

**Some Aspects of Corruption and Crime in India:
A Macro-Theoretic Study**

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Synopsis

1. Introduction

In this thesis, we have examined some of the implications of corruption and crime in India in macro-theoretic frameworks that we hope capture all the relevant salient features of India. The thesis consists of three core chapters: Chapters 2, 3 and 4. In Chapter 2, we have examined the implications of tax evasion on growth, inflation as well as on the well-beings of the rich and the poor. Chapter 3 focuses on the short-run implications of bank frauds, which are rising at an alarming rate in India at the present. Finally, Chapter 4 looks into the origin and impact of organized crime in India. In what follows, we will briefly present and explain the major results of the thesis.

2. Chapter 2: Corruption and Growth in a Country like India

The objective of this chapter is to examine how corruption manifested in the form of tax evasion affects growth and inflation in India. It also explores its implications for the economic well-beings of the rich and the poor. In this endeavour, to put our study in the sharpest possible relief, we have first abstracted from foreign trade. We have, then, extended our analysis to the case of an open economy. The model that we have developed first belongs to the tradition set by Keynes (1936) and Kalecki (1954). In this model, aggregate output or real GDP is determined by aggregate planned demand for produced goods and services and prices are set on the basis of the average variable cost of production. In the specification of the aggregate demand function, we have incorporated the relevant salient features of the Indian economy. We summarize and explain the major results of this chapter below.

2.1 The Effect of an Increase in the Rate of Tax Evasion on growth and Inflation

Following a given increase in the rate of tax evasion, the tax revenue falls at the initial equilibrium level of real GDP. This lowers government consumption (since the government adheres to a strict fiscal deficit target) and raises personal consumption demand. Since the marginal propensity to consume of the domestic households is less than unity, the former will be larger than the latter. The fall in government consumption expenditure leads to a deterioration in the services of government administration and infrastructure. This will produce two effects. First, the cost of production and, therefore, the price level will rise. Second, the investment demand will fall. There

will, thus, emerge a large excess supply at the initial equilibrium level of real GDP bringing about a cumulative fall in the real GDP through the operation of the multiplier process. The decline in the real GDP reduces government's tax revenue and, thereby, government's consumption expenditure. This, in turn, will bring about a cumulative increase in the price level.

Even though it is not explicitly stated in most of the text books, Keynesian theory or the model on Keynes-Kalecki line presented here seek to explain short period (annual or quarterly, for example) growth rate and inflation rate. Let us explain. The equations of the model represent an economy in a given short period of time. In the given period, the real GDP and the price level of the previous period are given and known. Hence, determination of the real GDP and the price level in the given period amounts to determination of the growth rate of the real GDP and the rate of inflation from the previous period to the given period. An increase in the rate of tax evasion in our model, therefore, lowers the growth rate of the real GDP and raises the rate of inflation from the previous period to the given period. This means that, other factors remaining the same, the higher the growth rate of the rate of tax evasion over time, the lower is the rate of growth of real GDP and the higher is the rate of inflation over time. The above discussion yields the following proposition:

Proposition 2.1: Following an exogenous increase in the rate of tax evasion, there takes place a cumulative contraction in real GDP and a cumulative increase in the price level. Therefore, other factors remaining the same, the growth rate of real GDP is a decreasing function and the rate of inflation is an increasing function of the rate of growth of the rate of tax evasion.

We have, then, extended the model to divide the economy into two sectors: the organized sector and the unorganized sector. The former consists of the government sector, the private corporate sector and the large unincorporated private enterprises, while the latter consists of the small producers. The people engaged in the production in the organized sector are divided into two classes: the rich and the low skilled workers. The former consists of the capitalists (who are just a few in numbers and control the private corporate sector), the capitalists' entourage of large businessmen running the large unincorporated private businesses and the high-skilled workers. The low skilled workers and the small producers constitute the class of the poor. The output of the organized sector is used for purposes of consumption by the rich and the government. It is also demanded for purposes of investment by the capitalists and their entourage of large businessmen. The small producers require it as intermediate input in their production.

