IMPEDIMENTS TO ECONOMIC DEVELOPMENT OF CONTEMPORARY ECONOMIES

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Abstract

Economic development in the 21 century differs in many aspects from the development we have aimed at in previous periods. This paper discusses the current challenges faced by modern economies. It highlights the main problems and impediments to growth and explains why economic development cannot be achieved or is at unsatisfactory levels both in developed and developing economies. Some examples are provided to illustrate the main points.

Keywords: *impediments, economic development, economic growth, developing economies*

1. INTRODUCTION

Ever since the late 80s humanity has gone through a major shift in its understanding of what factors matter for sustainable economic growth and development. The role of such factors as education, healthcare, institutions, property rights, and technology is becoming more and more debatable with regard to their contribution to the advancement of modern societies.

This paper deals with the major concerns which economies nowadays are facing amids constantly changing political contexts and climate changes. It examines corruption, state bureaucracy, low infrastructure and population growth as key impediments to the process of economic development. Furthermore, the paper discusses the major issues which undermine economic development and impede economic growth in modern-day economies. Even tough as factors they are more attributable to developing economies, their overreaching effect is affecting developed economies as well and creates general burdens to the global economic development.

In the late 80s and early 90s there was a shift in thinking within the development community and at the international financial institutions about the role of corruption in the development process. The most outstanding one is the fall of the Berlin Wall and the associated collapse of central planning as a supposedly viable alternative to free market capitalism. Obviously it was not inappropriate monetary policies that led to the collapse of central planning but rather widespread institutional failings, including authoritarianism and corruption. Also, another major event was the collapse of central planning in the late 1980s and the need for the international community to assist countries from Central and Eastern Europe for a successful transition to democratic forms of governance and economies based on market principles. It was a challenging time for those economies, struggling to make vital reforms while at the same time preparing to enter the new millennium and to compete with western economies that were making major technological advancement. The challenge still continues and factors outside the conventional macroeconomic indicators like inflation and unemployment are playing a significant role in determining the development of certain regions in Europe and elsewhere.

Another factor, which had the same effect in the beginning of the century, was the growing frustration with the increasing population both in Asia and Africa and the rising levels of poverty. This, by itself gradually led to increasing waves of immigrants from Africa and other parts of the developing world, who made their way to Europe in search of better conditions for working and living. Some advancement in the global fight against poverty was achieved but that was largely in China, while Africa actually experienced further increases in the number of poor – as absolute numbers and also as a proportion of the population. The immigration from the African continent to Europe has been named generally “environmental immigrants”.

2. GENERAL IMPEDIMENTS TO ECONOMIC GROWTH

2.1. Corruption

At the macro level, the literature generally shows that corruption has a negative, direct impact on economic growth and development [1]. Corruption also has an indirect effect on a country's economic performance by affecting many factors leading to economic growth such as investment, taxation, and effectiveness of public expenditure. There are a number of channels through which corruption may affect economic growth:

- Corruption distorts incentives and market forces, leading to misallocation of resources.
- Corruption diverts talent and resources, including human resources, towards "lucrative" rent-seeking activities, such as defence, rather than productive activities.
- Corruption acts as an inefficient tax on business, ultimately raising production costs and reducing the profitability of investments.
- Corruption may also decrease the productivity of investments by reducing the quality of resources - for example, by undermining the quality and quantity of health and education services, corruption decreases a country's human capital.
- Rent-seeking behaviour is also likely to create inefficiencies, fuelling waste of resources and undermining the efficiency of public expenditure.

Corruption also has indirect effects through investments, human capital and public expenditure. While the direct and indirect effects of corruption on growth hold true for all countries, they can be mitigated by contextual factors such as the level of development and the overall quality of governance. The effect of corruption is expected to be more detrimental for countries with higher levels of per capita income and institutional quality.

In addition, corruption is known to distort the decision-making process associated with public investment and it affects the composition of government expenditure. This is because it may lead public officials to allocate public resources less on the basis of public welfare than on the opportunity they provide for extorting bribes, such as large infrastructure or defence projects. It generally lowers capital productivity and constitutes an important element of investors' decision-making processes, while also increasing the costs of investment. This is due to the fact that corruption not only appears to increase costs and reduce levels of FDI, but it also affects the economies of those countries where FDI originated.

