PATH DEPENDENCE OF CORRUPTION IN THE CZECH REPUBLIC

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Abstract

In the paper we appear from the fact that corruption was, is and as well as in the future it will stay with the most probability one of the possible forms of economic behaviour of economic entities with significant impact on quality of economy of individual as well as economy of government. It is a characteristic feature of corruption that it occurs in all countries regardless their political and societal arrangements. Being aware of adverse consequences of corruptive behaviour every state attempts in the course of time to reduce corruption to the lowest level possible. The objective of the presented article is analysis of the past and current status of corruption in the Czech Republic, including an estimate of a future trend of corruption in this country. The corruptive environment will be analysed retrospectively looking back at the change of the social order in this country and in the context of the theory of new institutional economics.

Key words: corruption, New institutional economics, path dependence, informal institutions, Czech Republic

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Introduction

The level of the Czech Republics' integration in the all-European space is naturally assessed from various viewpoints. While, in respect of the increasing requirements for fiscal stability and budget responsibility of the member countries of EU, the attention is quite rightly directed to the evaluation of macroeconomic hard data, the wider significance of economic activities that is strongly determined by the quality of the institutional environment is often disregarded. Culture, customs, tradition, morality, in other words that which D.C.North,[1] a prominent representative of new institutionalism, named *informal institutions*, significantly determine

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[1] American economist Douglass C. North was awarded the Nobel prize for economy in 1993 (together with Robert W. Fogel) "for pioneering work in analysing transaction costs and their impact on the growth of governance and for creation of a general model of institutional changes and its application on the economic history of the western civilization".

the quality of economic activities after more than twenty years of the transformation of the entire society and the establishing of democratic structures. The presented article looks into the issue of corruption, which represents one of the most discussed forms of informal institutions. Taking into consideration the aforementioned facts the subject matter of this article is quantitative and qualitative analysis, comparison, evaluation and estimate of the trend of the corruptive environment in the Czech Republic in the historic retrospective overview of the change of the social order and in the context of the conclusions of the theory of new institutional economics.

1   Theoretical implications of the problem

In the context of new institutional economics we understand institutions in accordance with D.C. North's defining specification: institutions are *"rules of the game in the society (...), restrictions proposed by people that influence human relationships "*(North, 1990, p. 3). Such institutions can be:

- ▪ *Formal* – have *a legal status*. This means an entire legal framework of the economy that regulates the behaviour of people. The influence of formal institutions on the efficiency of economic subjects is vicarious, however it is substantial.

- ▪ *Informal* – established customs, traditions, habits, taboos, behavioural codes, establishment of social networks, all that what we call the "culture" of a given society. According to North these are *"socially transferred information that forms constituents of culture"* (North, 1990, p. 37).

Thus institutions represent a set of formal and informal political, economic and social rules (including their enforcement). North presumes that institutions have a key role in securing ownership rights, the environment of trust and incentives that directs human behaviour in a certain direction and facilitates economic and political exchange. By selecting those types of behaviour that are permitted and those that are not institutions influence the thinking and behaviour of economic subjects, co-create their preferences and expectations and in this way make certain behaviour predictable and the environment in question more stable. In this perspective we agree with the opinion that the quality of institutions should be such as to provide for relatively equal access to economic resources for the highest possible number of economic subjects and that, at the same time, institutions should be able to create mechanisms preventing various swindles against competitive behaviour and moral gambling. According to North culture facilitates communication among individuals and secures continuity of the

societal development: *"Culture provides a key for the trajectory in time, which is a term used to describe the strong influence of the past on the presence and future"*(North, 1994, p. 446). **The culture of corruption** then represents one of the key "cultural variables" that is necessary to study within various societies. From the perspective of new institutional economics we can therefore *define corruption as a deviation from formal rules.* In societies where corruption is strongly embedded as a custom or tradition it belongs to a wide network of non-ethical informal institutions. Corruption does not stand "outside" the economic system, if there is corruption it exists as an endogenous institution and as such it represents a distinctive system with its own culture and tradition. Corruption *"...functions as a social system that has its own rules of the game, internal mechanisms of its development that determine its strength, penetration and speed of spreading in the society"* (Frič, 1999). Corruptive mechanisms tend to embed themselves in such areas where "white spots" exist as failures of the system of the formal institutional arrangement. Failures of the official normative system of the society (so-called *social disorganization*) occur, as a rule, in three basic forms:

1. There are, in the society (or some part thereof), several rules opposing each other and it is not sufficiently clear to acting subjects which rules they should prefer. A tendency towards corruptive behaviour arising from the notion that it is this behaviour that generates the largest profit.

2. Observance of official standards does not lead to adequate results or reward.

3. A situation when official rules are missing completely. This situation is quite characteristic, for instance, for the transformation period of post-communist countries in which old norms no longer apply and new ones have not been created yet.