The output of the unorganized sector is constrained by the amount of intermediate inputs the small producers are able to buy from the organized sector with the given amount of fund they have at their disposal. The small producers produce their output using only family labour. The output of the unorganized sector is consumed by the poor who spend their entire income on it.

An increase in the rate of tax evasion, as we explained earlier, lowers government's consumption expenditure raising the price of the output of the organized sector. This forces the small producers to buy less intermediate inputs. This lowers their output. This fall in output lowers tax revenue and, thereby, government consumption further. Thus, there will take place a cumulative decline in the output of the small producers impoverishing the poor immensely. It is highly likely that the capitalists will utilize the resources released from the production of the small producers to raise their consumption and investment. This yields the following proposition:

Proposition 2.2: An increase in the rate of tax evasion will lead to a cumulative fall in the output of the unorganized sector leading to substantial impoverishment of the poor. There are also strong reasons to believe that the capitalists will raise their consumption and investment so that the resources released from the production of the output of the unorganized sector gets utilized for their own benefit.

This chapter shows that the above result will hold even if we incorporate foreign trade.

3. Chapter 3: Economics of Bank Frauds in India

Chapter 3 examines in macro-theoretic frameworks that, we hope, capture all the relevant salient features of India, the short run implications of bank frauds, which are principally confined to the public sector banks (PSBs), in India. We summarize here the main results of the chapter and briefly explain them.

We assume that the demand for banks' new loans comes from the investors only. They finance their entire investment with new bank loans. Some of the investors are also bank frauds. We also pointed out that the large borrowers are principally responsible for bank frauds. They secure loans from the PSBs to make some specific investments. However, instead of making the stated investments, they use it illegally in the cases we consider here to purchase foreign physical or financial assets. The modus operandi of these fraud investors may be the following. The frauds give donations to highly placed government officials and overstate their planned investment. They use the loans secured to finance the overstated part of their investment to buy illegally, in the case we consider here, foreign assets. These loans are never repaid. The government officials receiving the donations make sure that the PSBs accept the excuses of the defaulters for not being able to repay the loans and write-off the loans.

We have developed a suitable model for our purpose on the lines of Keynes (1936) and Kalecki (1954) so that the real GDP is demand determined and the price level is an increasing function of the average variable cost of production. We have also modeled here the financial sector, which is assumed to consist of only the central bank, PSBs and private banks. We have assumed the private banks cater to the credit needs only of the capitalists, while the PSBs cater to the credit needs of both the capitalists and the small producers. However, since the capitalists give hefty donations, the PSBs fully meet the credit needs of the capitalists but ration the small producers. The larger

the stock of the non-performing assets of the PSBs, the less is the amount of loan they give to the small producers. On the other hand, the capitalists hold their saving as deposits with the private banks, while the workers hold their savings as deposits with the PSBs. However, with an increase in the stock of non-performing assets of the PSBs, the richer of the workers shift their savings from the PSBs to the private banks, while the poorer of the workers shift their savings from bank deposits to currency. We will use this model to examine how a donation induced increase in bank frauds in the PSBs will affect the PSBs, the private banks and the small producers.

We will first show that under the standard assumption made in the text book open economy macro models, a donation induced bank fraud and the consequent increase in the illegal outflow of capital will lead to an expansion in real GDP. Following the increase in the illegal outflow of capital, there will emerge a BOP deficit at the initial equilibrium level of real GDP and the exchange rate. The exchange rate will rise and increase the net export by the amount of the increase in the illegal outflow of capital. It will do so by raising the real exchange rate leaving the domestic economic agents' aggregate planned demand for produced goods and services unaffected. Therefore, at the initial equilibrium level of real GDP, there will emerge an excess demand for produced goods and services bringing about a cumulative increase in the real GDP through the multiplier process.

This yields the following proposition:

Proposition 3.1: If by giving donations to the government officials it becomes possible for the capitalists to divert illegally a part of the new PSB loans from the creation of the assets for which the loans are taken to the purchase of foreign assets, it will lead to an expansion of real GDP and employment in the short run.