When it takes the form of tax evasion, corruption may lead to a significant loss in tax revenue collected in a country, which causes adverse budgetary consequences. Countries with high levels of corruption tend to collect less tax revenues, suggesting that only relatively incorrupt governments can sustain high tax rates. Corruption not only lowers the tax to GDP ratio, but it also causes long-term damage to the economies by increasing the size of the shadow economy, distorting the tax structure and corroding the tax morality of taxpayers. This is likely to further reduce the tax revenue base of a country ([2], [3]).

At the company level, corruption raises costs, introduces uncertainties, reputational risks and vulnerability to extortion. It decreases a company's valuations, makes access to capital more expensive and undermines fair competition. Also corruption may have a negative, indirect impact on companies through its effects on many factors affecting firms' growth and productivity such as investment patterns, efficiency, and innovation.

Another effect of corruption is that it reduces the resources available for other uses, including the financing of social spending, which primarily affects the poor. Corruption in social programmes may reduce the potential impact of social welfare programmes on poverty alleviation. A study examining the extent of corruption in a large Indonesian transfer programme distributing subsidized rice to poor households found that an average of 18 percent of the rice disappeared between the time it left government warehouses and the time it reached poor households [4].

The definition of corruption for many development economists is generally the "abuse of public office for private gains." Some economists like Andrei Shleifer and Robert Vishny (1993) [5] defined government corruption as "the sale by government officials of government property for personal gain." Also according to Nathaniel Leff "corruption is an extra-legal institution used by individuals or groups to gain influence over the actions of the bureaucracy" [6]. Joseph Nye (1967) claimed that corruption is "behaviour which deviates from the formal duties of a public role because of private-regarding (personal, close family, private clique) pecuniary or status gains" [7], and includes bribery, nepotism and misappropriation, while 30 years later Bardhan (1997) clarifies that in most instances "corruption ordinarily refers to the use of public office for private gains, where an official (the agent) entrusted with carrying out a task by the public (the principal) engages in some sort of malfeasance for private enrichment which is difficult to monitor for the principal" [8].

Furthermore, Banfield (1975) establishes an interesting distinction between personal corruption, in which the agent "sacrifices his principal's interest to his own, that is, he betrays his trust" and official corruption in which the agent violates a law and "acts illegally or unethically albeit in his principal's interest"[9]. Klitgaard (1988) draws on the principal/agent formulation to say that corrupt behavior occurs when "the agent is betraying her role as a public servant for her own private interests" [10]. In more recent studies, the principal/agent formulation has been developed by Banerjee, Mullainathan and Hanna (2012) as a new theoretical framework for analysing corruption [11]. In their model, corruption is a consequence of the interaction between the task being performed by the bureaucrat, his/her private incentives and what the principal can observe and control. In his research Kaufmann (2005) makes a strong case for a broader definition of corruption, not necessarily restricted to an exclusive concern with illegal acts involving the public sector [12]. His idea is that corruption generally involves collusion between two or more parties, at least one of which operates in the private sector, as when a transnational company pays bribes to the president of an African country to obtain an oil concession.

Furthermore, according to Claros (2013) some forms of corruption may be legal in some countries, such as when certain mechanisms of political party funding are artfully used to exert critical influence in the shaping of policies and institutions in ways that provide benefits to the contributing private parties at the expense of the broader public welfare, a process akin to the "privatization of public policy" [13]. Such instances of undue influence may not involve the payment of bribes but are conceptually indistinguishable from more conventional forms of corruption involving the abuse of public power for private benefit. The public sector bias in the conventional definitions of corruption may reflect the sense that corruption is more damaging in the context of developing countries, where the claims on scarce resources are more pressing. These countries will often have high levels of poverty and many unmet social needs, including weak institutions. An interesting example can be found in an empirical study by Bhattacharyya and Hodler (2012) which shows that higher rents from natural resources lead to a higher level of corruption, but only if the quality of the democratic institutions is relatively poor [14].

