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A Greek Canary in the European Goldmine

Fiscal turmoil has enfeebled the Greek state and empowered dubious actors such as Golden Dawn. Today, John Rapley worries that Northern Europe could be next. Inefficient governments and the increasingly uneven services they provide are starting to appear, as illustrated by Great Britain.

By John Rapley for ISN

The political fault-line that has supposedly emerged in Europe in the age of austerity pits prudent northerners against profligate southerners. Thus, while Italy and Greece may be flailing in a pit of economic despond, the Dutch or Germans feel little pity since they reckon their partners willingly leapt into the mire. But to the extent this perception might obtain, it could be misguided. Greece [may be a harbinger](#) of what might yet afflict many other countries which pride themselves on their efficiency.

As we know, the sharp retreat of the Greek state amid its austerity programme has created opportunities for non-state actors – some with sinister motives – to insinuate themselves into the country's governance system. But north Europeans, though seemingly far removed from Greece's neo-nazi street thugs, would be mistaken to assume that something in their cultural genes insulates them from this sort of fate.

Tax morale and cultural stereotypes

Take tax compliance, where an obvious discrepancy between 'honest Germans' and 'shifty Greeks' is often referenced. In many developing countries, where up to half the economy can lie outside the state's tax-net, it is misleading to say that people do or don't pay taxes. Most everyone, in some way, pays taxes. But they don't necessarily pay them to the state.

As [studies](#) of gang-turf in inner-city Jamaica have shown, businesses that under-reported their taxes were at the same time paying 'protection' money to local gangs. Although officially condemned as extortion, there was some element of consent to this: protected businesses in crime-ridden areas enjoyed a degree of security that the police alone could not provide. Research into the governance of communities involved in trans-national crime – in countries like South Africa or Brazil, or in African and Asian cities and regions in which Islamist organisations were well established – seem to confirm this picture. Informal governance structures delivered services to their clients in return for their loyalty and, for those in a position to do so, some form of tax.

If you draw a graph of the world's countries with per capita income on one axis and economic formality on the other, what you get is a cluster along an axis that rises fairly steadily upwards: the

richer the country, the higher its degree of tax-compliance. This was for a long time attributed to the fact that richer countries could hire more tax-collection officers, and had better data-collecting infrastructure, so they could monitor transactions more thoroughly. Tax-compliance would thus produce a virtuous cycle: as the economy grew, more of it was taxed, and as more of it was taxed, the government would be able to keep employing tax-collection officers.

But more recent scholarship on tax-compliance has uncovered what experts call tax morale – an intrinsic motivation to pay taxes which has various sources, a key one of which appears to be the perception of value-for-money. One way to conceive it is to think of tax as a price for services sold by a monopoly-provider – the government. And where the formal government cannot or will not provide the service, informal agents can step into the breach. In extreme cases, this tendency for informal governance agents to supplement and even replace formal ones gives rise to what I have called a neo-medieval state, in which self-appointed barons operate with a high degree of independence from the formal system (all while articulating with them).

Now if tax-evasion were merely a selfish act to maximise individual return at collective expense, one might expect it to show up in societies with weak social bonds. But the reverse is often the case. Informal networks of family, religion or neighbourhood are very strong in many of the societies, like those of southern Europe and more especially the developing world, where informal structures of governance provide a wide range of public services, from welfare to security. In fact, one can make the case that the reason the Mafia remains as strong as it does in Sicily is that it existed prior to the arrival of the modern Italian state, and so has always provided services an inefficient public-sector has never mastered. So what might be more accurate is to say that tax-compliance is stronger in societies where collective expression is more likely to take place through state channels. Britons or Germans are not known to resolve their differences through spontaneous community action, in part because they can look to the state to do it for them.

Put simply, the reason Canadians, Swiss, Britons or Germans are famously honest when it comes to reporting their taxes may owe less to some cultural predisposition than to the fact that the state in those countries has, for most citizens, delivered the goods. By and large, the tax system has been equitable, public services have been widely distributed, and there are no obviously large rent-seeking constituencies.