Failure of formal institutions opens space for the propagation of corruptive norms as informal institutions. However from the viewpoint of participants such norms are a rational response to the reality of the system since existing (or possibly non-existing) institutions do not represent for the participants a motivating factor and therefore corruptive behaviour appears to be economically rational in this situation. Corruptive institutions and formal institutions compete with one another. In the end corruption may take over the role of formal institutions. Corruption acts illegally in a hidden form. However from the long-term viewpoint it manifests significant stability linked to the network of informal social bonds (clientelism, favouritism, nepotism) and in such situation it is very difficult to enforce the necessary institutional change. North generally perceives *the Change* as *"adapting to a set of rules, standards and enforcements across space and time"*(North, 1990, p. 83). The change of formal institutions,

e.g. the change of rules for the allocating mechanism is relatively easy and fast. On the other hand with informal institutions one is to expect much longer periods necessary to establish the change. For instance Williamson (2000) differentiates among various hierarchical levels of institutions and matches them with various time periods.[2] The change of informal restrictions is more gradual and subconscious because it is related to the development of alternative models of behaviour that correspond to newly understood advantages and costs. The dependence of institutions in a given country and given time on the historical development of its institutional arrangement is established by *"path dependence"*. Despite a change in formal institutions informal institutions remain unchanged for a long time and so a certain tension occurs between informal restrictions and new formal rules. According to North (1995) economies with a long tradition of stable political and economic rules have a self-preserving tendency to develop, unlike economies with the legacy of inequality and inability to develop social norms common in the democratic society. Establishment of formal institutions leads to results that vary among individual countries. The state as a guarantor and co-creator of basic institutions should use a rational economic policy to influence these institutional changes in such way as to induce decrease in transaction costs and increase in the economic performance of a given country.

As far as the corruption issue is concerned the dependence on its trajectory can be very well observed. The situation in the Czech Republic is a good example.Following the change of the social order (and thus of the entire network of formal rules) corruption has adopted new forms. It accompanied and affected economic transformation and has turned out to be one of the most serious economic problems. While functional changes of corruption were, during the transformation period, mainly determined by *switching from corruption in the sphere of services and sales to corruption in the sphere of the public governance and administration,* the corruption of the transformation period came into existence in processes that were by their nature *unique and unrepeatable*. It can be said that, if during the period of the central plan corruption was facilitated by the stability of the system, the breeding ground for corruption in the transition period was the *instability of the system*. The disintegration of the old system also meant the disintegration of old social norms with their sanctions, which had happened before

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[2] On the first hierarchical level of the society there is (1) a long-term stable social structure that changes after revolutions or social crises (100-1000 years). The second level (2) is represented by institutions changing the rules of the game (formal institutions) in a time period of (10-100 years). (3) The third level is made up by institutions concerned with the game itself (social contracts) that change in the period of (1-10 years). The last (4) hierarchical level is formed by institutions that relate to the allocating mechanism (regulation, supervision), which can be changed on an operative basis.

a new system of morality and new sanctions for violation of norms were created. As a result of insufficiently developed administrative apparatus and political structures the transitional stage lacked legal legitimacy and institutional strength. Moreover, the legacy of communism multiplied the tendency towards corruption in question as an accompanying phenomenon of transformative processes. This legacy can hardly contribute to the formation of a functioning democracy and culture that would say no to corruption. The tradition of grand as well as petty corruption, embedded distrust in the state, belief in the fitness of such behaviour when stealing from the state is considered a standard, wide-spread clientelism and mutual exchange of favours, corruption in the private sector as a substitute for functioning competition. Up to now these phenomena have been a barrier to a well-functioning democracy and confirm the argumentation of D.C.North about the extensive influence of "path dependence". *"Economies that adopt formal rules of another economy will significantly differ in their performance from the performance of the copied economy due to different informal standards and rules for their observance. Consequently it means that the transfer of formal political and economic rules of successful western economies into the economies of the third world and into the economies of eastern Europe is not a sufficient prerequisite for good economic performance"*. (North, 1994)

2.   Perception of corruption in the Czech Republic

2.1.   Corruption in the context of entering into the EU

Corruption as one of the major problems of the institutional environment of former socialist economies and the fight against corruption had become a sharply monitored *criterion for the entry of these countries into the EU*. Taking into account how difficult it is to measure corruption the real evaluation of the European Commission mainly focused on the anti-corruption policy of the states in question, which lied in a very general list of criteria. The assessment of the corruption level by the Commission in which the seriousness of corruption in candidate countries is classified by statements from "a relatively limited problem" over "a territory arousing concerns" to "widely spread and systematic" is obviously intuitive. The Czech Republic was the country with the worst evaluation from the candidate countries. The process preceding the entry was completed at the meeting of the European Council on 12th and 13th December 2002 in Copenhagen. The European Council decided, in accordance with the opinion of the Commission, on the acceptance of 10 new member states. Even though it was a defined objective to reduce the influence of corruption in these countries in the period