However, if we incorporate into the model presented above the relevant salient features of India, the result noted above will get reversed.

Let us now explain what these features are. India's investment and production are highly import-intensive. Let us illustrate this point with the example of teaching economics in India. All the text books we use are foreign. All the journals we refer to are foreign. All the computers and software we use are foreign. This is true not only of economics but also of all other subjects. Therefore, to set up a college or university, all the required knowledge inputs and all the high-tech inputs have to be imported. This is the case not only with educational institutes but also with all modern production facilities. To set up a bank, for example, all the computers, software and all the high-tech machines have to be imported. This dependence on foreign knowledge and technology has also made India's production highly import intensive. To produce anything, India has to import quite a host of essential imported inputs such as petroleum and petroleum products, fertilizer, chemicals and components. Even though India is a price taker in the world market, its exchange rate varies a great deal. An increase in the exchange rate raises the average variable cost of

production and, thereby, the domestic price level substantially. An increase in the exchange rate also makes imported capital goods costlier. This, given expectations, lowers investment. Hence, the price level becomes an increasing function of the exchange rate and aggregate planned investment becomes a decreasing function of the exchange rate. The price level is also made a decreasing function of the real GDP, since an increase in real GDP raises tax revenue and, thereby, government's consumption expenditure. The increase in the government's consumption expenditure for reasons already explained in Chapter 2 lowers the average variable cost of production and, thereby, the price level. Since India uses only imported knowledge and technology, close substitutes of almost all the goods and services India produces are available everywhere else. Accordingly, it is reasonable to assume that India's net export is highly price elastic. However, its exchange rate elasticity is likely to be insignificant since an increase in the exchange rate raises the domestic price level substantially and, thereby, leaves the real exchange rate more or less unaffected. Accordingly, the real exchange rate becomes a decreasing function of the real GDP only. We have made the exchange rate a decreasing function of the real GDP and an increasing function of donations for the following reasons. An increase in the real GDP produces two opposite effects on net export. On the one hand, the fall in the price level that an increase in the real GDP induces leads to a large increase in net export. On the other hand, the increase in capitalists' and government's incomes raise their demand for imported consumption goods lowering net export. Given the likely very high price elasticity of net export, we consider it reasonable to assume that the expansionary impact on net export dominates the dampening effect and the exchange rate falls. An increase in donations raises illegal demand for foreign assets creating a BOP deficit. Hence, the exchange rate rises. This causes an increase in the price level.

Let us now explain what kind of impact a ceteris paribus given increase in donations will produce on the real GDP once we incorporate the above-mentioned salient features of India. As before, it will raise the incidence of PSB fraud and the ill-gotten money will create illegal demand for foreign assets creating a BOP deficit at the initial equilibrium levels of real GDP and the exchange rate. The exchange rate will, therefore, rise to raise net export by the amount of the increase in the illegal outflow of capital. However, it can do so only by lowering investment, as the real exchange rate is insensitive to the nominal exchange rate. Since the import intensity of investment is less than unity, the decline in investment is likely to be much larger than the increase in net export. Hence, at the initial equilibrium real GDP, there will emerge an excess supply. The increase in the exchange rate will raise the domestic price level bringing about a redistribution of income from the workers to the capitalists. This will lower aggregate planned consumption demand as well making the excess supply larger at the initial equilibrium real GDP. This will set into motion the multiplier process that will bring about a cumulative fall in real GDP. This yields the following proposition:

Proposition 3.2: Unlike what happens in the standard case, if the fraction of PSB loan illegally used to purchase foreign assets increases, in all likelihood there will take place a large and cumulative decline in domestic GDP in India bringing about a sharp fall in the growth rate from

the previous period to the given period. This will cause immense suffering to the workers and small and medium producers.

