

Entrepreneurship And The Shadow Economies of Southern Europe: A Vicious Circle Perspective

Abstract:

What is less researched today in entrepreneurship is that ‘the ability to create a new organization is characterized by the subjective difficulty of taking new paths, and by the resistance of the social environment’.

The result is the shadow economy, and it exists because of poor economic policies and the intensity of regulations associated with starting and maintaining a business. Three independent think tanks provide evidence that it is much more difficult to start and maintain a business in Greece and Italy than any other EU country.

The other significant factor that perpetuates the shadow economy is the level of illegal migration. Greece and Italy are most affected because of their proximity to North Africa and Eastern Europe.

This paper develops a circular model to analyze the vicious circle of the shadow economy in Southern Europe. This model shows that government policies contribute to the factors that perpetuate the shadow economy.

Keywords: entrepreneurship, shadow economy, corruption, migration, European Union

‘All of the countries in Southern Europe are facing the threat of a new recession with some degree of debt and deficit troubles and there is a strong possibility that they’ll all fail to

record significant growth. Not only is the near-term outlook for Southern Europe rather poor, but also the region's long-term outlook is also very troubling'.

(International Strategic Analysis 2011)

1 Introduction

Joseph Alois Schumpeter (1883-1950) is considered one of the most important figures in the field of entrepreneurship research; many regard his contributions as seminal. Schumpeter is often referenced regarding the importance he attributed to the individual in the entrepreneurial process. An aspect that is rarely discussed is the importance Schumpeter (1942) attributed to exogenous factors. He argued that economic leadership (entrepreneurship) is 'characterized by the subjective difficulty of taking new paths, and secondly by the resistance of the social environment'. (Schumpeter, Becker & Knudsen 2003). Taking new paths and gaining social acceptance varies according to government policies, regulations and whether the culture embraces an entrepreneurial culture.

Entrepreneurs do not act and make decisions in the abstract; they are constrained and enabled by "concrete living institutions", and social, economic and political factors... (Schumpeter 1991 [1946]). Therefore, entrepreneurship research should not only focus on entrepreneurs and their firms, but also "on the structure of and changes in the industries, markets, societies, economies, and political systems in which they operate" (Jones & Wadhvani, 2006b p.5-6).

In many countries entrepreneurship is an important aspect of government policy as it's touted as the solution for lagging unemployment because it creates wealth, raises living standards, and provides tax revenues that contributes to a nation's treasury (Dana 2001). In 2009, the World Economic Forum released an entrepreneurship education initiative in which they remarked, "Entrepreneurship is the engine fuelling innovation, employment generation and

economic growth. Only by creating an environment where entrepreneurship can prosper and where entrepreneurs can try new ideas and empower others can we ensure that many of the world's issues will be addressed" (Volkman et al 2009). Some governments have been spending considerable sums of money trying to ignite entrepreneurship. Whilst implementing national policies that contradict their support for small business and undermines entrepreneurial behavior. This is a problem in Southern Europe where governments and their economic policies are part of the problem. Furthermore, EU economic policies are not helping Greece or Italy deal with the long-term problem of sustainable economies. The EU and the USA, two of the world's largest economies, used different approaches to help solve their respective countries financial problems. These approaches impact on entrepreneurship in their respective regions. Whilst the USA is spending its way out of trouble the EU is trying to save its way out of trouble. The EU's focus on saving has a detrimental affect on small business and entrepreneurship and of course on the national economy. With regards to formal investment, in 2009 (Bosma & Levie p.56) venture capital investment "was around \$25 billion or 0.2% of GDP, in the U.S. compared to 7 billion in the European Union, approximately 0.05% of Europe's GDP". According to a number of independent think tanks it is difficult to start and maintain a business in Southern Europe, particularly in Greece and Italy, and that difficulty can be attributed to government policies.

Greece and Italy have many similarities, they are close, geographically, with similar cultures and they both have economic problems. The recent changes of the Greek and Italian prime ministers have not eased pressures as bond yields in Italy and other Euro-zone countries continue to rise and threaten these countries' ability to repay their debt.

Debt is not the only problem that these two EU member states share. According to Transparency International's (2011) Corruption Perception Indicator, Greece and Italy are in the top 5 most corrupt countries in the EU. Furthermore, in the EU the shadow economies are thriving. Greece and Italy's shadow economies represent 25% and 22% of their respective GDP's. In terms of government policies Greece and Italy, inhibit legal entrepreneurship with high taxes unnecessarily bureaucratic systems of licensing and registration, and the high cost of social infrastructure, which encourages illegal entrepreneurship.

Another problem that further adds to the size of the shadow economy is the illegal immigration. Shadow firms seek paperless migrants, as they are low cost, desperate, and cheap employees, as it's more difficult for them to attain legal employment because of their legal status. Whilst the failure of governments to deal with the informal economy is providing firms with cheap labor, the downside is that it doesn't provide SMEs with any incentives to learn to compete globally, through proper management practices and innovation strategies Baldwin-Edwards (2004). The low level of export competitiveness, a lack of economic reform and the failure to attract foreign investors, combined with the aging population will mean that most Southern European countries will continue to struggle for the long-term (ISA 2011). However, if the illegal entrepreneurship in the shadow economy could be made legal, could it provide a significant economic solution to the current financial crisis in Southern Europe. That leads to the question what is contributing to the current financial crisis in these countries, and what solutions are available.