before the entry, a number of states entered into the EU with serious problems in this sphere. According to investigations carried at the time[3] the most problematic issues appeared to be illegal contributions to political parties, corruption in the police, parliament and legislative corps and the sphere of public orders. Almost 20 % of firms from these economies stated that they give 2-10 % of annual revenues as unofficial payments to public representatives (in countries of the original EU-15 it was only less than 4 % of firms) (Volejníková, 2007). In 2004 a unique survey of the TI organization in cooperation with GfK Praha agency was carried out, which resulted in the construction of the *V4 index*. This was a result of the comparing survey in Prague, Bratislava, Budapest and Warsaw, the subject matter of which was to identify which selected anti-corruption tools are applied in the public administration of the capitals of the V4 countries and concurrently compare to what extent these tools fulfil their objective. The survey was based on the measuring of *the institutional tendency towards corruption* and took place in two stages: in the first stage objective data concerning the existence of anti-corruption tools and mechanisms in the public administration of the capitals of the V4 group were gathered (in the sphere of awarding public orders, internal audit and controlling mechanisms, ethic codes, the clash of interests and the information openness of the public administration). The collection of these data was executed in the form of content analysis of documents and interviews with representatives of the municipal authorities of the individual cities. Within the second phase of the survey it was identified to what extent the involved public perceives these anti-corruption tools as effective. In each of the cities 100 respondents were inquired (107 in Prague). On the basis of the final evaluation of the V4 survey Prague ranked fourth, that is, the last (the first position was successfully defended by Hungary followed by Slovakia and Poland).

## 2.2. Trajectory of corruption in the Czech Republic

It can be said that even though the process of approaching the EU itself had a positive impact on the development of the anti-corruption policy, the implementation of anti-corruption mechanisms and the creation of the transparent economic environment in the Czech Republic, the bribing frequency in this country has not changed. The lowering of the corruption level in economy under transition can signal the elimination of corruption related to transformation,

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[3] For instance competitiveness of economies is evaluated on the basis of so-called competitive indices created by World Economic Forum (WEF) or on the basis of so-called Global Corruption Barometer created in 2005, which is published periodically every year by the TI organization. This issue is discussed in detail in (Volejníková, 2007).

however common every-day corruption remains and its level may grow significantly. The mentioned specifics of the corruption sphere as well as the inertia on the development trajectory can be substantiated with the values of the corruption indices that reflect the situation in the given sphere. In order to maintain the comparability of the data we will use the specific index CPI[4].

Fig. 1: The development of CPI in the Czech Republic
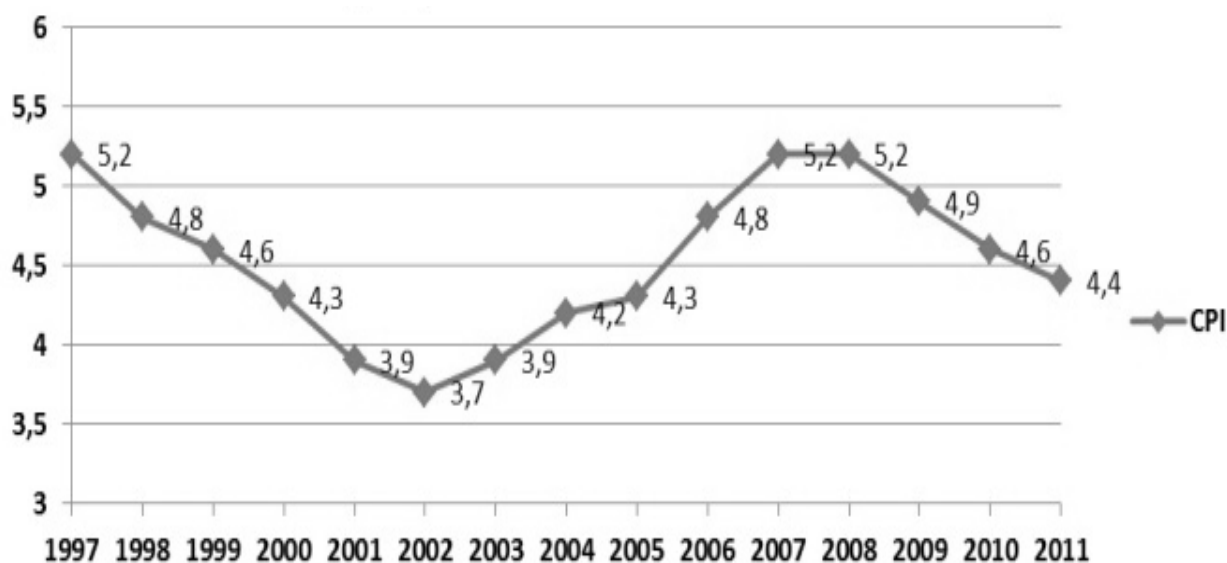
Source: www.transparency.org

Data analysis based on values of this index documents that the Czech Republic that had problems with corruption before joining the EU have not changed its position in any significant manner after the entry into the EU. Perception of corruption in the Czech Republic maintained its long historical trajectory with medium value 4,5. The short-term negative trend is confirmed that corruption in the Czech Republic is still a major social problem.