3.1 Bank Frauds, Tightening of Norms Defining Nonperforming Assets and PSBs

Nonperforming Assets (NPA) started rising at a fast rate in the PSBs since 2011-12 (see Tables 3.1 and 3.2 in Chapter 3). However, the RBI and the Government of India (GOI) through measures such as restructuring of loans etc. kept the NPAs hidden until 2015. In 2015, suddenly the RBI tightened norms for defining non-performing assets and forced the PSBs to disclose all their NPAs. As a result, the stock of NPAs in the PSBs jumped up substantially (see Table 3.1 in Chapter 3). The fear of the PSBs becoming insolvent began to haunt people. We have examined what impact the scenario just noted is likely to produce on the growth rate of real GDP, the scale of business and equity prices of the PSBs.

We assume here that the capitalists give donations to the government officials so that the RBI tightens norms for defining NPAs and steps up its supervision and monitoring of the PSBs. Hence, we make the stock of non-performing assets of the PSBs an increasing function of donations and a decreasing function of real GDP. Following an increase in donations and the consequent rise in the stock of non-performing assets, the PSBs become extremely cautious regarding lending to the small and medium producers. The workers also become worried about the solvency of the PSBs and, as a result, workers divert their savings from PSB deposits to currency. For both these reasons, at the initial equilibrium levels of real GDP and the exchange rate, the amount of loan given to the small and medium producers falls. Hence, their investment goes down. This sets into motion a multiplier process that brings about a large a cumulative fall in the level of real GDP. This yields the following proposition:

Proposition 3.3: If being bribed by the capitalists, the government officials through the RBI force the public sector banks to disclose all the non-performing assets which they were initially allowed to hide, there will take place a very large and cumulative contraction in GDP causing immense suffering to the workers and small and medium producers.

The State of the PSBs

Let us now focus on the PSBs. The increase in donations and the very large fall in the real GDP that it causes will lead to a sharp increase in the stock of non-performing assets. This will induce the workers to transfer their savings from the PSBs to the private banks and other assets. This will reduce PSBs' deposits, profit and equity prices drastically. This will give the government an excuse to sell off the PSBs at throwaway prices. The fall in the real GDP will hurt the private banks also. It will, however, be compensated to a large extent, if not fully or more than fully, by the transfer of deposits from the PSBs to the private banks. Even if the capitalists lose due to the fall

in the real GDP, their loss is only temporary because of the very large long-term gains that the acquisition of the PSBs will engender.

3.2 Conclusion

After carefully studying the available evidences, we argue in this chapter that the capitalists, who own and control India's corporate sector, devised a strategy to monopolize the banking sector, which is now dominated by the PSBs. They paid hefty donations to the highly placed government officials and borrowed heavily in times of booms (covering the period 2003-04 – 2010-11) from the PSBs to set up specific production units. However, they overstated substantially the values of the specific firms to be set up and, thereby, borrowed much more than what was needed to set up the targeted firms. They illegally diverted the excess PSB loans from the creation of the targeted firms to the purchase of other domestic and foreign assets. We have shown here that, if a part of the PSB loans instead of being used to build the targeted firm is used to purchase foreign assets, there will take place a large contraction in GDP drastically reducing India's growth rate. This will heap immense suffering on the workers and small and medium producers. We assume that the donations make this illegal diversion of PSB loans possible.

The capitalists ran the firms set up with PSB loans for some years. Then, when the recession set in since 2011-12, declared their firms, which were pledged as collateral to the PSBs, bankrupt giving the excuse of recession. The PSBs took over the bankrupt firms. However, by selling them, they could recover only a small part of their dues. They had to write off the rest of the dues. To produce a dramatic effect on the public, the capitalists gave donations to the government officials to make the RBI adopt the following strategy. It initially allowed the PSBs to hide a large part of their nonperforming assets (NPAs) and when the hidden NPAs assumed a substantial volume, tightened the norms for defining NPAs and forced the PSBs to suddenly declare their NPAs. As the NPAs of the PSBs increased steeply, the RBI adopted punitive measures against them and made such comments and observations that the people became very much apprehensive about losing their savings parked with the PSBs. Our analysis in this chapter shows that in such a scenario, there will be a cumulative contraction in GDP, PSBs' business will contract sharply and their profit and equity prices will plummet precipitously. This will give the government an excuse to sell off the PSBs to the capitalists at throw away prices on grounds of efficiency.

