

Corruption and Anticorruption in the Czech Republic

By: Lubomír Lízal and Evžen Kočenda

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Lubomír Lízal and Evžen Kočenda

CERGE-EI, Prague, Czech Republic
W. Davidson Institute, University of Michigan Business School, USA
CEPR, London

Abstract:

It is widely acknowledged that corruption has negative impact on economy and society. Transition process in the Central and Eastern Europe (CEE) uncovered dormant possibilities for corruption that consequently required appropriate steps to be taken against. We attempted to document the state of corruption in the Czech Republic and the measures introduced to fight it. We covered sectors of society and economy according to their importance in the prevention of a corruption and a consequential hazard to the society. We also described the governmental concept of anti-corruption measures and outlined achievements and failures of such a program. The overall impression favors persistent presence of corruption within the society and economy in the Czech Republic. The state of corruption in the country, measured by the Corruption Perception Index, presents a serious problem since the index does not improve as transition process advances. Numerous comparative studies, however, suggest that corruption is more prominent feature in a number of other transition countries. We believe that the institutional framework to prevent and fight corruption appears to be improving.

Keywords: corruption, institutions, transition, hidden economy, administration

JEL Classification: H50, I20, K42, O17, P27, Z13

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Non-technical Summary

The corruption in the transition countries has become more severe problem as these countries increase their openness and involvement in the international communities and organizations. With a dramatic change in the Czech political regime in 1989, the whole process of social and economic transformation initiated changes in the environment of corruption. In this article we attempted to document the state of corruption in the Czech Republic and the measures introduced to fight it. To understand the evolution of corruption under new conditions of transition process we had to tackle historical roots and origins of corruption.

In addition to the classical division on high-level corruption that involves elected and senior public officials and on low-level corruption that involves mid and low level bureaucrats we cover sectors of society and economy according to their importance in the prevention of a corruption and a consequential hazard to the society. Based on such comparison over different categories where bribery may occur the following hierarchical division of corruption occurrence is formed:

1. Police, State Prosecution, Judicatory and Court Systems including Parliament and Government,
2. Tax and Fiscal Authorities, Licensing Laws and Procedures, Public Tenders, Monopoly Regulation, and State, Local and Municipal Administrations,
3. Education, Health Care, and Social Care,
4. Private Businesses and Citizens.

Each category listed above is discussed in detail with its linkages to other categories. The licensing in addition to economic sectors with natural monopoly elements also covers bank and finance licensing. The monopolies are also dealt with in a special section. Unlike in western economies, a special attention is paid to the area of state social assistance. For example, the health system is designed in such a way that the patient is not able to recognize whether the service is adequate or too expensive or redundant, or to discover that the provider has charged the insurance company for non-performed services or non-supplied drugs.

Among the two basic methods, how to measure the corruption we prefer the one that is based on opinion pools, surveys, and case studies. These measures are less precise, however they more realistically reflect the situation in the country and/or particular sector compared to those based on documented cases and hard numbers since these are not able to measure the latent

corruption. It means, that in the highly corrupted environment, where any true and independent investigation is impossible, such measure can give an extremely low level of corruption. The state of corruption in the country, measured by the Corruption Perception Index, presents a serious problem since the index does not improve as transition process advances. For example, according to the CPI the corruption environment in both Czech and Slovak Republics is slowly gaining strength. Current forms of corruption have the same origin in the Czech and Slovak Republics due to the common experience in the former Czechoslovakia. This measure has long lasting negative trend in both countries.

We also described the governmental concept of anti-corruption measures and outlined achievements and failures of such a program. It is understood that the concept of anti-corruption measures must be systematically linked with steps that deal with other social problems. Thus the goal of the Program of Combating Corruption is to describe the nature and objectives of combating corruption, define its principal methods and means, propose specific measures to be taken in respective areas, define responsibilities and a time schedule, and indicate the method of monitoring. We look at such program in line with its three major components. First, there is Educational Program to increase awareness about corruption and ability of civil servants to fight it. Second, there was launched so-called governmental campaign “Clean Hands” and finally we look at the improvements and disimprovements of legal system and evaluate the proposed changes.

The overall impression favors persistent presence of corruption within the society and economy in the Czech Republic. Numerous comparative studies, however, suggest that corruption is more prominent feature in other transition countries with economies of the former Soviet Union leading the pack. Nevertheless, the state of corruption in the country, measured by the CPI, presents a serious problem since the index does not improve as transition process advances. We believe that the institutional framework to prevent and fight corruption is improving, though.