Conclusion

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[4] *CPI (Corruption Perception Index)* is based on the principle of "corruption perception". Transparency International (TI) has been compiling this index since 1995 in cooperation with Göttingen University in Germany. The index relates to the perception of the corruption level as perceived by people in the business sphere, analysts and the professional public. The evaluation takes place on the scale from 10.00 (countries without corruption) to 0.00 (high occurrence of corruption). At least three surveys must be executed in a country, if it is to be included in the CPI rankings (i.e. surveys performed by institutions which meet the set methodological criteria: the World Bank, EBRD, WEF, Pricewaterhouse Coopers, Freedom House etc.). More detailed information can be found at www.transparency.org.

Analysis of the corruptive environment in the Czech Republic, the specification of qualitative and quantitative characteristics of this phenomenon prove that perceptions, the real status and expected trends represent a constant problem in this country. It has been confirmed that corruption as an informal institution has a tendency to remain on its trajectory for a long time, which is true despite changes in the wider economic and societal environment and despite the essential change of the formal institutional framework. The renovation and building of democratic structures in this country for more than twenty years has not been taking place for a sufficient period of time to provide for an essential change in informal institutions. The requirement for the meeting of political criteria for the entry into the EU, encompassing provable fight against corruption, could not and cannot declare desirable or expected positive changes in the given area. It can be said that in the Czech Republic a consistent anti-corruption reform policy has been implemented, which included extensive amendments and the passing of many important laws restricting corruption opportunities (especially laws concerning the clash of interests, laws on legal liability of juridical persons, laws concerning the awarding of public orders etc.). Still, corruption in the Czech Republic is widespread, despite the fact that European anti-corruption standards have been met, which is true especially for the sphere of politics and public administration, judicature, customs administration, the police, health service, awarding of public orders. A large share is made up by administrative corruption and corruption based on influence, corruption related to the financing of political parties, corruption of government representatives and top state officials. In the course of recent years many corruption scandals have been registered in which ministers, politicians and ordinary officials were involved. Investigation of corruption cases arising from privatisation processes and activities of non-governmental organization continues. Corruption is increasing in the private sector too. There are extensive tax evasions, it is estimated that shadow economy represents more than 20 % of GDP. However uncovering of corruption cases is not, as a rule, the result of the effectiveness of responsible institutions and prosecutors and the enforcement of laws, it is mostly to be attributed to media. In the country relatively low trust in politicians and the state in general prevails on the part of the population.

We are of the opinion that the inertia of corruption in the Czech Republic can be explained by the combination of the destruction of the social capital at the time of communism on one hand and social disorganization during the transitory transformation period on the other, which is more probable than any other or different factors frequently presented in specialized literature

studying corruption across countries. Legal uncertainty and political chaos have been prevalent for a long time, most people are abandoning belief in democracy and state institutions. We think that despite the fact that the Czech Republic has always been part of Central European civilization sharing the same intellectual and cultural values and religious traditions, the existence of certain shared factors determining corruption in the group of these countries does not provide sufficient grounds for assuming on this basis that these factors are absolutely the same and therefore it is possible to fight corruption using the same tools. After all there are certain institutional-societal, cultural, historical and other differences among the individual countries that are reflected in the phenomenon of corruption. As it is stated for example in (OSI, 2002) "*...corruption in the Czech Republic has most probably not evolved only from the legacy of communism but is also related to the historic legacy of the Habsburg monarchy and its bureaucratic traditions, while corruption in Poland is considered – especially by many domestic commentators – to be, among other factors, a consequence of the centuries-long distrust in the state whose history is composed of a series of occupations by foreign powers.*" Corruption as a form of the informal institution has a tendency to retain its "path dependence on the past" in the long term. Therefore changes in the corruption trends in the Czech Republic are to be expected to take much more time. These changes will be determined by gradual evolution of the human, or on more general terms, social capital in this country. Therefore an efficient and long-term tool for fighting corruption in the Czech Republic could be: no huge investments into controlling and monitoring schemes but directing a part of the means into the development of the social capital. Support of investments into education, the overall quality of institutions and political stability, all this could lead to the increase of trust on the part of the population in the society as a whole. Such investments undoubtedly have other advantages since they lead to the growth of the economy and the wealth of the society.

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