Another point argued by Tanzi (1998) is that the tax system itself is often a source of corruption, particularly in those cases where the underlying legislation is unclear or otherwise difficult to understand [15]. Unclear tax laws will give rise to "compromises" between tax inspectors and taxpayers. There are various ways in which various features of government organization and policy create incentives for the emergence of corrupt behavior. An important point is that ***the imposing presence of the government in the economy and, in particular, the provision of goods and services at below market prices create fertile ground for corruption***. This is because they give rise to the creation of some form of rationing mechanism to manage excess demand, requiring the exercise of discretion on the part of some government official(s). Claros (2013) argues that the Russian government in 1992 operated under a system of export quotas, for which licenses were needed. Since the difference between the export price and the domestic price was often enormous (a ratio of 50 to 1 was not at all unusual), securing an export license was a key to vast riches and, indeed, fortunes were made during this period, sometimes by government officials themselves who found the system just too tempting to scrap [13]. The IMF pressed hard for the elimination of these quotas and the meetings where the case was raised were often hostile. It was obvious that powerful vested interests would hold out as long as possible and, indeed, it took two years to begin to remove them. Another legacy of the Soviet Union was a system of directed credits, essentially highly subsidized loans to agriculture and industry. At rates of interest that were absurdly

negative in real terms, the demand for them was unusually strong and, of course, the criteria for allocation opaque in the extreme.

Another example, provided by Claros (2013) is Spain in the late 1980s, when the Spanish government was engaged in a program of ambitious economic reforms as part of which they were trying to improve the administration of various social benefits [13]. One issue of particular concern to the authorities was the unusually high number of individuals who were being granted invalidity pensions, made possible by false certifications being provided from doctors who were either being bribed or were doing friends favors. Thus, an unusually large number of disability pensions were putting a heavy financial burden on the pension funds and were also unfair to those who opted for honest behavior. While it is easy to see the incentives for bribes provided by such examples, the resulting losses in economic efficiency are evident.

2.2. State bureaucracy

An important source of corruption stems from the distributional attributes of the state. The role of the state in the economy has expanded significantly over the last century and this has led to the proliferation of benefits under its control, as well as in the various ways in which the state imposes costs on civil society and the business community. A large state is not necessarily associated with higher levels of corruption – e.g. the Nordic countries have the highest levels of public spending in the world but are also the least corrupt. The larger the number of interactions between officials and private citizens, the larger the number of opportunities in which the latter may wish to illegally pay for benefits to which they are not entitled.

Fan, Lin and Treisman (2012) observe data from 80 countries which provides evidence that firms are more likely to report bribery in countries with more government tiers, or with a larger number of local government employees [16]. In such countries the state is involved in the distribution of social benefits in ways that are not transparent which may involve corruption. Governing often translates into the issuing of licenses and permits and hence the average citizen has to enter into transactions with some government office or bureaucrat to engage in one of the following: to obtain a birth certificate, to get a passport, to pay taxes, to open up a new business, to drive a car, to register property, to engage in foreign trade, to sell a good or service to the government, to hire an employee, to use the publicly provided health services, to be allowed to build a house, etc.

The World Bank's Doing Business Report (DBR) covered a summary of the burdens of business regulation in 183 countries. It becomes clear, for example, that it takes 18 procedures in Equatorial Guinea to start a new business and an average of 135 days to fulfill them. Also, it takes 1,442 days to enforce a contract in Bangladesh and 1,300 in Greece. In Argentina it takes 24 procedures to get a construction permit and 365 days to actually receive it. The data in the report highlights the extent to which many countries discourage the development of entrepreneurship in their own private sectors. The countries with the greatest need for entrepreneurship and private sector development are those that generally create the greatest obstacles for the creation of new enterprises and entrepreneurial capacities which are vital for the development of an appropriate environment for innovations.