1. Introduction

It is widely acknowledged and supported by numerous studies that corruption has negative impact on economy and society. The economic and social transformation in the Central and Eastern European (CEE) countries inevitably created and enhanced opportunities where corruption could easily flourish. The corruption in the transition countries has become more severe problem as these countries increase their openness and involvement in the international communities and organizations. This analysis aims to document the state of corruption in the Czech republic and the measures introduced to fight it.

With a dramatic change in the Czech political regime in 1989, the whole process of social and economic transformation initiated changes in the environment of corruption. There exist particular shifts in corruption from one area to another that occurred along with economic and legal transformation, and sometimes led to a growth in large-scale corruption. Corruption shifted primarily from the region of general services and sales to the region of state clerical/administrative services.

In order to understand the evolution of corruption under new conditions of transition process we have to tackle, at least briefly, historical roots and origins of corruption. Comparison with corruption scheme common under the communist regime, which was based mainly on the mutual friendly services, and time dependent evolution of corruption shows, that the legislation was quite appropriate to punish the classical bribery corruption of state officials. It was, however, completely inappropriate to prevent the newly emerged forms of corruption associated with rent seeking.

Moreover, the old common approach based on the services, small gifts, and small bribes has sustained even up to date since it evolved during the communist past to be a norm of behavior and negotiation with the state administration. In the past, the general public perceived as a repressive body any part of the state administration. Since the state was an “enemy,” small-scale misuse and theft of the public goods and sources became a part of the passive opposition against the communist regime. Of course, after forty years such behavior had to become not only a socially acceptable norm and sometimes even a norm of proper morale not only on the citizens’ level but also on the administrative level.

General public does not perceive the state administration at any level as a socially prestigious and valuable occupation. The income of the administration is relatively low and almost no income differentiation exists. Consequently, the state administration is not a competitive job opportunity on the labor market, and does not attract the skilled people. As the result the system as a whole is extremely bureaucratic. These symptoms cause that administrative officials almost at any level do not belong to the middle-class. Therefore the low-level administrative staff is often unqualified and unable to make any independent decision and to take personal responsibility for such decisions. Thus, the prevailing tendency is to delegate responsibility to resolve pertinent matter on higher level within the administration structure. In

addition, the front-desk clerks often compensate their feeling-of-non-importance by unfriendly approach and bureaucratic rigidity toward general public. The general practice of all state administration requires the citizens to use specific part of administration according their so-called permanent residency. This means that not only the procedure depends on the interpretation of rules by the regional (local) office but also the citizen cannot use administration in another region. Semi-private institutions, like a major health insurance company, are mimicking the state administration behavior.

These roots might be the main reason why the recent changes, which are presented to the public as a harmonization with the EU norms, represent a visible increase in the power of state administration in its discretionary decisions as a by-product.¹

With the previous account in mind we can divide corruption, albeit somehow artificially, into two dominant forms:

High-level corruption involves elected and senior public officials.

Such a category covers, in particular, financing of political parties and their election campaigns, inadequate parliamentary lobbying activities, and public tenders at any level of state administration. Lobbying at high-level administration does not mostly contain features of transparent process known in Western democracies. Instead, it resembles rent seeking activities of political and business influential groups. Rose-Ackerman (1999) provides a comprehensive analysis of relationship of corruption and government, specifically in cases of corruption that occurs at the highest levels of government and involves major government projects and programs. The economic impact of corruption is examined extensively.

Low-level corruption involves mid and low level bureaucrats.

In this respect, the classification refers to municipalities, all forms of public services provided by the state through regional and local agencies, as well as state guaranteed health care. Such level also entails informal links among private companies themselves and low-level state bureaucracy. According the recent EBRD survey (EBRD, 1999), the main obstacles to the growth of small and medium enterprises (SME) are anti-competitive practices and corruption, followed by taxes and business regulations. A priority for the next decade of transition is to embrace competition policy that focuses on reducing barriers to business start-ups, introducing measures to combat corruption and crime and hardening the budget constraints on declining industrial enterprises. Lizal and Svejnar (2000) show that problems with soft-budget constraint persist in the Czech economy, mainly via banking sector. Thus, credit related corruption possibilities are well warranted to be studied.

Further spread of corruption embraces direct economic activities as well as less direct ways through administrative processes. On aggregate or macroeconomic level the costs of

¹ For example, there are proposed changes in the hunting law to prevent poaching. The new law would put the status of hunters on the same level as that of policemen, however, without the qualification requirements the police should meet.

corruption should be emphasized in terms of economic growth. During transition process the fight against corruption is surely not cheap and cannot be independent from the reform of the state. If certain reforms are not made, corruption is likely to continue to be a problem regardless of actions directly aimed at curtailing it.

2. Sector Comparison of Dominant Forms of Corruption

We now proceed with a classification and description of dominant forms of corruption according to different sectors of society where corruption appears.