This paper aims to disentangle the complex process; we call the vicious circle model that illustrates the relationship between government policies, the growth of illegal immigration, and entrepreneurial activities in the shadow economy. We argue that corruption is only one

node in the whole circle composed of many other complicated factors. To better appreciate how this situation can be changed the following is a discussion about entrepreneurship, and the entrepreneurial society.

2. Entrepreneurship: From Man of Action to Social Animal

According to Swedberg (2009), of all the theories of entrepreneurship that exist, Schumpeter's is still the most fascinating, as well as the most promising theory of entrepreneurship available. Schumpeter thought that in order for something radically new to emerge, the economic actor has to be bold and willing to take up a fight against the old and that, obstacles do exist and these have to be overcome. In brief, if there is to be economic development, there has to be leaders – those very special people who display energy to act in new ways and are also motivated to do so. Schumpeter repeatedly refers to this type of person or leader in the 1911 edition as “Man of Action” (Mann der Tat), and he describes this “Man of Action” as someone who does not accept reality as it is (Swedberg, 2009). Therefore, an entrepreneur's action can be summarized as either (Becker & Knudsen, 2003):

- a) the production and carrying out of new products or new qualities of products;
- b) the introduction of new production methods;
- c) the creation of new forms of industrial organization;
- d) opening up new markets;
- e) opening up new sources of supply.

During his career Schumpeter's view of entrepreneurship changed, the final version of his theory of entrepreneurship still retains many of Schumpeter's 1911 ideas. The entrepreneur is still an innovator, not an inventor; nor a risk-taker – risk-taking is still attributed to the capitalist financier; however, he is only the entrepreneur during the creative or innovative

phase of his firm's development. When the enterprise matures and operations become routine, he becomes a manager. The final version is also consistent with his big enterprise 1939-1942 version in its move away from a focus on the individual, in that the entrepreneurial function is no longer vested in one person and may be performed by teams of executives: "The entrepreneurial function may be and often is fulfilled co-operatively." (1989 [1949] p.256), Swedberg, 1993 p.173).

One thing that didn't change in Schumpeter's view was that, the ability to accomplish any of the above forms of organization' are 'characterized by the subjective difficulty of taking new paths, and secondly by the resistance of the social environment' (Schumpeter 1934). Taking new paths and gaining social acceptance varies according to government policies, regulations and whether the culture embraces an entrepreneurial culture. This work begins with an appreciation of the role of the individual and then considers the social environment.

2.1 The Schumpeterian Entrepreneur then & now

Schumpeter (1934) proposes 4 different types of entrepreneurs; the factory owner, the modern captain of industry, the manager as an entrepreneur and the one we focus on here the founder/promoter.

The founder/promoter is completely focused on the entrepreneurial function. This person is characterized by the 'lack of a social reference point' and a 'focus of seeking and carrying out new possibilities' (Schumpeter 1934). This person has little if any relationships with established economic institutions. Because of his/her low social and moral status they are generally ignored as a normal element of business life, particularly as an economic leader. It's this form of entrepreneurship that attracts the most attention in the entrepreneurship

research literature, because of an individual's ability to make something out of nothing. Thus the definition of entrepreneurship: "is the pursuit of opportunity without regard to resources currently controlled", (Stevenson, Roberts & Grouseback 1994, p5)

In today's literature there is a general consensus that, an entrepreneur is someone who independently owns and actively manages a small business (Stewart & Roth 2007). Yet some researchers advocate definitional criteria for entrepreneurship that extends beyond venture ownership, according to how the entrepreneur attained ownership and some advocate a focus on growth as a defining element of entrepreneurship (Woo, Cooper, and Dunkelberg 1991; Carland et al. 1984) in order to distinguish high potential ventures from small "mom and pop" businesses (Stewart & Roth 2007).

Currently entrepreneurship is regarded as a process, which involves entrepreneurial alertness, opportunity recognition, exploitation, and decisions concerning growth (Webb, Tihanyi, Ireland & Sermon 2009). To understand all these different aspects of the entrepreneurial focus researchers are trying to understand how entrepreneurs think (Mitchell et al 2007). The focus of this work is on the social environment of the entrepreneur.

2.2 *Social Environment of Entrepreneurship*

According to Schumpeter, entrepreneurs face resistance that they must overcome, if they're to succeed as entrepreneurs. Resistance comes in three types. First, there is the resistance that is associated with "the task"; then there is the resistance associated with "the psyche of the businessman"; and finally there is the resistance from "the social environment" (Schumpeter 1934:86). The reaction of the social environment includes all "legal or political impediments" (Schumpeter 1934:87). More importantly, however, there is also the hostility that any

population tends to show to those who behave differently. People are usually quick to spot and condemn differences in dress and manners. They are even more hostile, he adds, when it comes to behavior that is different in areas that are more important to them, including economic behavior (Swedberg, 2009).

Here we focus on social environmental resistance because some environments are more likely to support entrepreneurship than others (Reynolds 1991). ‘Social environments consist of groups of individuals, such as organizations, clubs, religious sects, political parties, government agencies or indigenous communities (Reynolds 1991) p.47. The conceptual frameworks of the social system contributes to our understanding of entrepreneurship in three important ways; societal conceptions regarding productive activities, societal characteristics affecting entrepreneurship such as cultural factors, the government’s role and finally through the impact of social context on individual behavior (ibid, p.47).