The increase in the NPAs in the PSBs cannot be attributed to their inefficiency relative to that of the Indian private banks. The reason may be briefly stated as follows: Data given in Tables 3.1 and 3.2 in Chapter 3 show that the stock of nonperforming assets as a percentage of total advances started rising in the PSBs since the onset of recession in 2011-12, even though domestic private banks remained free of this problem. This calls for an explanation. The recession caught Indian firms, PSBs and Indian private banks completely unawares. No national or international

forecasting agencies such as the RBI or IMF made any prediction about the impending recession. The recession, as should normally be the case, led to an increase in the loan default rate. However, surprisingly, the increase in the default rate was confined to the PSB loans in the main. This cannot be explained on grounds of efficiency. Neither the PSBs nor the Indian private banks could predict the recession. They were equally inefficient in this respect. Since these two types of banks could not predict the recession, it was not possible for them to predict what form it would take, that is, how it would affect different sectors and firms of the economy. Therefore, it is not possible to attribute Indian private banks' success in withstanding the onslaught of recession to their efficiency relative to that of the PSBs. One should also note in this context that most of the banks and financial institutes of the US, which were all private, were either bankrupt or on the verge of bankruptcy following the collapse of the house price bubble in 2007. Moreover, in recent years, bank frauds are rising at an alarming rate and these frauds are, again, confined principally to the PSBs. Finally, the large increase in the stock of nonperforming assets of the PSBs is principally due to loan defaults by large or corporate borrowers. All this suggests that the plight of the PSBs is due to a conspiracy hatched by the capitalists to discredit them and, thereby, to take them over at throwaway prices.

4. Chapter 4: Macroeconomics of Corruption and Crime in India

The objective of this chapter is to explore the macroeconomic implications of the link between corruption and crime using a macro-theoretic model that we hope captures the salient features of India. This chapter, however, is based on a very different presumption regarding how the capitalist world works. It presumes that the capitalist world is completely under the control of the capitalists. It develops arguments to vindicate this presumption. It argues that almost all the developing countries like India were former colonies of Western Europe and the USA and they are at the present completely dependent on the Western Europe and the USA for knowledge and technology. Accordingly, their production and investment are highly import intensive, while their ability to export is extremely limited, since it is not possible to compete in the world market with imported knowledge and technology. Therefore, these countries cannot get themselves going. The capitalists of the Western Europe and the USA, who by our assumption control the capitalist world, get these countries going by placing export orders with them and by buying their financial assets on a large scale (for evidential support of this line of thought in case of India, one can go through Ghosh and Ghosh (2016), Chapter 8). The capitalists, therefore, have these developing countries like India completely under their control. In many of these developing countries including India, the small producers produce a significant part of GDP. This chapter argues that the capitalists wield State power and own all the political parties. Taking advantage of their State Power and the political parties, the capitalists appoint criminals to extort money and land from the small producers so that the corporate sector can grow at the expense of the small producers.

Given the hypothesis stated above, the criminals in a capitalist country cannot operate unless they work for the capitalists and enjoy the patronage of the capitalists through the political parties. The

objective of this chapter, as we have pointed out above, is to show how the criminals extort money from the small producers so that the business empire of the capitalists can grow at the expense of the small producers. We have developed a simple model to achieve our objective. Unlike the models in mainstream macroeconomics (both neoclassical and Keynesian), our model has as its basis the following hypothesis. A capitalist economy, instead of being driven by impersonal market forces, is completely under the control of the capitalists who are a united lot. They dictate all the policies of the government. They decide what the levels of GDP and employment would be, what prices the buyers will face, what the level of aggregate investment would be etc. (For empirical support of this hypothesis, one may go through Ghosh and Ghosh (2019, Chapter 5 and Chapter 7).) This hypothesis is completely at variance with the mainstream economics (neoclassical and Keynesian), which believes that a capitalist economy does not have a driver. It is driven by impersonal market forces and the objective of economics is to discover the laws these forces obey.