Although all forms of corruption are socially and economically dangerous, we can divide the sectors into four groups according their importance in the prevention of a corruption and a consequential hazard to the society. The first group consists of sectors, which were also designed to fight with the corruption and to guarantee legal status. The second group consists of various ways of the state administrations. The third area consists of services provided by the state and society to the general public and citizens and the last one involves a private sector and citizens themselves.

Despite the fact that we provide possible means of corruption, there is little evidence in the criminal prosecution of all these forms. Therefore, we include major known cases as illustrative examples whenever possible. Our division is made in such a way that the members of the subsequent category have more incentive to corrupt the members of the preceding one than to be corrupted from this one. Therefore, the hierarchy we use describes mainly the ways of receiving bribes. However, one should keep on mind that corruption is not a strictly one-way process.

The Table 1 illustrates how the perception of corruption by ordinary citizens has changed over the first decade of transition process. The numbers in a table also implicitly show in which sector the resources are scarcer and their rationing does not function properly. Two major changes are immediately visible. Services and sales in general, e.g. all categories that were already almost completely privatized, show a dramatic decline in perceived corruption. State administration, on other hand, records an almost tenfold increase in corruption perceived by citizens.

Table 1
Question: In Which Area Is the Bribery Most Prevalent? (in %)

Sector	1989	Sector	1998
State Administration	3	State Administration	31
Sales and Repair	11	Judiciary System	15
Health Services	21	Health Services	15
Transport, Construction Materials	5	Police	9
Services	31	Services	9
Education	1	Education	2
Restaurants	3	Restaurants	2
Retail Sales	26	Army	0

*Source: Výzkumný ústav obchodu, 1989, N=1643, data for Czechoslovakia.

**Source: GfK - Praha, April 1998, N=967, data for Czech Republic.

Based on the above intertemporal comparison over different categories where bribery may occur the following hierarchical division of corruption occurrence is formed:

1. Police, State Prosecution, Judiciary and Court Systems including Parliament and Government,
2. Tax and Fiscal Authorities, Licensing Laws and Procedures, Public Tenders, Monopoly Regulation, and State, Local and Municipal Administrations,
3. Education, Health Care, and Social Care,
4. Private Businesses and Citizens.

In addition, all the institutions, with the exception of the private firms in the last category, are fully or partly financed through public finance budgets. Hence, there is always a possibility for the representative of this group to try to corrupt any member(s) of the previous (upper) category to increase either financial means allocated or competence on usage of the allocated funds. One of the main reasons for presence of corruption in private businesses is caused by persistent presence of soft-budget constraints.

In the subsequent subsections we list possible ways of corruption for each part of the state administration separately. The system of police work, prosecution and court system is a quite complex one to be described in detail and beyond the scope of this paper. Therefore we do not describe this part of the system and we focus directly on the possible methods of corruption only.

2.1 Police and Investigation

A major sustaining conceptual problem prevails from the communist past, and is common both to the general public and state administration. The police are still viewed as a repressive part of the state administration and not as a major contribution to a crime prevention

and their natural authority and public appearance are perceived as a simplest way to keep the public order.

In particular, the most susceptible to the low-level corruption are those parts of police that are in the direct contact with general public. The main reasons for corruption include inadequate incentive schemes, inadequate technical equipment of the police, at certain cases undefined legal status of policeman, poor management and controlling, and management of human resources and qualification of the newly accepted staff. Currently, the lack of qualified labor is suggested to be solved by reducing the required educational standards.

Each corruption in the police involves the misuse of power while not each misuse of the power involves the corruption. The exact forms of corruption depend on the specific situations and also vary with the specific departments (criminal, traffic, foreign and border service, and alike). The most visible part involves the traffic police since the traffic fines (especially those for speeding or driving after drinking any alcoholic beverage or intoxicated) are more or less arbitrary and certain fines could be paid on the spot.

We can identify two basic types of police power misuse related to corruption. The first one involves the expected various forms of crime cover-ups. The second one is just the opposite: to find and discover even nonexistent criminal acts in the anticipation of possible promotion and pay rise. The aforementioned forms of corruption starts from receiving free services, over slow acting or inaction during investigation, to racketeering, providing coverage for criminal acts, hiding the evidences, protectionism, providing information on the status of criminal investigation and the undergoing intelligence actions to the criminals. In 1999, 345 policemen were investigated for more than 500 criminal delinquencies. The highest proportion of police delinquencies was found among officials under the age of 29, and service shorter than 5 years (report of the Police for 1999).