Governments impact an entrepreneurial culture and behavior (Carrol et al. 1988). Some effects are subtle others not so such as witnessed in the Australian government’s 2004 low priority, fragmented policies on entrepreneurship and innovation which didn’t support or even discouraged entrepreneurship (Hindle and Oconnor 2004). According to Hindle & Oconnor (2004) the Australian government didn’t appreciate that it needed to develop education, training and research programs with a specific emphasis on increasing entrepreneurship in the curricula of key educational institutions. Whilst in the USA there’s an extraordinary number of Silicon Valley companies registered in Delaware, why, Delaware, it has the lowest company taxes in the USA, considerably lower the California. Californian government policies discourage firms from registering in California because of their high taxes.

In France the government recently has a program to encourage entrepreneurs to start businesses. The program is Auto-Entrepreneur. After an individual registers online they can then operate as sole proprietor and they pay their taxes through this system. The system is so complicated and bureaucratic a colleague of one of the authors spent 6 months trying to register as an auto-entrepreneur and finally gave up in frustration. Therefore, government policies cannot be ignored because they affect the prevalence and role of entrepreneurship and it's an autonomous actor in societal processes (Evans et al. 1985).

The next section addresses how the impact of the social environment has resulted in creating shadow economies.

2.3 *Entrepreneurship in the Shadow Economy*

Recently, the field of entrepreneurship has become increasingly interested in the relationship between entrepreneurship and the shadow economy (Williams and Nadin, 2010) because it provides an example of how entrepreneurs overcome the socio/environmental resistances to start their own firms.

The shadow economy is known by many names, the black economy, the grey economy, the parallel economy, and it's also regarded as illegal entrepreneurship (Aidis & van Praag 2006). Whilst there's some disagreement over the definition of a shadow economy, this work has opted to use the following definition by Schneider (2009). The "shadow economy" - includes untaxed trade in goods and services, such as cash-in-hand construction work or car repairs, it excludes serious crime such as prostitution and drug trafficking (Schneider 2009). The

shadow economy, by all accounts, is a sizeable realm and is far from being some marginal enclave consigned to a few occupations and/or sectors.

The shadow economy is a reflection of the dynamic entrepreneurial capacity in a community. It's most likely to occur where there's a dispersed economy, a dense system of social networks and government regulations that discourage work force participation (Weiss 1987). Maloney (2004) has argued that the informal sector is best viewed as informal entrepreneurship involving somebody actively engaged in starting a business or is the owner/manager of a business who participates in the paid production and sale of goods and services that are legitimate in all respects besides the fact that they are unregistered or hidden from the state for tax and/or benefit purposes (Williams, 2006a, 2007a).

3. Vicious Circles in the Italian and Greek Economies

Greece and Italy were chosen because the problems they have are very similar, they are in close proximity geographically, and they have similar cultures and the most severe economic problems and similar problems regarding illegal migration.

From 2000-2010 Italy's real mean GDP growth rate was 0.185% per year, whilst Greece's real GDP Growth per year over the same period was 2.75% (Wolfram Alpha 2011). In 2010 the European Union approved a 140 billion euro loan to prevent Greece's problem from spreading to other EU Countries. Greece has had severe austerity measures imposed in order to guarantee a continuous flow of money from EU members. In March 2011, Moody downgraded Greek bonds to highly speculative (2011). Italy on the other hand has only recently gained the attention of EU with the resignation of Berlusconi and an acknowledgment that they have severe economic problems. Public debt as a percentage of

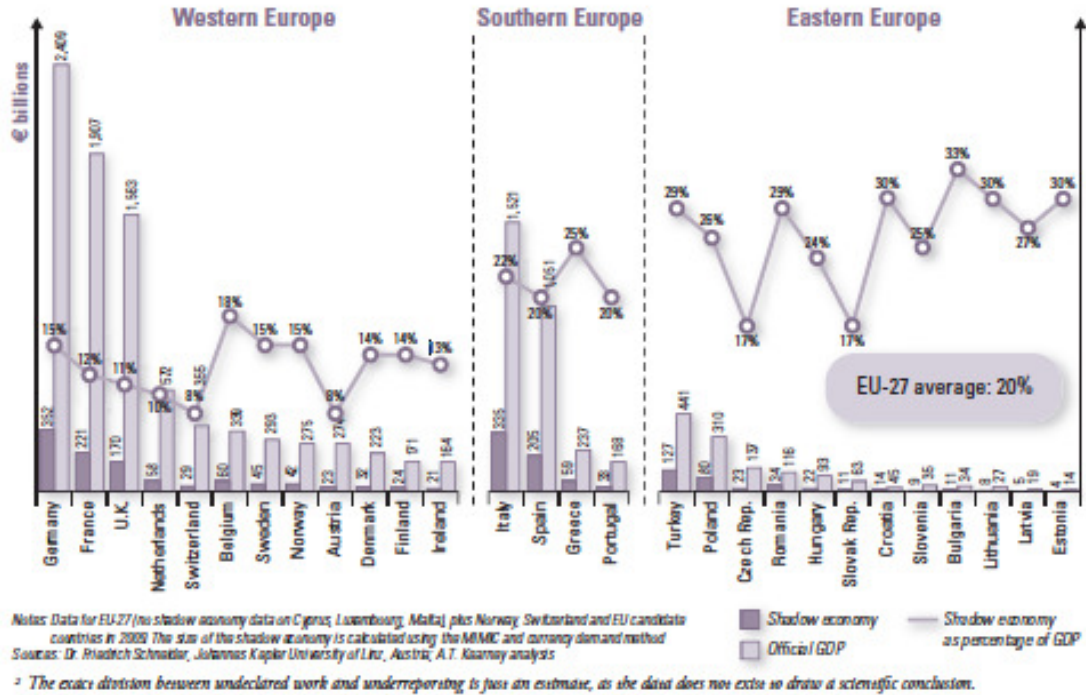
GDP in Italy and Greece rank the highest in the OECD except for Japan whose debt is more than double their GDP. According to Global Finance (2011) Italy's Public debt as a percentage of GDP is 120.3% whilst Greece is 152.3%

