Greasing the Machine, Inverted:
Corruption as an Intermediary of Informal Governance in Developing Economies

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Introduction

Corruption, defined as the abuse of public power for private gain, has often been cited as one of the most prominent issue worldwide and especially in transitional economies.

Studies have convincingly demonstrated that rapid economic progress in developing economies often coincide with rise in the level of corruption. In this context, some literature have characterized corruption as a "lubricant" that speeds up processes and bypasses red tape in inefficient bureaucracies. Depending on how one characterizes the nature of corruption, one could interpret its consequences– and thus the appropriate mitigation strategy– very differently.

This specific project survey the literatures on developing economies– particularly those with limited oversight via formal institutions or accountability mechanisms due to material or historical reasons– as case studies. It attempts to demonstrate that the structural functions corruption performs must be understood in the context.

Key findings

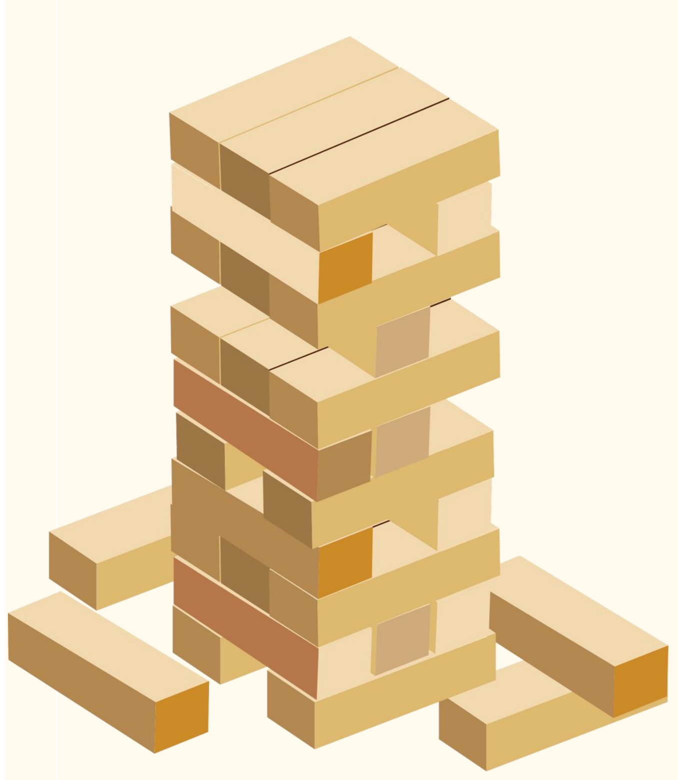
Corruption under specific, constrained conditions acts as one of the intermediaries —in some cases, a necessary one—that permits informal institutions to function when formal institutions are politically and materially blocked due to ambiguity. As such, "it may be said that the economy took off because of—rather than despite—corruption" has substantive validity when deployed in a certain developmental context.

This does not mean that corruption is moralistically "good". Rather, it emphasize that informal governance is temporary and entails significant developmental and social externality costs, meaning that states must, eventually develop formal institutions as the correct remedy and the path forward for developing economies

Traditional Framework

"Good governance → Development"

Question: Then, what come before good governance?



Jenga Analogy:

May we treat institutions like a Jenga tower, where a specific kind of corruption is a "hanging" block that contributes to future fragility, and removal without replacement could risk a collapse?

Popular Model I: Grease

Political institutions are weak with inefficient red tapes → Corruption fill out the gap by "greasing" the machine → Corruption speed up development by cutting red tapes

Popular Model II: Sand

Officials enforce new requirement or refusing services to solicit bribery → Corruption become sands that "clog" the machine → Corruption hurt development by economic inefficiency

"Why Nations Fails" Explanation

Claim	**Corruption is a symptom, not a cause. Countries stay poor because they lack inclusive institutions (unbiased law, level playing field, open entry, secure property rights, etc). Growth without them are temporary**
Mechanism	• Extractive economic institutions transfer wealth from the many to the few, while extractive political institutions let that elite exercise power without accountability from the general. • Extractive elites have a self-interested stake in some prosperity — they need a pond with fish in it — so they supply "a degree of law and order and a system of rules"– but this is an unsustainable practice that promotes growth on the surface while being damaging in the long run.
Prediction	• Growth is unsustainable without a "fundamental political transformation toward inclusive political institutions" — which is unlikely until "by chance" via "critical junctures".
Limitation	• Validity depends on whether inclusive-institution gains outweighed corruption's deadweight loss. In some cases, where "inclusive" criteria (unbiased legal system, level playing field, contract enforcement) simply did not exist. By WNF's own criteria, some countries should have failed already • Therefore, the question is not why they exist, but why they survive. Could informal institutions exist forever given that the extractive institutions are careful enough? If so, why formalization?

Revisionist Explanation

Claim	**Corruption is a second-best substitute" that performs functions in the absence of formal institution. Developmental effect is neither inherently extractive nor inherently productive but depends on the institution it inhibited in**
Mechanism	• Corruption can lower transaction costs where state–business relations are mutually dependent. Office had no incentive to sanction companies, vice versa. By contrast "too many or too few actors" breeds uncertainty and unproductive corruption. • Corruption could substitute trust, reputation, reciprocity and repeated interaction, converting bribery into a performance where both external (detection) and internal (opportunism) risks are managed • In a "gray" market where the state can block any transaction and property rights are "ambiguously specified and poorly protected," corruption allows firm to buy a protective shield against other state actors, where officials reciprocate because "their promotional rank is directly related to the good performance of the local economy"
Prediction	• Corruption only cease when it becomes too expensive, at which point a clean formal model is preferred , which a cost–benefit threshold, not a moralistic one
Limitation	• Explains individual rationality, not macroeconomic development. Even if corrupt exchange is sustained, there is no reason why actors choose these specific arrangements and how these uniquely serve a developmental function. The open question is how isolated, informal, illegal transactions scale up into systemic, society-level growth rather than the enrichment of a few actors. Most importantly, it fails to lay out the next step.

New Framework

The state "harness weak institutions to build markets " (steroid)

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"emerging markets stimulate strong institutions "

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"strong institutions preserve markets."

Further Study

Hypothesis: Under conditions where:

(1) political and economic constraints prevent the establishment of formal institutions
(2) the state nevertheless faces strong incentives to pursue economic growth
(3) due to (1), the state is unable to supply the institutions necessary for (2)
(4) institutional ambiguity exists between planned and market systems,
(5) due to (1)-(4), institutional ambiguity were exploited to serve the function for (2) via access money corruption

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