2.2 State Prosecution (State Attorney Offices)

The prosecution is designed to monitor the investigation, to decide whether the investigation is in the stage when the indictment should be filed in or whether to drop the case. The prosecutor at higher level can always override the decision of a lower-level prosecutor. Such controlling mechanisms make the possibility to corrupt the (state) prosecutor more complex than to corrupt the police and hence the corruption is less likely. On the other hand, the prosecutors' decisions can waste the police investigation and a corrupted high-level prosecutor can almost paralyze the system. Finally, the methods of corruption would be quite similar to those used to corrupt the police.

A specific feature is that the prosecutors can decide independently on each other. This causes situations where in limiting cases prosecution at a certain district considers one specific behavior as a criminal one while prosecution located in other district considers similar cases as non-illegal ones and stops the investigation. This, of course, opens a space for corruption,

especially in these limiting cases where the interpretation of the law is not straightforward.

2.3 Judicatory and Court Systems including Parliament and Government

The judges are independent on the state in the Czech Republic and only the law limits them. Such a feature makes their decision making really independent on the interests of any group. On the other hand, the tradition in the decisions is to focus more on the formal aspects of the case than to interpret the law (extensive interpretation).

This is driven not only by the nature of the Continental law but also by the historical tradition. The decision making in transition periods when the laws are not adequate to the rapidly changing environment has severe limitations compared to the case-law approach, or at least, more extensive approach in the case judgement.

Looking at the recent past, vast amount of *legal* economic cases would be considered illegal in the West (for example, so-called Ponti's scheme and similar ones) while the Czech legislation was not explicitly mentioning these types of behavior as illegal. Therefore, the whole Czech stock market became almost worldwide infamous because of its lack of transparency, price manipulation and abuse of power by shareholders with majority stakes. Although the situation started to improve during the last years when the Exchange and Securities Commission was established and new laws were approved by Parliament.²

The current government declared its interest to fight corruption and its program "Clean Hands" was a major election topic.³ On the other hand its effort can not be seen as fully credible. Both major parties in the Czech Republic, social democrats and civic democrats, are suspected and investigated, or their members are under investigation, for use of illegal funds, misuse of economic information, and tax evasions.⁴

As a final note, unfortunately there is quite a lot of lobbying in the Lower House of Parliament involved. We can judge this on the basis of the amendments and modifications suggested (and approved) during the final (third) reading. These modifications of newly accepted laws become a part of the law (if accepted) even if they were not aforementioned during the previous readings. A perfect illustration is the Property Execution Act. The intention of the law was to allow better debt repayment in cases of default and indirectly to speed up the bankruptcy

² The initial attitude towards the privatization process and the regulation of the stock exchange can be illustrated by a controversial statement made by former Minister of Finance, Mr. Klaus: "I do not know a method to distinguish dirty and clean money in practice; to do so would mean to cast doubts about the process of small privatization, I think it would not be a good decision", in an interview for the Czech Press Agency (CTK), September 27, 1999.

³ More on this can be found in other section.

⁴ Former Minister of Finance in the current social democrats' government is investigated for asset stripping. A former minister responsible for EU coordination was found to have illegal deposits abroad and is suspected of receiving provisions and tax evasion. Moreover, one of the Prime Minister's advisors was publicly accused of blackmailing and the case is under investigation. Civic democrats are suspected of illegal financing, Swiss police confirmed this suspicion in part by acknowledging the existence of a suspicious account in one Swiss bank, investigation is still under process.

procedures. However, in the third round all firms were excluded so only citizens' properties could be execution levied on.

2.4 Tax and Fiscal Area

The Czech laws are quite strict in the collection of income taxes and there are only few ways of possible leakage. However, there exist groups of approximately five officials at the Ministry of Labor and Social Affairs and at the Ministry of Finance who can forgive fines for late payment of taxes and social security payments. The decisions are in reality made ad hoc; the procedure has even no rules that would describe the process and therefore justify the exceptions granted. Moreover, existence of such groups is not known to general public, hence, the citizens (and small ordinary taxpayers) even do not know that they can apply for the pardon.

Although the tax law is quite transparent, the associated laws on health insurance and social security are more complex and less transparent. The employees even do not see on their paychecks that two thirds of the social and health payment is constructed as a payroll tax and directly paid by the employer. An implicit illustration of ignorance as for the level of such contributions was an opinion pool held on this topic by the STEM agency in 1998. The respondents indicated that the rich should pay higher taxes, about 25% of the net income. Such a perception is in sharp contradiction with reality since at that time the high-income brackets defined tax payments as 39% of the net income - after payment of almost 40% of health and social insurance. The illustrative example of average shares of income tax, various taxes like payroll and a net income can be found in Turnovec (1999).