3.1 The Shadow Economy and Illegal Migrants

In Southern-Europe the shadow economy is so deeply rooted that one could think about the existence of a “natural rate of underground economy” (Castelluci & Bovi 1999) or of a “complementary inter-sectoral economic environment” (Katsios 2006). Schneider & Kearney (2010) estimate that the shadow economy in the European Union is valued at €2.1 trillion. And whilst it's an integral part of all European economies, it is difficult to get accurate information because those engaged in the shadow economy wish to remain anonymous (Jandl 2003), furthermore it is a hot political issue and governments do not like to make such information available to the public. Hence, there's little agreement about the true size of the shadow economy (Katsios 2006). As it is such an important aspect of business in Southern Europe it needs to be understood, therefore, we've used Schneider's (2010) calculations, as he's the most authoritative researcher in the field.

Between all the southern European countries, Italy and Greece have the largest shadow economies. In 2010 Greece's shadow economy was 25% of GDP. In the same year Italy's shadow economy was 22% of GDP (Schneider 2010) Figure 02. The existence of the shadow economy doesn't only affect the loss of revenue from uncollected taxes but also increases government expenditure because curbing these activities, by means of regulation, inspection, and/or enforcement is costly (Fadahunsi & Rosa, 2002).

Figure 01 The EU Shadow Economies in Relation to GDP



(Kearney & Schneider 2010 p.3)

Contributing to the problems associated with the shadow economy is the increase of illegal migrants crossing into Italy and Greece. Reyneri (2003) argues that the shadow economy is powerful attractant to illegal migrants from third world countries and as such recommends that government efforts would be better spent on addressing the problems associated with the underground economy to stem the flow of illegal migrants.

The first wave of immigrants to a new country may discover job opportunities not available in their own country. They then generate a chain migration through their ethnic and family social networks (Logan, Alba & Stulus 2003). The resulting growth of that community provides opportunities for some of the more entrepreneurial migrants. This community provides an enclave that sometimes results in a mobility trap, where the illegal status of the immigrant may condemn them to poorly paid jobs because they are unable to escape the

enclave for fear of losing their employment or being caught. So, most of the low skilled jobs, which are not sought by native inhabitants, jobs in restaurants, construction, and unskilled factory work (Malherios 1999) are filled by the “paperless”. Furthermore, employment in the shadow economy provides some sense of security as the firm doesn’t officially exist so they don’t expect immigration officials to raid their workplace.

Becoming self-employed can serve as an alternative to participation as an employee in the shadow economy. Once in the shadow economy, becoming a successful entrepreneur is not easy. There are many barriers for ethnic minority groups, who are already experiencing social exclusion and prejudice and who also lack formal qualifications, training, capital and legal status. Immigrant entrepreneurs know they are working on the fringes of society, but they have no alternative but to pursue informal economic activities. The shadow economy often allows them the only opportunity available because of the many obstacles to entry into the mainstream labor market. The discrimination that minority groups face can actually generate and reinforce the internal solidarity of ethnic economy.

Once in business, immigrant entrepreneurs recruit labor through immigrant networks. And it is in the ready access to a cheap and stable supply of immigrant labor that the competitive edge to immigrant enterprise resides. Hiring through informal networks not only provides a privileged conduit to a cheaper source of labor, but also enables owners to define employment in terms of ethnic loyalties and paternalistic relationships, thus strengthening attachment to the firm. Use of labor from within the ethnic community enables immigrant owners to surmount the organizational problems traditionally associated with domestic small firms, leading to the development of an enclave wherein possibilities of accumulation are contingent on continued isolation of the immigrant community from mainstream society.

Immigrant entrepreneurship appears to find the most fertile ground in industries where the labor force is immigrant, female and vulnerable (Oncü A, 1990). And this situation can often be found in the illegal immigrant firms of southern Europe.

Baldwin-Edwards, Arrango (1999 p.3) attributes illegal immigration to a number of factors; proximity of Greece and Italy to Eastern Europe and North Africa (this proximity enables easy return to their native countries), the weak immigration laws, the level of corruption compared to adjoining countries and even past colonial links. Furthermore, the large shadow economy of Southern Europe attracts immigrant labor because there's a history of illegal migrants successfully settling in either country despite all the challenges (Baldwin-Edwards 2004).

