taxes is not possible (Barbas and Finokaliotis, 2011).

The OECD argues that in terms of stabilization, indirect taxes borne by households raise the prices of the products on which they are levied and reduce real income. A decrease in real income causes a decrease in consumption and therefore in aggregate demand. The magnitude of the effects of indirect taxes depends on whether consumers perceive that the imposition of the tax reduces real income. From the point of view of fair distribution of income, a fairer distribution of income exists when the tax-imposed limits income differences and sets higher taxation on the highest incomes while at the same time taking into account the personal circumstances (wealth, marital status, etc.) of the taxpayers. While direct taxes meet both of the above conditions, indirect taxes do not. Therefore, direct taxes provided that the tax services have the required organization and the means of certifying and collecting the income tax from the debtors are an effective means of redistributing the income and achieving a socially fairer tax system.

The taxation of property, in addition to the taxation of the income derived from it, is imposed for many reasons. The arguments commonly advanced in favor of separate property taxation can be classified into five main categories: reasons of social justice, favorable economic effects, increased tax revenue, tax advantages, the retributive nature of property taxes. Reasons of social justice: Separate taxation of property is imposed for reasons of social justice, because it promotes both the principle of horizontal and vertical tax equality, which cannot be done by income taxation alone even if we impose higher tax rates on income from property.

In particular, it is argued that property taxes do not meet the principles of either vertical or horizontal tax equality. The reasons put forward mainly by the OECD are the following: It is difficult to calculate the additional non-monetary benefits to the property owner in the form of independence, security and opportunities for profitable investments that property ownership affords him and to impose a proportionate taxation that satisfies the principles of horizontality and vertical equality. The various exemptions and exclusions of assets, usually recognized mainly for tax technical reasons, definitely hinder the realization of tax equality. The asset valuation system has many flaws and does not allow an accurate calculation of the property's value. Problems arise when taxpayers' wealth changes differently during their lifetime, as is often the case. Thus, if two people have on average the same wealth over their lifetimes, but over time the variation in one's wealth is greater than the variation in the other's wealth, the first person will pay more tax than the second. However, we must note that the arguments presented, although correct, cannot compensate for the advantages of property taxes in terms of social justice (Finokaliotis, 2014).

Greece's tax system has undergone significant changes, particularly in the aftermath of the financial crisis that began in 2009. The crisis highlighted the weaknesses in Greece's tax structure, including tax evasion, a narrow tax base, and inefficiencies in tax administration (Matsaganis & Leventi, 2014). Direct Taxes in Greece: Before the crisis, Greece relied heavily on direct taxes, particularly on labor and corporate income. However, these taxes were often characterized by high rates but low compliance, leading to substantial revenue shortfalls. The IMF (2017) pointed out that Greece's complex and fragmented tax code, combined with widespread tax evasion, severely undermined the effectiveness of direct taxes.

Indirect Taxes and Austerity: In response to the crisis, and under the guidance of international creditors, Greece increased its reliance on indirect taxes, particularly VAT. VAT rates were raised several times, with the standard rate reaching 24% in 2016, one of the highest in the EU (European Commission, 2019). These increases were part of broader austerity measures aimed at restoring fiscal balance. While these measures helped to stabilize government finances, they also had contractionary effects on the economy, exacerbating the recession and increasing poverty levels (Koutsogeorgopoulou et al., 2013).

## 5. The Objectives of Tax Policy – Harmonization with OECD Guidelines

Public Administration Agencies take steps to intervene in markets and assist the price mechanism to achieve society's goals. Thus, the Public Administration Agencies, after having complied with the OECD guidelines, seek: the adequacy of tax revenues, the stabilization of the economy at the level of full employment, the improvement of the distribution of productive resources, the limitation of inequalities in the distribution of income, the acceleration the rate of economic growth. One of the means of action for the realization of the above general objectives - is the budgetary means which includes all the means related to the expenses and revenues of the Public Administration Bodies. More specifically, these goals are pursued with the appropriate structure of taxes, both with the coexistence of many types of taxes and with changes in the amounts of taxes, that is, with the exercise of tax policy. Therefore, the objectives of the tax policy will be as mentioned in the beginning.

