



## Corruption and Economic Development

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**Abstract :** This paper is an attempt to analyze the impact of corruption on economic development of a country. The paper assesses whether corruption greases or sands the wheels of development. After discussing both the positive and negative impact of corruption on economic development of a country, the relationship between corruption and poverty is discussed by highlighting the channels through which corruption negatively impacts development and deepens poverty. At the end a number of measures and proposals, based on insights from economic literature, have been suggested especially for a developing economy like India to tackle corruption.

**Keywords:-**Corruption, Economic Development, Poverty, Measures.

### 1. Introduction

• Corruption is a global Phenomenon found in all countries. As per United Nations Convention Against Corruption, "Corruption is no longer a local matter but a transnational phenomenon that affects all societies and economies" Kautiliya in his Arthashastra said, "Just as it is impossible not to taste the honey(or the poison )that finds itself on the tip of the tongue, so it is impossible for a government servant not to eat up, at least a bit of king's revenue". Therefore, corruption is not a new thing .It has always existed.

### What does corruption mean?

As per the World Bank "corruption is the misuse of public office for private gain. 'It is an act in which the power of public office is used for personal gain in a manner that contradicts the laws of the state.

D.H Bailey has explained it as "misuse of authority as a result of consideration of

personal gain which need not be monetary."

According to Toke S.Aidt,"Three conditions are necessary for corruption to take place and arise as implied by its definition. First, the public official should possess some discretionary power. Second, the discretionary power must allow extraction of existing rents and creation of rents that can be extracted. Third, political, economic and legal institutions are weak which give an official an incentive to exploit his discretionary power."

### 2. Economic development and "Grease The Wheels Hypothesis"

Common people generally view corruption as an obstacle to development and growth. But some development economists during 1960s and 1970s argued that corruption may be good for economic growth, especially for the developing economies. According to them, it is because of laws, procedures and regulations which are opaque, lengthy and cumbersome in the developing countries. Therefore, in order



to bypass such time consuming regulations, which may not be required at all, corruption works as a lubricant. The most popular justification of the beneficial effects of corruption rests on the so called "Grease the wheels Hypothesis" put forward by Leff(1964), Huntington(1968), and Leys(1965). The ill functioning of bureaucracy is considered as the most prominent inefficiency that corruption could grease. According to "Grease the Wheels Hypothesis" corruption may be beneficial to developing economies because of the distortions caused by ill-functioning institutions. These economists argued that corruption could work as a screening device between an efficient and an inefficient firm as an efficient firm is one that is good at getting the job done even if it is accomplished through corruption. Professor Nathaniel H. Leff argued that corruption is an extra legal institution used by individuals and groups to gain influence over the actions of bureaucracy. Leff wrote, "As such, the existence of corruption per se indicates only that these groups only participate in the decision making process to a greater extent than would otherwise be the case. Corruption refers to the extra-legal influence on policy formulation and implementation. Since bribes are in nature of tax levied on economic activity, these payments have not been legitimized by the correct political process, they are appropriated by the bureaucrat rather than the state, and they involve subversion of government's economic policies-hence the stigma that attaches to them. The question for us to decide is whether the net effects caused by such payments and policy redirections are likely to favor or hinder economic development. He also argued that corruption reduces uncertainty and

increases investment. Leff asserts that corruption may constitute a hedge against other risks originating from the political system, such as expropriation or violence. Corruption will help mitigate these risks and will make investment less risky.

Some authors praise corruption for its role in allowing economic agents to escape the consequences of some policies. Leff and Bailey argue that corruption works as a hedge against bad public policies. This is particularly true if institutions are biased against entrepreneurship. Corruption may also result in an alteration of the policy in a way that is friendlier to growth. According to Huntington, 'In terms of economic growth, the only thing worse than a society with a rigid, overcentralised, dishonest bureaucracy is one with a rigid, overcentralised, honest bureaucracy. There are various aspects of ill-functioning of bureaucracy that can be compensated by corruption. First one is slowness. Corruption could efficiently reduce the time spent in queues. The reason is that bribes could give bureaucrats an incentive to speed up the process. Furthermore, Huntington argued that corruption could overcome tedious bureaucratic regulations and foster growth. Another consequence of an ill-functioning bureaucracy is the inefficient civil servants. Leys and Bailey argued that corruption can improve bureaucracy by improving the quality of civil servants. If wages in government service are insufficient, the existence of perks may constitute a complement that may attract able civil servants who have otherwise opted for another line of business. Some studies have lent empirical support to the "Grease the Wheels Hypothesis." Peter Eggar, based on data



set of 73 developed and developing countries, suggest that corruption encourages foreign direct investment(FDI). This view supports the position of Leff who also argued that corruption can be beneficial in circumventing regulatory and administrative restrictions. However, the argument that corruption has a positive impact on economic development of a country fell out of favor especially after 1990s, due to mounting empirical research that suggested otherwise. Although bribery may have benefits in a weak institutional environment, it may as well impose additional costs in the same circumstances. The existence of such costs provides a rationale for the "Sand the Wheels Hypothesis."