The remaining segments of the fiscal system and administration are more problematic. There are quite common frauds in the value-added tax (VAT) collection and collection of consumption (excise) taxes and custom duties. These frauds are estimated in billions of Czech crowns (CZK) and there are links with international crime. Similar cases are reported to occur in Poland and Hungary. In this area we face not only corruption but also highly organized international criminal activities. Quite a popular scheme in the middle of the 1990's can serve as an example to refer to. The imported oil (petroleum) products were declared to be for heating purposes but in reality it was a truck fuel. After the custom clearance the declared heating oil was sold as a truck fuel. The unpaid consumption tax comprises more than one half of the final sale price. The total state revenue from truck fuel consumption tax was 17.5 billion CZK in 1996 and the loss in tax revenues was estimated at 2.5 billion CZK. Of course, such activity required at least passive attitude of the state administration.

During the first half of 1990's the evasion from payment of consumption tax on alcoholic beverages and cigarettes was alarming. Currently, each pack of cigarettes has to have a fee stamp and the method of stamping is under consideration for alcoholic beverages as well. Value added tax system is misused for tax crimes as well. According this tax law the financial office (i.e., the state) has to refund the VAT to the exporter. Therefore, fictional exports, or overvalued exports, can generate substantial cash.

All these mentioned crimes require at least passive cooperation of tax authority or custom authority, which is also a part of the fiscal administration. Quite common are also cases of imports with declared low value to reduce the import duty. The most prevalent cases were imports of used cars where the declared custom value was estimated to be only one tenth of the real value.

2.5 Licensing

The licensing is used to regulate the access mainly in areas of telecommunications, radio and television broadcasting, insurance and finance, foreign trade with selected commodities (armaments or goods with existing import quotas), and mining. The procedure of licensing should be transparent and, if possible, single-criteria, or the selecting criteria of multi-criteria tender should be at least integral part of the license provided. There are well-known cases from the past where the license procedure resulted in a suspicious conclusion.

Banking and Finance

At the beginning of the transition the state allowed new entry and it was very easy to receive a banking license. All new small banks got into liquidity problems or were tunneled and had to merge or went bankrupt. The state responded on by the freeze of issuing new licenses instead of more professional and prudent regulation.

The investment funds, newly established during the voucher privatization, became, with several exceptions, synonym for asset stripping and abuse of small shareholders. There existed no effective regulation of investment funds. The complete lack of stock market regulation even speeded up the process of dishonesty through obvious price manipulation. This is also a reason why there is a strong opposition against the existence of a compulsory private pension fund scheme, although the pay-as-you-go pension system is getting into a huge deficit and the prospects look blandly.

The situation on the insurance market is more optimistic despite the fact that the regulation is quite similar to that used for investment funds. So far only one insurance company went bankrupt. On the other hand, the market is still not fully open and licensing is limited.

Telecommunications

The monopolist fixed line provider has its exclusive rights granted till January 1st, 2001. Then new licenses will be issued. The reason is that in the past the fixed line network required enormous investments. Therefore during privatization process a strategic partner was selected and in exchange for commitment to build up and modernize the network such exclusivity was granted. As an experiment, in several regions small local companies were licensed to provide the fixed lines, however the incumbent controls 99.9% of all lines (OECD, 1999).

The exclusivity right even on building the fixed end-line network was questioned in the

past since it may slow down the speed of wiring the whole country. However, no direct evidence was found although the case was reopened by the press during the investigation of illegal sponsoring of political parties.

In 1999 a third license for mobile telephony (GSM) provider was granted. Although the license was based on multi-criteria choice, certain promises are not part of the license conditions. Moreover, the winning pricing scheme offered in the tender is handicapped by additional disadvantageous conditions, like cash deposits or long-term interminable contracts.

Radio and TV Broadcasting

Almost a classical example of high-level lobbying is the case of free terrestrial license available and granted. The original tender involved many criteria. The license was granted to the firm that offered low price and a program of intellectually higher standards than the (state) public TV broadcast. Once the license was granted, the law was changed in a way that the program composition is not a part of the license and the TV company became highly commercialized. Quite recently, an open fight for the complete control of this highly profitable firm started between the Czech license holder and foreign investor. Fortunately, there exists a sufficient amount of radio frequencies to grant enough licenses to prevent the above situation in radio broadcasting.

2.6 Public Tenders

Most cases of corruption that are disclosed in the media are connected with public tenders both on the state and municipal levels. Pre-selection of the prospective supplier is one of the most cited flaws. The selection of the pre-selected firm to sign a contract with is done by the means of custom-made conditions in the tender, custom tailored weighting of criteria or even by changing the tender conditions during the tender process. Such non-standard behavior is highly susceptible and opens broad opportunities of corruption to materialize. The available means to disclose a possible manipulation in the aforementioned schemes are quite limited.