Some government actions promote illegal immigration and therefore support the growth of the shadow economy. Holding an amnesty is one such law that sends the wrong message to illegal migrants. Between 1986 and 2003, Italy had five, four in Spain, three in Portugal, one in Greece (Reyneri 2003). Since 2003, Spain has had two more amnesties and Italy held one in 2009. Such actions give illegal immigrants the hope needed to cross borders because they believe the government of their chosen country will provide another amnesty and give them legal residence status some time in the future. According to the independent think tank Migration Watch UK (2011), Amnesties set up a vicious circle, "granting amnesties does not reduce the number of illegal migrants; it may very well encourage further illegal immigration". In May 2005, the then French Interior Minister Dominique de Villepin said that further amnesties for France were "completely out of the question". He said that the amnesties in France in 1981 and 1997 had encouraged further waves of illegal immigration.

We are not blaming illegal migrants for the existence and creation of shadow economies. We believe that corruption is an important catalyst in the development of shadow economies.

Whilst Italy and Greece have the largest shadow economies, research by Jandl (2003), indicates that Germany possibly has the largest number of illegal migrants and yet its shadow economy is relatively small at only 14.6% of GDP, smaller than, Greece, Italy, Spain or Portugal's whilst their level of corruption is relatively low at 8.0 compared to Italy's 3.9 and Greece's 3.4¹. Unlike Greece and Italy it is very difficult for illegal migrants to access schooling, healthcare or other public services in Germany because under German Law there are heavy sanctions for anyone found supporting illegal migrants.

3.2 The Structural Roots

Many attribute the problem of Greek and Italian shadow economies to their high level of corruption, self-interested motives and the negligence of formal institutional agents who may undermine efforts to control deviant behaviors. Bribery often fulfills the motives of self-interested institutional agents. Some institutional agents may also lack the expertise or desire needed to enforce regulations guiding economic activities. Finally, the values of institutional agents may align with those of the informal economy entrepreneur, leading the agents to believe that enforcing more restrictive formal institutions is not worthwhile or necessary (Webb, Tihanyi, Ireland, & Sirmon, 2009). According to Methos (2010), Greece loses 8% of GDP to corruption. Corruption "increases the cost of doing business, and therefore we don't have a lot of new foreign investment". Aris Syngros, head of transparency international office in Greece said, "Corruption is one of the main reasons why Greece has an economic crisis". Even in the last 12 months corruption rose in Greece and is now the 2nd most corrupt country in the EU at 3.4, whilst Italy is the 4th most corrupt in the EU at 3.9 (T.I. 2011).

¹ In the Corruption Perception index the higher the number the lower the level of corruption 10 being no corruption and 1 being an extremely corrupt country.

According to Schneider (2006 p.), corruption and the shadow economy can either complement or substitute one another. For them to be substitutes of one another, Choi and Thum (2005) argue that entrepreneurs who go underground hamper a corrupt official's ability to ask for bribes because the official does not know the firm exists. Hindriks et al. (1999) (in Schneider) proffers that the shadow economy is a complement to corruption because the taxpayer conspires with the tax inspector so that entrepreneurs under-report their earnings in exchange for a bribe. In Schneider's (2006) analysis of 145 countries of all incomes between 1999 and 2003, he found that heavier regulation leads to more corruption, while better public service, rule of law, police force and enforcement of contracts imply less corruption.

Dreher & Schneider (2006) believe that these arguments ignore a third important factor: the relationship between corruption and the shadow economy, and that it might differ according to whether the country has a high or low income, but he doesn't elaborate or define high and low incomes. In high-income countries the rule of law, enforcement of contracts, and the police force are all effective. Bribes are unlikely as there is an expectation that corrupt individuals will be dealt with, and that only small firms and tradesman are capable of evading taxes and other regulatory requirements. They further argue that in a high income economy entrepreneurs may bribe to gain an advantage at winning contracts in the official economy. Because two thirds of the money earned is then spent in the official economy (Schneider and Enste 2000), it strengthens the public resources resulting in the eventual abolition of the large-scale shadow economy.

In low-income countries, Dreher & Schneider (2006) proffer that the rule of law, enforcement of contracts, and the police force are all largely ineffective. That leaves an opportunity for

small and large firms to avoid operating in the official sector thereby avoiding taxes and legal operating costs. “Big companies, however, are comparably easy to detect and – in order to escape taxation and punishment – they have to bribe officials, thereby increasing corruption” (ibid, p.5). Corruption, they argue, is a result of the shadow economy entrepreneur defying detection by public authorities. Therefore, “the shadow economy and corruption are likely to reinforce each other, as corruption is needed to expand shadow economy activities and – at the same time – underground activities require bribes and corruption to survive” (ibid, p.5).

However, Italy and Greece are both modern economies with a high income and a modern public sector (rule of law, police force, and contract enforcement) and yet corruption and the shadow economy thrive in these two countries. We believe that these interactive effects indicate that it is the configuration of all institutions, not just the size of the informal sector that affects entrepreneurial outcomes.

Delmonte & Papagni (2007) argue that there are three factors that must be considered in understanding a countries level of corruption, they are, economic, political and cultural influences. And we add the level of illegal migration. Accordingly, our hypotheses must be framed in the broader context of institutional theory and this is the objective of the next subsections (Estrin and Mickiewicz, 2010), which shows that all of the cultural, political, and economic factors are equally important in understanding corruption, the shadow economy, and its entrepreneurial dynamism.

