Scott Gehlbach: Representation through Taxation. Revenue, Politics and Development in Postcommunist States

Scott Gehlbach’s new book adds an important argument to the literature on the political economy of taxation. Focusing on the tax systems in post-communist countries in Central Eastern Europe and the former Soviet Union in the 1990s, Gehlbach argues that a state’s economic policy may promote those branches of the economy which can be most easily taxed. “The postcommunist experience [...] suggests that governments may structure their tax bases to maximize revenue in the least costly way, promoting through various means those sectors that are relatively tax compliant at the expense of those that are not.” (p.6) This means that if a government wants to maximise revenue but is not capable of organising a complex tax administration, the easy way out is to rely on the economic branches that find it hardest to evade taxes. These industries tend to be highly concentrated, enabling the government to direct its taxation efforts at just a few companies, or else rely on visible, for instance, state-controlled, distribution channels, like state-run oil pipelines.

This argument has a number of important implications for the analysis not only of tax systems but also of economic policy and of interest groups in general. First, the state may not necessarily support the branches of the economy with the biggest political influence in terms of Olson’s logic of collective action (or those that foster the socio-economic development of society), but might simply favour the sectors that are easiest to tax. Second, the dependence of the state budget on tax revenue from a few key sectors may then steer economic policy into a ‘revenue trap’, as Gehlbach calls it. Given that big (often monopolistic) and highly taxed industries, which the state supports in such a scenario, are unlikely to drive economic innovation, economic policy increasingly ends up promoting structural inefficiencies. In this case, the author asserts that ‘small businesses [...] had two strikes against them in the competition for resources. Not only did they find it difficult to organize in defense of their interests, but the relative ease with which they hid revenues from the state gave politicians little other reason to promote their development’. (p.14) With that, Gehlbach’s focus is on policy implementation, while Olson’s focus is more on bargaining over policy-related legislation.

The focus of economic policy on a few taxpayers (i.e. on large monopolistic firms in certain industries) thus hampers economic innovation and development, as these enterprises not only face the minor (according to Gehlbach) disadvantage of a higher tax burden but also enjoy the greater advantage of broad state support. On the other hand, new, private, small and often innovative companies can evade taxes but suffer from red tape. ‘Whether for revenue reasons or because of the organization of interests, politicians seem unlikely to shift support to the entrepreneurial economy, given the current allocation of labour and capital. Hope for change therefore seems to rest on the ability of entrepreneurs to find private substitutes for public goods and so circumvent a political economy biased against them.’ (p. 147)

Contrasting Central Eastern Europe (the ten post-communist countries that are now in the EU plus Albania, Croatia, and Macedonia) with the CIS (the twelve states on the territory of the former Soviet Union minus the Baltic states), Gehlbach demonstrates that after the end of communism the Central Eastern European states shifted to a ‘Western’ tax system with a broad tax base and assigned a prominent role to taxes on personal income, while the CIS states focused taxation on a few big, often monopolistic industrial enterprises and with that on corporate taxes and taxes on goods
and services. The CIS thus constitutes Gehlbach’s empirical case for the revenue trap, while Central Eastern Europe serves as a contrasting case. Gehlbach summarises his line of argumentation as follows:

Variation in initial conditions leads to variation in postcommunist tax systems, such that tax systems in the former Soviet Union are generally structured more around ‘old’ revenue sources, whereas those in [Central] Eastern Europe draw more on ‘new’ sources. These tax systems, in turn, determine the division of gains between politicians and firms from collective-good provision and so structure the incentives to provide those goods. Politicians in the former Soviet Union respond to these incentives by promoting economic activity that they know how to tax, whereas their counterparts in [Central] Eastern Europe exhibit little bias of this sort. These initial outcomes then interact with factor mobility to determine long-run trajectories of economic development, with labour and capital responding to collective-goods provision and vice versa, until eventually politicians and factory owners settle into a relationship of mutual dependence. (p. 17)

Gehlbach uses econometric analyses to determine the explanatory factors for the variation in tax systems among the two aforementioned regions to identify which branches of the economy were favoured by the different states and why and to determine the resulting consequences for economic development. He uses tax data and economic data for the 1990s from the World Bank, secondary sources, and interview results from the 1999 round of the World Bank’s and EBRD’s Business Environment and Enterprise Performance Survey (BEEPS), which included about 4000 enterprises in 25 post-communist countries. Gehlbach then goes on to build a formal model of the revenue trap and of representation through taxation, that is, of political decision-making when policy-makers take into account not only the promises of the collective actors (lobbies) but also the uncoordinated activities (like tax payments) of members of both organised and unorganised groups. The author presents and tests his hypotheses in a very concise and stringent way. He thoroughly discusses data quality, which he admits is not too good in parts, but is nonetheless sound enough to support his overall argument.