Contrast this with countries like Greece or Italy, where public-policy has a long history of favouring in-groups and well-connected interests at public expense. Ask most Neapolitans or Athenians who under-report their taxes why they do so, and you're liable to get a response that indicts the public system as a den of thieves operating to the benefit of a few. The rhetoric may be exaggerated, but it is not without foundation. When a division begins to emerge between in-groups and out-groups, the latter can begin to withdraw from the tax net. The question then is whether this sort of division between haves and have-nots could ever emerge in northern societies, thereby weakening collective bonds and causing at least part of the society to withdraw from the state as is happening in Greece.

State retreat in Northern Europe?

One cause for complacency when it comes to tax policy is that when it comes to providing public services, there is no other game in town. You can't not use public services, and you can't legally refuse to pay for them. All it takes is enough tax-officers to find you, and you are brought into the net. But this is not always how tax-regimes work in practice.

Over six centuries ago, Ibn Khaldun observed that excessive taxes on farmers could lead them to retreat to remote lands where they could avoid supervision. Contemporary scholars have developed such insights into a fully-developed understanding of the conditions of successful taxation. The

economist Mancur Olson famously referred to governing classes as 'sedentary bandits' who could in principle squeeze as much from their subjects, but in practice limited exactions to an optimal level that ensured subjects had an interest in maintaining output. Similarly, Margaret Levi and Yoram Barzel have developed theories of the state which recognize that successful revenue-generation always depends on an element of consent by the taxed, and that governing classes encourage people into the tax net by delivering services with greater efficiency -which is to say, giving tax-payers more for less.

The corollary to this is that when they have to pay more for less, tax-payers have an incentive to retreat to the proverbial hills. This is where past experience in the developing world, and more recently Greece and other European countries, offers insights. In many of these cases, tax morale seemed to diminish as austerity amid chronic public-sector indebtedness increased. The reason is that when governments are forced to maintain tax-collections to cover the fixed cost of debt-payments, but have to cut spending to pay off interest on expenditure that has already occurred, the effective price of government has gone up. This is only worsened in cases where the weight of austerity falls unevenly, as well-connected groups - from corporate oligarchs able to shelter their assets offshore to public-sector unions which can turn out the vote -- are able to defend their share of the pie, making everyone else's slices smaller.

Often overlooked in discussions of Greek austerity is that although a quarter of the country is unemployed, once one removes young people from the count of unemployed, Greece's unemployment rate is no longer so far off the charts. This is because cuts in employment have tended to favour those with jobs and freeze out new entrants. As a result, Greece's youth unemployment rate stands closer to an astonishing 50%.

In that respect, the country is only further along the spectrum of austerity than most. Take Britain. While both of the principal political parties contesting this May's election agree on the necessity for austerity, both seem keen to protect their key constituencies: the governing Conservatives have ring-fenced pensions and are slashing welfare spending, while Labour seems keen to protect public-sector unions. More politically marginal if numerically significant groups, like first-time voters, are finding employment opportunities cut back just as their tuition expenses are rising. They may not be suffering 50% unemployment, but not unlike their Greek counterparts, they are three times more likely to be unemployed than older Britons. If such retrenchment continues to protect in-groups, the danger is that a generation of people will begin to look at alternatives to a system that appears not to be working for them.

It does not beggar the imagination that, should this kind of policy regime persist, there is a very good chance that tax-collection will begin to suffer. Should that happen, the sort of vicious spiral in which Greece finds itself could emerge in some north European countries. If their citizens feel any smugness today about the sorry lot of the Greeks, they may feel it much less later on.

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Dr. John Rapley is a researcher at the Centre for Development Studies at Cambridge University. He has worked at universities in Britain, the US, Canada, France, South Africa and the Caribbean. From 2003-2011 he left the classroom to create the Caribbean's first independent think tank, the Caribbean Policy Research Institute. He also has a long history as a public scholar, and has published in a wide variety of newspapers and magazines, from the Jamaica Gleaner to Esquire.

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