In what follows, we will just state the principal results of this chapter and briefly explain them.

4.1 The Model

To capture the impact of corruption related exploitation of the small producers through extortion and other means, we divide the Indian economy into two sectors: the organized sector and the unorganized sector. The organized sector consists of the corporate sector, the government sector and the large unincorporated private enterprises. The unorganized sector consists of small enterprises including small farming units and cottage and village industries.

4.2 The Extortion of the Small Producers by the Middlemen in the Loan Market

The capitalists through the political parties create a scenario where the small producers have to seek the help of the middlemen to secure loans from the financial institutions. In return for their services, the small producers have to pay the middlemen a given amount of money. We will examine here the impact of this illegal payment of commission. The small producers' output is constrained by the amount of intermediate inputs they are able to purchase from the organized sector with a given amount of fund at their disposal. This fund consists of their own fund and a given amount of loan that they are able to secure from the financial institutions. They secure the loan by pledging their land as collateral. When they default on their loan, they lose their collateral to the lenders and the amount of loan they are able to secure next time also becomes less.

Following the payment of the commission, the amount of loan that the small producers can use for cultivation falls and as a result their output goes down. The resources released thereby enables the capitalists to raise their investment. The fall in the output of the small producers leads to a fall in their revenue corresponding to the given initial equilibrium amount of loan. This raises their

default rate at the end of Round 1. The lenders, accordingly, take away some amount of land of the small producers. At the beginning of Round 2, the lenders decide to reduce their lending to the small producers as they have a smaller amount of collateral to offer. Hence, output of small producers fall and capitalists' investment increase again and this process continues until a new equilibrium is reached. From the above discussion we get the following proposition:

Proposition 4.1: If the capitalists using their political parties and State Power ensure that the small producers have to seek the aid of the middlemen to secure loans in return for a part of the loan as commission, there will take place a cumulative fall in the amount of the small producers' output and a cumulative decline in the amount of land in the possession of the small producers. Their misery and destitution will increase immensely. The capitalists will use the resources released from the output of the small producers to raise their investment.

4.3 The Extortion of the Small Producers by the Criminals at the Time of the Sale of their Produce in the Loan Market

The criminals appointed by the capitalists take away a part of the sales revenue of the small producers. Obviously, the criminals get away with it because they work for the capitalists who wield State Power. The amount of money extorted by the criminals also, as in the earlier case, raises the default rate of the small producers starting a process that brings about a cumulative decline in the amount of output and land of the small producers. This yields the following proposition:

Proposition 4.2: If the capitalists using their political parties and State Power employ criminals to take a part of the sales revenue of the small producers, there will take place a cumulative fall in the amount of output of the small producers and a cumulative decline in the amount of land in the possession of the small producers. Their misery and destitution will increase immensely. The capitalists will use the resources released from the output of the small producers to raise their investment.

4.4 Land Grab of the Small Producers by the Criminals

The criminals appointed by the capitalists force the small producers to part with their land for a pittance. Obviously, the criminals get away with it because they work for the capitalists who wield State Power. As a result of this land grab, the amount of collateral the small producers can offer declines. This, just as in the earlier cases, bring about a cumulative decline the output and land of the small producers. From the above discussion we get the following proposition:

Proposition 4.3: If the capitalists using their political parties and State Power employ criminals to take away a part of the land of the small producers, there will take place a cumulative fall in the

amount of output of the small producers and a cumulative decline in the amount of land in the possession of the small producers. Their misery and destitution will increase immensely. The capitalists will use the resources released from the output of the small producers to raise their investment.

4.5 Conclusion

This study is based on the hypothesis that the capitalists in the capitalist countries and their satellites like India own the political parties and wield the State Power. It follows from this hypothesis that the criminals who commit crimes and get away with them are employees of the capitalists. In other words, the sector of organized crime is an enterprise of the capitalists. In India, quite a large part of the GDP is produced by the small producers. This study shows how the capitalists by using the criminals can make the output of the small producers shrink and grab their land.

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