Such a behavior during transition is in line with the exposition of Acemoglu and Verdier (2000) who argue that room for corruption is created by transferring resources from one party to another by government interventions. As corruption often undermines the purpose of the intervention, government tries to prevent it. By doing so it may create rents for bureaucrats, induce a misallocation of resources, and increase the size of the bureaucracy. Since preventing all corruption is excessively costly, second-best intervention may involve a certain fraction of bureaucrats accepting bribes. Moreover, Stiglitz (1999) argues that privatization created an opportunity to collect all expected future bribes in their discounted value at the time of privatization.

Public tenders that lead to public investments may have a negative economic impact not only due to corruption associated costs. Equally important is an impact on economy in general. Tanzi and Davoodi (1997) argue that corruption, particularly political or "grand" corruption,

distorts the entire decision-making process connected with public investment projects. The degree of distortions is higher with weaker auditing institutions. They presented evidence from various countries that higher corruption is associated with higher public investment, lower government revenues, lower expenditures on operations and maintenance, and lower quality of public infrastructure. The evidence also shows that corruption increases public investment while reducing its productivity. These are five channels through which corruption lowers growth. These findings are supported by Mauro (1995) who investigated impact of subjective indices of corruption on economic growth and found supportive evidence that corruption lowers investment, thereby lowers economic growth. Therefore, in countries with high corruption, very high public sector investments should be evaluated with caution. Since the total aggregate investment to GDP ratio in the Czech Republic is one of the highest among the CEE countries (CESTAT, 1999), the argument made by Mauro could be applied for the Czech Republic as well.

2.7 Monopoly Regulation

As in the cases of public tenders and licensing, the state uses chiefly discretion to regulate the monopolies (Lizal, 2000; Kočenda and Čábelka, 1999). In addition, there exists no independent regulator or regulatory office. Although the existing regulatory institutions are formally independent, they are financed by and subordinated to the founding (supervisory) ministry. According to the law and existing regulations, any disputes should be settled either by the ministry or by the regulatory office. Such an institutional arrangement will have to be abolished with the accession to the EU.

In most of the network industries the state controls the majority stake in the utilities companies (Kočenda, 1999). On the other hand, the state should behave as an independent regulator, which creates an obvious incentive problem. Such a problem cannot be solved independently on the state. Of course, absence of clear rules opens up the space for higher level corruption, although there are no proved cases. In addition, almost every monopolistic provider has to have a license. This applies not only on the large utilities but also on small local monopolies like local heat suppliers, etc.

Regulatory issues were extensively discussed by Johnson, Kaufmann, and Zoido-Lobaton (1998) who recently used cross-country regressions to explain the size of the unofficial economy in regions of Latin America, OECD countries, and transition economies in the Central and Eastern Europe (CEE). They found evidence that countries with more regulation tend to have a higher share of the unofficial economy in total GDP. They also found that higher tax burden leads to more unofficial activity and countries with more corruption tend to have a larger unofficial economy. Findings of Lacko (2000) support such a view with the evidence from the transition CEE countries. Stagnation or further increase in the size of hidden economy was experienced in the economies of the former Soviet Union, while an explicit declining tendency could be seen in more advanced transition countries.

2.8 State, Local and Municipal Administrations

Earlier in the text it was mentioned that the public administration is still not perceived as a service to the general public paid by the taxpayers but as an annoying structure to be tolerated and dealt with only in the case of necessity. What is felt as a major flaw of the administration is that frequently the officials seek reasons why not to proceed on. They search for bureaucratic mistakes and do not seek methods how to help the asking citizen to achieve his/her goal. The reasonable practice the citizens should require is different from the existing one. Currently the administration proceeds on only if the action is explicitly permitted by the existing regulation. The logic would suggest proceeding on in all cases that are not explicitly forbidden or illegal, though.

As a final illustration we provide a quite frequent, although not fully legal, practice used during renovation or construction of family houses. It is easier to start the construction work without a permit and ask the District Construction Office for a subsequent permit with a small fine to be paid. The risk of not getting the permit is extremely low and such procedure is often easier than to ask for all the permits before the beginning of the construction. Such behavior perversely saves a lot of time and, hence, money as well.

Another area of behavior apt for potential corruption concerns local authorities. The local administration, especially municipalities, often put state or municipal property as a collateral to back a third person's private loans. Such behavior is not only highly questionable but also creates opportunity for corruption to emerge. In this context, sale of a part of a National Preserve on a municipal territory serves as a flagrant example.