### **3. Economic development and "Sand the Wheels Hypothesis"**

In a broader sense, corruption must be considered as an obstacle to development. The positive impact of corruption on slowness rests on the assumption that a civil servant can speed up an exogenously slow process. However, according to Gunnar Myrdal, corrupt civil servants may cause delays that would not appear otherwise, just to get the opportunity to extract a bribe. Moreover, the ability of civil servants to speed up the process can be very limited when the administration is made of a succession decision centers. In this case, civil servants at each stage can have some form of veto power or some capacity to slow down a project. Using industrial organization models, Shleifer and Vishny showed that the cost of corruption can be higher when, say to get an authorization for a project, many independent agents are involved than when only one is. Burdhan reports that an Indian official once declared that he

could not be sure to be able to move a file faster but could immediately stop it. Under these circumstances one distortion adds up to the others instead of compensating them, which is precisely the meaning of "Sand the Wheels Hypothesis."

Corruption at the microeconomic level cannot be taken as evidence that corruption can be efficiency-enhancing at the macroeconomic level. How does corruption sand the wheels of corruption? Literature has discussed number of channels through which the negative impact of corruption is transmitted to development. James Wolfenson, ex-president of the world Bank in his address in 1996, known as 'cancer of corruption' address, spelled out how corruption impacts development. He said, "corruption diverts resources from the poor to the rich, increases the costs of running businesses, distorts public expenditure and deters foreign investors. It is a major barrier to sound and equitable development."

Public expenditure is a key instrument of development, especially human resource development. Corruption alters public distribution among sectors and also distorts technology choices. Corruption also impacts employment negatively in the developing countries. Most of the developing countries have abundance of labor. But corruption distorts technology choices. Developing countries import capital intensive technology because of the potential opportunities of corruption attached with such imports. Therefore, corruption decreases employment opportunities available in the developing economies.

Corruption misallocates resources and talent. Empirical studies suggest that



corruption is associated with high military spending both as a share of GDP and total Government spending. Sanjeev Gupta, based on data of about 120 countries for the period 1985-1998, have confirmed association between corruption and high military spending. Moreover, military spending is a unproductive expenditure and has no direct impact on economic growth and development of a country. Corruption misallocates talent in society. People being rational human beings, join the fields of employment possessing maximum potential for rent seeking. Public sector employment in India is a pertinent example of misallocation of talent. A majority of candidates appearing in civil service exams come from medical and engineering backgrounds. Although other factors such as security of service tenure and passion for public service should not be ruled out as motivating factor, yet the fact remains that rent seeking by grabbing more power remains one of the core reasons for joining the public sector in India. Empirical evidence suggests a negative relationship between corruption and expenditure on education and health. This negative relationship is because Government finds it easier to collect bribes on some expenditure items than others. Empirical studies also suggest that corruption reduces spending on goods like medicines and textbooks. The empirical findings further suggest that child mortality rates in countries with high corruption are about one-third higher than countries with low corruption. Infant mortality rates and low birth weight babies are almost twice as high and dropout rates in schools are five times higher compared to less corrupt countries. Thus there exists a deep nexus between corruption and composition of public expenditure.

Corruption appears to distort the structure of public expenditure in favor of defence, fuel and energy, culture, public service and order, at the expense of social sectors such as education, health and social protection. Corruption hampers ability of the state to raise taxes encourage informal sector. Due to corruption in the tax machinery and complex procedures of tax collection upon which corruption thrives, businesses avoid getting registered for tax purposes.

#### **4. Corruption-Poverty Nexus**

Corruption and poverty rise and fall together. There are number of channels through which corruption aggravates poverty. First of all, corruption negatively impacts economic growth. Dampening of economic growth means that income will not be sufficient to feed the increasing population. Empirical literature on China shows that poverty reduction was mainly possible due to sustained growth rates. Corruption also impacts economic growth by increasing income inequalities. It is an empirically well-established fact that the impact of corruption is not uniform on the individuals as well as businesses. The impact is disproportionately severe on poor and marginalized sections of society. Ultimately it is the poor who bear the brunt of corruption-whether it is committed by low-grade public functionary or a big business tycoon. Corruption also breeds corruption through perpetuating distortions in the tax system. In a country where corruption is high, tax evasion is also high. As a result, Government gets less revenue than expected, low revenue means that the state will not have sufficient money to invest for development of its people, and increasing



income inequalities have negative implications for economic growth.

Corruption also affects targeting of social programs. If corruption is pervasive, leakages in such programs will be high. It is an open secret now that the major chunk of funds allocated for development of infrastructure like roads, schools and hospital buildings is eaten into by corruption as commissions and kickbacks by engineers, construction companies. As a result, quality of the infrastructure is low and deterioration creeps within no time of their completion.

### **5. Measures to control corruption**

1. Effective law enforcement is essential to ensure the corrupt are punished and break the cycle of impunity or freedom from punishment or loss.
2. Reform public administration and improve finance management.
3. Promote transparency and access to information.
4. Close international loopholes so that corrupt public officials throughout the world would not be able to launder and hide the proceeds of looted state assets.
5. Empower citizens by strengthening citizen's demand for anti-corruption and empowering them to hold Government accountable.
6. Tax system should be reasonable and transparent, backed by clean and clear enforcement.
7. Minimize discretionary powers of ministers and bureaucrats.

### **6. Conclusion**

Corruption is a cancer which every citizen of a country must strive to obliterate. Eliminating corruption when

it is rule rather than an exception in society is not an easy task. There are many ways to control corruption but as long as corruption fails to attract legal, moral and social censures, there is no hope of eliminating or even reducing it. Also the leadership at the top must be honest and dedicated who have unflinching commitment to the cause of eradicating corruption. Corruption must be eliminated or considerably reduced so that a country can grow and develop in a smooth manner.

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