Furthermore, some bribes are offered as incentive payments for bureaucrats and can take a variety of forms, such as "speed money," typically used to "facilitate" some transaction. This has given reason to some economists to argue that such incentives could improve efficiency since they are provided to work more quickly and those who value their time highly can move faster. Yet over time, incentives could work the other way - bureaucrats will deliberately slow things down or, worse, will find imaginary obstacles or themselves create new obstacles in order to attract facilitation fees. Eventually "speed money" is not paid to speed things up but rather to avoid delays artificially created by corrupt bureaucrats. Some of the regulations enforced in many parts of the world are so devoid of rationality that one can only infer that they were introduced to create opportunities for discretion and corruption. Instead of enhancing efficiency, paying bribes is a way to ease them, to preserve and strengthen the bribery machinery. Other bribes are aimed at lowering costs. The typical example is the payoff to a customs official so that goods can clear customs more rapidly, cheaply, or without intrusive inspections or, more generally, to a tax official to reduce tax liabilities.

Kaufmann (2005) shows that OECD firms operating in other OECD countries tend to behave more or less as they would in their home country. However, once they move to non-OECD countries, their behavior is much more similar to that of domestic firms, exhibiting a tendency for bribery and other illegal practices, particularly in the area of public procurement. Other types of bribes include bribes to obtain contracts for the sale of goods and services to the state, bribes to gain preferential access to public enterprises that might be in the process of privatization, as well as bribes to buy political influence and votes.

2.3. Low infrastructure

Inadequate infrastructure, including unreliable energy, an ineffective urban-rural road network, and inefficient ports, is considered one of the largest impediments to economic growth in Africa. It limits the returns from human capital investment such as education and health. Hospitals and schools cannot function properly without electricity [17]. According to 2009 World Bank study it was estimated that sub-Saharan Africa's infrastructure needs are about $93 billion a year. Also according to IMF estimates the budget spending on infrastructure by sub-Saharan African countries reached about $51.4 billion, meaning a financing gap of about $41.6 billion [18].

Furthermore Sy (2016) observes that except for Nigeria and South Africa, sub-Saharan African countries have been unable to attract significant private investment outside the telecommunications sector [17]. In 2013, sub-Saharan Africa received about $17 billion in private funds, of which all but $2 billion went to South Africa and Nigeria in sectors other than telecommunications. Overall, private investment (which includes public-private partnerships) went mostly to information and communications technology and electricity from 2005 to 2012. Hence, a *policy agenda for building and maintaining infrastructure in sub-Saharan Africa under these circumstances should have at least three priorities:*

- First, domestic budget spending—the largest source of African infrastructure financing—should be increased.
- Second, sources of domestic revenue should be broadened.
- Third, funds must be spent efficiently.

The above priorities can be widely applied to other developing countries or, in general, countries experiencing economic and financial difficulties. It is evident that most of the debate on infrastructure needs in sub-Saharan Africa focuses on financing issues. *However, there is also evidence that efficiency, not financing, is often the barrier to investment.* According to IMF estimates [19] about 40 percent of the potential value of public investment in low-income countries is lost to inefficiencies in the investment process due to time delays, cost overruns, and inadequate maintenance. It is pointed out that such inefficiencies are often the result of various factors, including undertrained officials, inadequate processes for assessing needs and preparing for and evaluating bids, as well as corruption. Hence, reducing inefficiencies could substantially increase the economic dividends from public investment.

2.4. Growing population

The first and foremost economic explanation of underdevelopment or the existence of mass unemployment and poverty of today's developing countries is the serious imbalance between population and productive resources, especially the stock capital. This imbalance between resources and population has manifested itself not only in low per capita income and poverty, but also in the existence of huge unemployment and disguised unemployment in the underdeveloped countries. The present capital (including land) is quite insufficient to employ the entire working age population and at a reasonable level of real per capita income.

For several decades in the past the rate of investment and therefore the growth of the capital stock has not been following the rate of growth of population in underdeveloped countries like India, Bangladesh, Yemen, etc. This implies that opportunities for productive employment have not been increasing commensurate with the growth of population and labour force and this has resulted in mass poverty and unemployment.

The lack of real capital per head of population is a characteristic feature of the developing economies and they are often called "capital-poor economies". Low productivity of the population and therefore their low income in the developing countries is considered to be due to the small amount of capital per head of population. Hence the most important economic explanation for underdevelopment and poverty is the imbalance between capital and population. Capital is too small in relation to the huge amount of population in developing economies.