According to the OECD, the criterion of tax revenue adequacy means that, between two or more taxes that have the same effects in every other respect, the tax that generates the most revenue must be chosen. Even if a tax achieves an excellent distribution of the means of production and a fair distribution of tax burdens, this tax generally has no reason to exist if it does not generate revenue at least equal to the cost of its administration. The above also applies to the tax system as a whole, i.e., from two or more tax systems, which exert the same side effects on the economy; the one that generates the most revenue is preferred.

The application of the criterion of the adequacy of tax revenue would not present difficulties if it were possible to design tax systems equivalent in all respects except that of revenue. In reality, however, there are a large number of taxes, each of which affects the various manifestations of economic life in different ways, and some of the effects of taxes cannot even be quantified, such as e.g., their effect on the level of (individual or social) well-being. The problem of the tax legislator is therefore not what to choose between tax systems equivalent in every respect except that of efficiency - after all, it is practically impossible to design such systems, but what to choose between tax systems which yield different revenues and affect differently the individual objectives of fiscal policy (Barbas, 2011).

The conditions that a country's tax system must meet in order to ensure sufficient tax revenue are the following: (a) the adaptation of the tax system to the prevailing socio-economic conditions: The tax authorities when formulating the tax system must take into account the economic and social conditions prevailing in the country. By economic conditions we mean the amount of national income in relation to the population, the way it is distributed, the degree of economic development, the organization of the economy, etc. (b) the rational structure of the tax system: The tax legislator must exclude those taxes, which make it difficult to apply the principle of adequacy, and instead enrich the tax system with taxes, which facilitate the application of this principle. In the category of taxes that make it difficult to apply the principle of adequacy, belong the taxes that generate revenue at the expense of revenue from other taxes. Of course, all taxes are in principle competitive, in the sense that they derive the national product from the same source, therefore with given tax rates, each tax weakens the efficiency of the others, e.g. the personal income tax reduces the disposable income of households, which are thus forced, given the marginal propensity to consume, to limit their consumption expenditure.

The result is that consumption taxes yield less revenue for the public treasury. When comparing Greece to other OECD countries, several key differences emerge. Greece's pre-crisis tax system was less effective at generating revenue compared to the OECD average, largely due to high levels of tax evasion and avoidance. According to a study by Artavanis, Morse, and Tsoutsoura (2016), tax evasion in Greece was estimated to cost the government approximately 27% of total tax revenue. Indirect Taxation as a Revenue Tool: Post-crisis, Greece's shift towards greater reliance on indirect taxes is more in line with the broader OECD trend. However, the social and economic impacts of this shift have been more pronounced in Greece due to the already strained economic conditions and the limited effectiveness of social safety nets compared to other OECD countries (OECD, 2020).

Equity and Efficiency: The literature suggests that while indirect taxes are generally efficient and less distortive, their impact on equity is a significant concern, particularly in countries like Greece where income inequality has increased post-crisis. Studies by the World Bank (2018) indicate that to address this issue, Greece needs to enhance the progressivity of its direct tax system while improving tax compliance and administration.

## 6. Discussion

Government Agencies can use taxes to intervene and correct deviations from full employment, i.e. a situation of recession or inflation. The OECD guideline suggests that if we assume that there is underemployment of the labor force in the economy which is due to the economy's aggregate demand being less than the aggregate supply at full employment then aggregate demand should increase, Tax policy should then to reduce taxes so as to increase the purchasing power of households and businesses so that they have an increase in demand (consumption), production and incomes. Here, of course, the competent authorities should decide which taxes to use - direct or indirect - depending on their advantages and disadvantages (see disadvantages - advantages of direct - indirect taxes) (OECD).

Conversely if the economy is experiencing inflationary pressures because aggregate demand is greater than full employment output the fiscal policy of taxes. The degree of impact on demand depends on the category of entities charged by each tax and on the form of the tax. Thus, if taxes are imposed on households, they exert different effects than taxes imposed on businesses because the former affect consumption while the latter affect investment. Also, the effects on active demand differ between the various tax categories (income taxes - direct, expenditure taxes - indirect) (Barbas and Finokaliotis, 2011).