3.3 Cultural Roots

In order to understand the evolution of corruption in Italy, it's helpful to understand the unification and federation of the Italian empire. Italian unification didn't begin until early

1810 and took almost 140 years for federation to occur even though many revolutionaries were in favor, but they couldn't agree on the form of the unified state. With 10 independently governed regions insurrection amongst the different regions was a regular occurrence made all the more difficult by the intervention of the Austrian empire, and the Habsburg's with the help of Swiss Mercenaries. It took many insurrections, two revolutions (1848-49), and the Italian war of independence. It wasn't until the end of world war one that Italy became a unified country. Italy today is still a fractured country: the prosperous industrial north is inhabited by the ruling class, whilst the south is made up of less well-educated rural farmers (Watkins 2011).

In a study of Italy's 20 regions, Putnam (1993) found a strong correlation between "Civic-ness", and the respect towards regional governments. Social trust, cohesion and participation (all aspects of civic duty) increase the quality of democracy (Almond-Verba 1963) and it is highly correlated with economic development (Inglehart 1997). In Italy many studies have shown that the distribution of civic values among Italian regions is not uniform: in this distribution the gap between North and South has been exemplified in the "amoral familism" theory: "Maximize the material, short-run advantage of the nuclear family: assume that all others will do likewise". Putnam (1993) who calculated the level of "civic-ness" of each of Italy's twenty regions in 1970, found a lower index in Southern Italian regions and concordance between the performance of regional governments and the degree to which social and political life in those regions approximates the ideal of civic community.

The belief of Southern Italians that you can only trust in families is consistent with the work of Bianchi, Raimondi & Fasone (2004) They found this to be a hindrance to business growth and development in Southern Italian firms. Bianchi, Raimondi, and Fasone (2004) argue that many small firms suffer from dwarfism, (stifling growth), because southern Italians will only

pass the control of a business to family members, many of whom are not skilled capable or even willing to continue in the family business.

In Greece, the cultural factor that contributes to corruption is ignoring the “arm’s length principle”. In most western countries this is an important economic principle, in that personal relationships play no role in commercial transactions. In Greece, “this would conflict with the generally accepted norms as one has an obligation and even a right to favorably assist friends, relatives and personal “clients”, ignoring this norm is seen as breaking the moral code” (Katsios 2006). With this in mind it is only a small step to demanding payment from citizens for the duties a civil servant is ordinarily required to perform.

Leandros Rakintzis, Greece's General Inspector of Public Administration has spent 38 years on the bench of the Supreme Court. In 2005 he was given the job of routing out corruption in Greece's public system. He says, "Small-time corruption ... is in our DNA, it is a part of our way of life (Koutsoukis 2010)."

Here are some examples of the problems he deals with;

The government agency Korais, which is located in the North of Athens was established in the 1950s to oversee the draining of a lake and the construction of a new road, it was completed in 1957. "Today Korais still has a full-time staff of 30 people; no one knows what they do. Not only that, but every year they advertise for new staff. It has a board, a president and the president of the board has a full- time driver." In 1997 Thessaloniki, was chosen as the European cultural capital, the government established an agency to oversee the year's cultural activities. Thirteen years later the agency is still in existence and claims still to be finishing work associated with its original mission. "In Greece this is how politicians have sought to gain favours, and generate employment. No government has been prepared to take

the risk of doing something about it. Rakintzis said. He estimates that corruption costs the Greek economy about 15-20% of GDP a year.

3.4 Political Roots

The political factors that impact on corruption and the shadow economy is dependent on the form of government, i.e.: democracy, socialism, etc., the extent to which the government is decentralized (Delmonte & Pagagni 2006). The greater the independence and effectiveness of a state's legal system, the less corruption is likely to occur. Also, the greater the distance between the elected officials and their constituents, the less likely they are to come in contact with opportunities for bribes (Delmonte & Papagni 2006). Local officials are more vulnerable to corruption as they are in contact with their constituents. Finally, democracies are less likely to be corruptible, as their behavior will ensure that they lose the next election.

Italy's corruption problem stems from the system of political patronage, called *clientelismo* - "it allows groups of citizens linked directly to politicians to reap high rewards through special laws (*leggine*) or through political appointments" (Delmonte & Papagni, 2006, p.2). Such rewards and appointments are not aimed at enhancing efficiency or recruiting professional expertise. The interaction between politicians, bureaucracy and groups of citizens directly linked to politicians is a characteristic of the Italian political system (Delmonte & Papagni 2006) all of which might explain the Italians proclivity for corruption, as can be seen from Transparency International's Corruption Perception Indicator (Transparency International 2011).

According to the former Economy and Finance Minister George Alogoskoufis Greece's current economic crisis can be attributed, to the economic policies, dated labor laws, state

bureaucracy, legal ambiguity regarding land use, corruption and the lack of long-term planning (Yannopoulos 2011).

The Global Entrepreneurship Monitor (GEM) provides evidence that environmental factors inhibit entrepreneurial desires. According to GEM, there's a marked difference between Italy (24.7 vs 42.4) and Greece's (15.9 vs 52.2) perceived opportunities versus perceived capabilities. Whilst entrepreneurs in Greece and Italy believe they have the capabilities to be entrepreneurs they believe that the opportunities are not available, that is there's a need 'to address conditions in the environment that can bring into balance this alertness to opportunities with their beliefs' (GEM p.20). This continues an ongoing pattern over the past seven years and reflects a strong aversion to risk, which is confirmed by the relatively high employment protection in Greece & Italy. GEM p.20