Concerning his conclusions on causal relations, however, there is one unexplained shift of focus. In the chapter dealing with the explanatory factors for the variation in tax systems he stresses the importance of initial conditions: ‘I demonstrate in particular that much of the variation in postcommunist tax structure can be traced to three initial conditions that varied across countries in Eastern Europe and the former Soviet Union: the industrial structure inherited from communism, proximity to the West, and the level of economic development at the start of transition.’ (p. 28) However, in the sections of the book summarising his results, the focus is on policy choices: ‘The lesser taxability of new private economic activity in the former Soviet Union – the result of decisions made in the early and mid-1990s about what revenue sources to tap […]’ (p. 146). Here a more systematic debate would be of vital importance for the argument, as it would either attribute the revenue trap to political incompetence or to path dependencies.

More broadly speaking, a student of political economy will miss a systematic elaboration of the conditions causing (or promoting) the revenue trap. Many of them are mentioned in passing. They include 1) a deep structural crisis in the economy, which offers the state the chance to influence the economic structure in the short term; 2) an industrial structure dominated by big (often monopolistic) enterprises, which are easy to tax; 3) the absence of orientation towards EU membership, which would demand a Western-style tax reform; 4) a low level of economic development,
implying an inefficient (i.e. incompetent, under-financed, or corrupt) state bureaucracy and tax administration; 5) few restrictions on formal economic policy-making, such that the dominant state actor can push related tax regulation through the legislative process without relevant opposition from other political forces or business interests; and finally 6) policy choices based on tax revenue as a first-order political concern and favouring easy revenues from enterprises with high taxability. However, this convincing set of explanatory factors found throughout the book is then dropped by Gehlbach in favour of the policy choice argument. Though this shortcoming does not limit the validity of his argument about the nature and consequences of the revenue trap, an elaboration of the causes would offer criteria for a generalisation beyond the specific case (i.e. the former Soviet Union of the 1990s).

For an area studies specialist with a focus on the CIS (and especially on its major economies, i.e. Russia, Ukraine, and Kazakhstan), Gehlbach’s study offers a compelling argument for explaining not only tax policy but also a state’s general attitude towards different branches of the economy. It thus provides important insights into the political role of oligarchs, who own some of the most taxable enterprises, and expands the debate about the nature curse, that is, the dependence of national economies on natural resource production. In addition, the study also adds to the recent discussion about the nature and policy aims of Russia’s re-nationalisation drive. The revenue trap thesis thus makes an important contribution to the analysis of economic policy and economic development in the region.

However, area studies specialists will miss a detailed case study of the causal mechanisms of the revenue trap as well as a discussion of the political and public debates about it. Because Gehlbach treats countries as mere data sets (focusing on a few key indicators) and does not cover state actors, he is not able to identify the main actors in the policy-making process leading to the revenue trap. Therefore, he cannot examine the interaction between big ‘taxable’ enterprises and relevant state actors, which is an important part of the revenue trap story, because it determines the relative success of a state’s strategy. For example, there is no mention of why Russia’s Gazprom, a partly state-owned gas monopoly and thus one of the country’s most taxable enterprises, was overdue in more than 40% of its tax payments at the end of the 1990s. Gehlbach is also not able to explain why taxation differs between big enterprises within the same sector, the way it did between Russia’s major oil companies in the 1990s. Although these points do not weaken Gehlbach’s overall thesis, which seems to be the best explanation of Russia’s tax policy available so far, they nevertheless demand a more detailed study. A closer look at CIS countries like Belarus, Turkmenistan, or Uzbekistan, however, might reveal that their tax policy is closer to the communist planned economy, where ‘taxation was largely an accounting matter’ (p. 5), than to the post-communist revenue trap, where state actors struggle to regain taxation power over parts of the economy.

In sum, Gehlbach’s book makes an important contribution to collective action theory, to the political economy of taxation, and to theories of economic development. Its contribution to area studies, however, is less marked. As the book has just some 130 pages of text (the remaining pages are filled with tables and graphs) it cannot be the source of all kinds of analyses for all kinds of readers. Instead Gehlbach presents a concise, well-argued, innovative and empirically based treaty on the political economy of taxation in the case of states with weak administrative capacities.

Heiko Pleines
University of Bremen
pleines@uni-bremen.de