2.9 Education

A major problem of the higher education (except for the lack of finances) is a limited supply. Certain fields at universities or high schools face excessive demand, which is up to ten times the capacity. Last year, there was a case at the Law Department of a major university, where entry exams test were sold for CZK 100,000 (approx. \$3,000). No one was prosecuted or held responsible. The suggested yearly tuition is approximately ten times less than the aforementioned amount. Since the government is not in favor of introducing tuition payments at the state universities due to its possible social impact, the current situation paradoxically favors students from wealthier families. Hence, such approach is more discriminatory with respect to students from poorer families that should not be overburdened by tuition payments.⁵

Most of the higher education is still publicly financed. The private schools also receive certain state supplement but lately the scrutiny for private school to receive such a supplement became excessively harsh. As a final effect such conduct may result in reduced government spending on education in general.⁶ Furthermore, the other corruption possibilities include a

⁵ We do not mention one's high moral standards as an obvious attitude towards obtaining entry-exam answers for charge.

⁶ Mauro (1998) argues that corruption is found to reduce government spending on education in a cross-section of

preferential treatment or acceptance of selected students whose parents are able to pay extra tuition (selection of accepted students to private schools on the basis of social status) or to lobby for state finance (in case of both private and public schools).

2.10 Health Care

Historically, the Czechs are used to receive health care as a free service provided by the state. In the centrally planned era a limited health supply existed and such state caused the tradition of “gifts.” For the service already received or to be received in the future the gifts ranged from flowers, books, coffee, and alcohol to money.

The health care is provided through a mandatory health insurance. All terms of the insurance, including premium and coverage, are determined by the state. However, the payment of health insurance is still not generally viewed as payment for the health service but rather than a tax. Health providers are not viewed as (private) businesses providing the care and being paid through the insurance companies, but as a part of the state services. This is also caused by the non-transparent system combining taxes, health insurance, and various social insurance payments. Despite the fact that people view their health as a major asset they should preserve, they do not often receive a full information on the appropriate care needed and on its fair or real price.

Aside from above mentioned, there exists a pressure from the pharmaceutical industry toward usage of more profitable drugs and there is no definition of the standard health care covered by the insurance as guaranteed by the law. The regulation is ad-hoc and usually even retrospective, sometimes punishing the provider for past efficiency.

To sum up, the patient is usually not able to:

1. recognize that the service is adequate and treatment is ethical,
2. realize that the service is too expensive or redundant, and
3. discover that the provider has charged the insurance company for non-performed services or non-supplied drugs.

On the other hand, the insurance companies are abusing their power as well.⁷ They pay late and the average overdue is well above two months. There exists a silent threat of contract cancellation from the dominant insurance companies towards dependent health care providers. The providers are warned not to charge overdue interest and even manipulated to sign agreement amendments that make the contract even more disadvantageous for them. Quite recently, the newly issued regulation even worsened the situation, and medical professional society claims that the change was adopted just to prevent the financial collapse of state governed dominant health insurance company. All this can be viewed as, at least, passive corruption.

countries.

⁷ Association of medical doctors filed up a case against the dominant insurance company (VZP) at the Antimonopoly office.

2.11 Social Care

This area concerns mainly a state unemployment policy. There exist two state unemployment policies. Active policy when the financial resources are allocated to creation of jobs, and passive policy - payment of unemployment benefits. The district labor offices govern both policies. A case study commissioned by the Ministry of Labor and Social Affairs in 1998 showed that more than 80,000 households misused the social safety net, mostly in connection with unemployment policy and welfare benefits. The Czech Republic has less than 3 millions household in total and thus the misuse occurred in about 3% of households.

There were cases in the past when people registered as unemployed and received the benefits while working part-time or full time without a legal contract in the shadow economy home or abroad. It might be questionable to which extend the officials were aware of the illegality of the claims. Other possibilities include preferring a particular candidate either to find a job or to prolong the unemployment spell.

More problematic from the corruption point of view might be the area of active policy. The rights of the district labor offices also define the possible ways of corruption. These rights include the selection of private businesses, which would receive a loan to retrain their employees, and also forgiveness of the repayment of such a loan, the selection of areas of training and selection of the re-training company. The office can also provide aid to create jobs for fresh graduates or secured jobs and provide a loan to start a private business.

2.12 Private Businesses

The most visible forms of corruption in private (and also semi-private) businesses involve the selection of pre-specified partners in public tenders. In the banking sector corruption is associated with provisions of loans for unreasonable or even nonexistent projects. Such practices even led to a collapse of several banks and a loss of people's deposits. Bribes associated with corruptive behavior are not marginal and thus represent substantial costs. The distressing scope of such a phenomenon was revealed in the EBRD study (EBRD, 1999), which found that 26.3% of Czech companies admit giving bribes. Czech companies spend, on average, 4.5% of their annual income on bribes. According to the study bribery is more prevalent in Poland and Hungary.