Contributing to the problems associated with the shadow economy is the large increase of illegal migrants crossing into Italy and Greece from Eastern Europe and North Africa. In Greece, undocumented migrants have no choice but to engage in informal business activities because one has to have a residence and work permit in order to obtain authorization to set-up a business (Lazaridis & Koumandraki p.4). Illegal Migrants in both Greece and Italy are faced with disadvantages: lack of documents, such as work and residence permits result in the lack of employment opportunities and that forces them into self-employment (ibid). Lazaridis & Koumandraki (p.4) also argue that these multiple forms of exclusion have been the reason why many illegal entrepreneurs strive to create a business of their own in order to 'survive' p.2

3.5 Economic Roots

The Heritage foundation and the Wall Street Journal issue an index of Economic Freedom. They define economic freedom, as the “fundamental right of every human to control his or her own labor and property. In an economically free society, individuals are free to work, produce, consume, and invest in any way they please, with that freedom both protected and unconstrained by the state.” The Heritage Foundation (2011) argues: “In economically free societies, governments allow labor, capital and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent necessary to protect and maintain liberty itself” (Heritage Foundation 2011). On the index of economic freedom, both Greece and Italy are ranked at 60.9%, moderately free with both countries having declined 2.4% from 2009.

Figure 02 Distribution of Global Economic Freedom



Heritage foundation (2011)

They are only less than 1% from being declared mostly unfree and are worse than countries such as Rwanda, Kazakhstan and the United Arab Emirates. The highest-ranking country (free) is Hong Kong at 89.7% and Singapore at 87.2% with the lowest ranking countries (repressed) being Cuba at 27.7% and Zimbabwe at 22.1%.

The International Finance Corporation and the World Bank also have a measure that ranks countries on the Ease of Doing Business. This index averages the country's percentile rankings on 9 topics; these topics are made up of a variety of indicators, giving equal weight to each topic. Of the 30 OECD countries, Greece and Italy are rated 30th and 29th respectively making them the most difficult countries in OECD for starting and maintaining a business (World Bank 2011).

The growing number of laws and regulations in labor restrictions, license requirements, market regulations and trade barriers which steer the Greek economy increases the cost of doing business and the propensity for entrepreneurs to move into the shadow economy (Katsios 2006).

Dell'anno (2003) argues that Italian entrepreneurs' propensity to operate in the shadow economy is caused by the Italian tax and social security burden, and the complexity of the labor market regulations. Likewise in Greece, the burden of tax, insurance and the intensity of regulations contribute to the shadow economy and corruption (Katsios 2006). Katsios (2006) argues that the shadow economy may be characterized as a constructed response by civil society to unwanted state interference. According to Katsios (2006), Greece's shadow economy is particularly vibrant because of the high taxes and social security burdens placed on firms. Therefore, the labor supply shows a preference for shadow firms. There are many examples of ill-designed rules and regulations. Among the most pervasive are taxation and labor policies. High tax rates and poorly administered taxation systems reduce profit margins encouraging tax evasion and informality. Similarly, restrictive labor regulations impose substantial, fixed burdens on firms (especially low income-earning ones) and make hiring informal workers attractive. Which encourages entrepreneurs to avoid the time, money and headaches of burdensome regulations through tax evasion and noncompliance.

3.3 *The Circular Model*

What can we learn from the situations in Greece and Italy? Above all, their large shadow economies lower government revenue to finance essential business-related goods and services such as the court system, administrative agencies, roads, and health care. It is one of the causes of their current debt crisis. There also appears to be a relationship between corruption and the shadow economy. The factors that contribute to the development of corruption also support the shadow economy. Contrary to Schneider's (2009) view of the economic situation of a country, whether they are high income or low income is not necessarily a determinant of the level of corruption and does not provide a better understanding of the link between corruption and the shadow economy.

From Schumpeter's entrepreneurial perspective, both corruption and the shadow economy in Greece and Italy are environments that need to be overcome for entrepreneurship to flourish. They are at the very heart of the problem of informal entrepreneurship - which provides continuous dynamic to the whole situation. An import labor demand from the shadow economy and a corrupt society can have a pull effect on illegal immigration. Illegal migration is above all caused by the established shadow economy in receiving countries, not simply by too weak controls on the borders. Through strategic social actions, immigrant entrepreneurs can construct new meanings that may eventually alter community norms and values and lead to new rules and regulations. In their communities, immigrant entrepreneurs who are firmly embedded in local networks of trust begin with a reservoir of moral legitimacy (Aldrich, 2005). This interaction between shadow economy as structure and informal entrepreneur as agent can be shown in the middle of Figure 03, (appendix 1).

However, whilst the size of the shadow economy appears to explain the propensity of illegal migrants to choose countries, it's not the only determinant. As mentioned earlier, Germany is one such example where the level of illegal migrants is high, but the size of their shadow economy is relatively small compared to the rest of Europe. One could proffer that Germany being the most successful of the EU countries may be a factor in attracting illegal migrants (Castell & Portes, 1989). Illegal employment of foreigners is often the consequence not the cause of an inefficient economic system, and the result of poorly targeted financial incentives generated by poor labor market regulations and expensive social security systems (Jahn & Straubhaar 1999).

Tax and social security contribution burdens are regarded as another cause of shadow economy. Poor government policies, in the form of high taxes, government charges to start a business, and the intensity of regulation (such as license requirements, labor restriction, and trade barriers, etc.) all affect significantly the level of illegal migrants. Behind over-regulation is the corruption, which ruins the rule of law, the integrity of police force, and enforcement of contracts. The resulting institutions and distortion drives normal business underground. Entrepreneurs go into shadow economy, not only to avoid official tax burdens, but also to reduce the burden of heavy bureaucracies and corruption (Samers, 2004).