The literature provides several policy recommendations for Greece and other OECD countries. For Greece, improving tax compliance and broadening the tax base remain critical challenges. The IMF (2019) suggests that Greece should focus on simplifying its tax code, strengthening tax administration, and enhancing the progressivity of its direct taxes to reduce inequality and improve revenue collection.

Diversifying Revenue Sources: For OECD countries in general, the balance between direct and indirect taxes should be carefully managed to ensure both efficiency and equity. The OECD (2020) recommends that countries explore innovative taxation approaches, such as environmental taxes, which can provide revenue while also addressing broader policy goals.

Post-Crisis Adjustments: As Greece continues to recover from the economic crisis, future adjustments to the tax system should aim to reduce the burden on lower-income households, possibly by introducing more targeted tax credits or reducing VAT on essential goods.

## 7. Conclusion

Public Administration Agencies intervene in many ways to achieve the efficient allocation of resources. This means that the means of production must be allocated in such a way as to produce those goods and in those quantities that society as a whole desire. In free economies, this is achieved through the price mechanism, but this is not always achieved. A key finding of the OECD is that taxes should be used not only to secure revenue to finance expenditure but also as a means of mitigating economic inequalities created in the distribution of national income and wealth among citizens. A more effective tax to mitigate inequalities in the distribution of income is considered the progressive income tax and has been implemented in all countries of the Western world. Effective taxes for mitigating inequalities in the distribution of income and wealth are secondarily considered property taxes. The tax rates of this tax are progressive, while inheritance taxes have high tax rates to prevent unlimited accumulation of wealth (Barbas, 2011).

Taxes are considered as an effective means to ensure two basic conditions of economic development, i.e., the upward trend of the national product over time: (a) the creation of savings also by the private sector, (b) the promotion of investments and especially those that contribute to increasing the productive base of the economy. It was mentioned above that taxes are unilateral benefits from private entities to the public, because they are not compensated by a special compensation from the public to private entities proportional to the amount of each benefit. Because of this unilateralism, taxes impose a burden on private entities known as the tax burden. This tax burden is nothing more than the cost of providing frees public goods and financing the other activities of public bodies.

A key problem that concerns the branch of Public Finance is finding a way to fairly distribute the tax burden among citizens. Two main issues arise here. The first refers to the (definition) of the fair distribution of the tax burden while the second refers to finding appropriate criteria on the basis of which taxes should be levied, so that the distribution of the tax burden is fair. The total tax burden, measured based on the ratio of total tax revenue to the gross domestic product, is currently quite large both in our country and in most countries of the world. The total tax revenues in our country currently amount to 33% of the GDP, a rate that is 10 percentage points lower than the Community average. However, the tax burden increased by 84% in the last twenty-five years, a rate more than double the corresponding rate of increase in the tax burden for the entire European Union as a whole. This rate of increase in the tax burden in Greece is greater than the corresponding rate in all other countries of the Union with the exception of Spain and Portugal (OECD).

Direct taxation is attributed by the liable person, while indirect taxation is transferred according to the ability of each person to react to the relevant market. The OECD supports, for member countries, the strengthening of direct taxation, which takes into account income and other social criteria and satisfies both the criterion of efficiency and the criterion of fair distribution of economic burdens. On the contrary, indirect taxation is reduced to inversely progressive taxation in terms of the income of consumers and is not consistent with the OECD principles of socially just and effective taxation in economically developed countries.

The taxation of the citizens in general follows the principle of the citizens contributing to the public burdens according to their powers, for there is nothing more unjust than to treat unequal men as equals. From this proportional treatment of the taxing units, the constitutional principle of equality is also satisfied by reflection. The examination of direct and indirect taxation in OECD countries, with a focus on Greece, highlights the complex interplay between tax policy, economic efficiency, and social equity. While indirect taxes provide reliable revenue stream, especially in times of fiscal austerity, their regressive nature necessitates careful consideration of their impact on different income groups. Greece's experience underscores the importance of tax system reforms that enhance compliance, broaden the tax base, and improve the overall progressivity of the tax system to support long-term economic recovery and social equity.



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