Not only was the existing stock of capital very small, but the rate of capital formation in the 1950s, when most of the developing countries started the process of development, was also very low. The rate of investment in most underdeveloped countries at that time was only 5% to 8% of the national income. In the United States, Canada and Western European countries, however, it was generally valid from 15% to 30% of the national income.

One of the reasons why poor underdeveloped countries have failed to grow economically is that they are trapped in vicious circles of poverty. These vicious circles of poverty operate both on the supply and demand sides of capital formation. Supply side of capital formation refers to saving required to accelerate capital formation to raise productivity and per capita income. Investment being low leads to a lack of capital per head and because there is small amount of capital per head the productivity of the people or real income per head will also be low. Thus, the vicious circle is complete. (Fig.1)

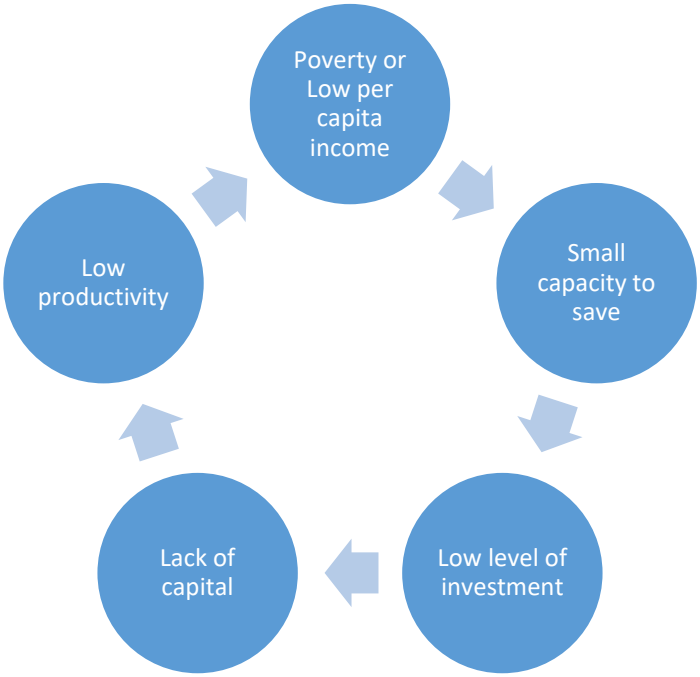


Fig. 1. Vicious circle of poverty on the supply side of capital formation.

When the average productivity of a community is low, it will have the greatest difficulty in producing enough consumption goods to satisfy the basic human needs. Thus it will have little productive power to spare for the production of investment goods and countries which are in this position are involved in a vicious circle. Thus, a larger supply of capital equipment would enable them to escape from the toils of over-population but unfortunately they are already too deeply caught in those toils to be able to produce that equipment for themselves. Therefore they cannot escape without assistance from outside. Apart from the low level of per capita income, the low relative level of real income in developing countries as compared with the developed countries also makes their capacity to save very low. The great and growing inequalities between the income levels and the living standards of different countries, combined with increasing awareness of these inequalities, have pushed up the general propensity to consume of the underdeveloped countries and have reduced their capacity to save.

In order to break the vicious circle of poverty and restore economic growth, it is important that in developing countries the rate of saving and investment can be increased without the reduction in consumption. It is well-known that the rate of saving in underdeveloped countries is low and with a given rate of saving and investment some rate of economic growth can be achieved. If out of this incrementing-income proportionately greater part is saved, the rate of saving of the economy will rise and this will eventually contribute to economic growth.

3. CONCLUSIONS

This paper analyzed the major concerns which economies nowadays are facing. It highlighted four major impediments to economic growth and development, i.e.: corruption, state bureaucracy, low infrastructure and population growth. Furthermore, the paper focused on the major issues which undermine economic development and impede economic growth in modern-day economies. It stated clearly that such impediments are detrimental both to developed and developing economies and affected both in many cases. Even tough as factors they are more attributable to developing economies, their effect is impacting developed economies indirectly and may significantly affect global economic development.

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