Furthermore, another contributing factor maybe that most of the migrants finding their way to Southern Europe come from transition economies where the rule of law is weak, and enforcement of contract is non-existent. Migrants tend to live in similar ethnic enclaves so that they can continue to follow the morals, ethics and culture of their homeland. North Africa and most Eastern European countries have significantly higher levels of corruption than Southern Europe (Transparency International 2011). Furthermore, shadow economies

are a significant aspect of trade in these regions. It is not surprising then that citizens from these regions, who move to Greece or Italy, don't consider it immoral when operating a business or working in a shadow firm.

Amongst the causal factors of immigrant entrepreneurship, immigration policy intersects with the enforcement of labor and workplace legislation. In Greece, for example, a "white card" which entitles an immigrant to work is given to those applications that are approved. But it is only normally given for a few months, and those holding white cards must apply for a green card, which shows proof of employment during the interim. In Greece, of the 373,000 who were granted white cards in 2001, only 220,000 applied for permanent work permits "green cards" even though they had a year to apply. This resulted in a return to unauthorized status for many that had succeeded in obtaining the white card (Reyneri, 2001).

In the center of the circular model (figure 03 Appendix 1) informal entrepreneurship and the consequent shadow economy undermines government revenue and becomes a hidden source of government deficit and public debts. Bigger shadow economies reduce the quality and quantity of publicly provided goods and services. Poor quality public goods discourage even more entrepreneurs from paying taxes and business-related fees, which in turn, further decreases government revenues and service levels encouraging informality and corruption. Informal entrepreneurs bribe government officials to obtain services or escape costly punishment for their illegality. Corruption pads the pockets of officials, robs the government of much-needed revenue for essential services and raises the price of goods and services. As a result, the quality of public goods declines as does formal entrepreneurs' productivity levels, unleashing a vicious circle.

4. Conclusion and Implications

Today's literature argues that entrepreneurs are opportunity focused. The focus of much of the research on entrepreneurship is to understand how entrepreneurs think and therefore how they collect and process information that makes them different to every other person.

Schumpeter (1934) had a wider view of the entrepreneur. He considered there to be different levels of entrepreneurs. Furthermore, entrepreneurs do not operate in isolation; the social situation in which they find themselves will impact on their ability to create their vision or fulfill their entrepreneurial aspirations.

This research focuses on the forgotten aspect of Schumpeterian entrepreneurship - the impact of the social environment. It focuses on two particular countries, Italy and Greece. As both countries are in Southern Europe and both countries are experiencing economic problems, also they have and continue to experience a large influx of illegal immigrants. According to the index of economic freedom, and the ease of doing business, both Greece and Italy rate very poorly relative to their EU neighbors. The research here shows that the level of corruption and the level of government intervention in these two countries are the highest in the EU and therefore it can be seen that both government intervention and corruption affect the level of legal entrepreneurship. Our argument is that because of their cultural, political, and economic roots of shadow economy in these two countries, their economies have fallen into a vicious circle of informal entrepreneurial activities and enduring public debts.

But the self-sustaining shadow economy can bring us an alternative evaluation of the real economic situations in Greece and Italy. The formal economy is in debt, but the shadow economy prospers. It might imply that the Euro, as a currency might have a much less important role in the real economics of Greece and Italy than many policy makers believe. Greek and Italian governments might have more space to maneuver: quit the Euro zone, at

worst go back to barter system for a short period of time, but the economy will recover; adjust new policies and regulations to accommodate shadow economy to formal framework; make use of Euro rescue package as an opportunity to clean up the governance problem in administration and stop the vicious circle; learn from shadow entrepreneurship and adopt new policies to transform more illegal entrepreneurs to legitimate entrepreneurs.

Convoluting and expensive tax, social security systems, together with corruption and immigration policies all contribute to the informal entrepreneurs, and are the source of shadow economies. If shadow firms were legalized, they could make a significant contribution to the struggling economies of Southern Europe. But they have to be supported instead of being driven underground by the continuing increase in taxes, social security contributions and the increasing intensity of regulations (Katsios 2006). Furthermore, countries need to make it easier for immigrants to integrate and to remove ineffective control systems, which encourage immigrants to enter countries illegally. It's in the interest of the immigrants and the government. As legal aliens they gain access to benefits such as healthcare, retirement support, and they are less likely to be exploited by shadow firms. For the government they have an increase in revenue from taxes of legal employees and it has a negative impact on the shadow firms because it reduces the amount of paperless workers Baldwin-Edwards (1999).

Finally, amongst many problems another negative aspect of corruption is that it has a negative impact on a country's economy because corruption is a deterrent to foreign investment. *Many economists argue that malfunctioning government institutions constitute a severe obstacle to investment, entrepreneurship, and innovation. North [1990] emphasizes the importance of an efficient judicial system to enforce contracts as a crucial determinant of*

economic performance. Low security of property rights over physical capital, profits, and patents may reduce incentives and opportunities to invest, innovate, and obtain foreign technology. Cumbersome and dishonest bureaucracies may delay the distribution of permits and licenses, thereby slowing down the process by which technological advances become embodied in new equipment or new productive processes (Mauro 1995).

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Appendix Figure 03 The Vicious Circle of Shadow Economies