It would be misleading to think about corruption only in terms of extra monetary costs. Corruption in private businesses is accompanied also with spending of time of managers. Kaufmann and Shang-Jin (1999) found that firms which pay more bribes are also likely to spend more management time with bureaucrats negotiating regulations, and face higher costs of human capital. Such finding is based on data from three worldwide firm-level surveys that do not include the Czech republic. However, we assert that bribe payments, management time wasted with bureaucrats, and cost of capital may be positively correlated as well across Czech firms.

Another perspective of corruption in private businesses is associated with hiding parts of their activities in order to reduce tax payments. Such conduct requires additional cover-up steps that involve bureaucratic corruption. We do not have a representative survey for the Czech Republic; however, we can use some proxies from other European transition countries. McMillan and Woodruff (2000) conducted a survey among the private manufacturing firms about the size of hidden unofficial activity. The firm-level regressions for the three Eastern European countries, namely Poland, Slovakia and Romania, documented that bureaucratic corruption is significantly associated with hiding output.

Hiding output is closely connected with lower ability of tax collection by state administration. In another survey Johnson, Kaufmann, McMillan, and Woodruff (2000) found the size of hidden unofficial activity to be much larger in Russia and Ukraine than in Poland, Slovakia and Romania. A comparison of cross-country averages has shown that managers in Russia and Ukraine face higher effective tax rates, worse bureaucratic corruption, greater incidence of Mafia protection and have less faith in the court system than in more advanced transition counterparts.

3. Measures of Corruption

In previous section we described and classified dominant forms of corruption according to different sectors of activity. Now we give a brief sketch on how such phenomenon is measured in two different ways.

There are two basic methods, how to measure the corruption. The first one is based on the counts of discovered, monitored and prosecuted cases. It uses the police statistics and statistics of Department of Justice. Its major advantage is that these are hard numbers and well-founded figures. The critical disadvantage is that it is not able to measure the latent corruption, i.e., the undiscovered cases. It means, that in the highly corrupted environment, where any true and independent investigation is impossible, such measure can give an extremely low level of corruption.

Table 2

Question: Did you ever give an bribe in the following sector?

Sector	1989*	1998**
Personal Services (hairdresser, etc.)	61	45
Health Service	42	31
Purchase of Durable Goods	39	2
Repair Services	36	37
Car Repair Services	30	17
State Administration (any level)	12	17
Housing	11	4
Funeral Services	9	1
To Put Child in a School of Any Level	9	2
To Get a Job or an Advantage in a Job	6	7

*Source: Výzkumný ústav obchodu, 1989, N=1643, data for Czechoslovakia.

**Source: GfK - Praha, April 1998, N=967, data for Czech Republic.

The other method of measuring tries to overcome the possible bias of the preceding method. Such method involves opinion pools, surveys, and case studies. The measures are less precise, however they more realistically reflect the situation in the country and/or particular sector. According to this principle, Transparency International constructs so-called Corruption Perception Index (CPI). CPI has a maximum value of 10, which means no corruption is perceived, while value of 0 denotes the most corruptive environment. The Czech Republic ranks in the middle of the surveyed countries, as well as Poland and Hungary. In 1998, the Czech Republic was on the 37th place out of 85 countries surveyed while a year later the country occupied 39th place among 99 countries. The last survey from 2000 contained 90 countries and the Czech Republic was on the 42nd place. The evolution of CPI is given in below Table 1.

Table 3

Comparison of Corruption Perception Index Evolvement

Country	1980-85	1988-92	1996	1997	1998	1999	2000
Czech Republic	5.13	5.20	5.37	5.20	4.8	4.6	4.3
			(1.45)	(0.47)	(0.8)	(0.8)	(0.9)
Slovak Republic			not evaluated		3.9	3.7	3.5
					(1.6)	(1.5)	(1.2)

Source: Transparency International. Note: Standard errors given in parentheses when available.

It is nothing to be happy about but according to the CPI the corruption environment in both Czech and Slovak Republics is slowly gaining strength. Current forms of corruption have the same origin in the Czech and Slovak Republics due to the common experience in the former Czechoslovakia. The existing legal systems are also quite alike, which implies that if we observe

one type of corruption in one of the Republics, there is a high probability that the very same corruption takes place in the other. Therefore, it is plausible to take known Slovak cases as supportive evidences.

Nevertheless, one of the main reasons of the split of the former Czechoslovak Federative Republic could be attributed to the uncontrolled power of the former Slovak political representation in 1992, which wanted to pursue privatization as a form of giveaways to its political supporters. Such practices are probably the major reasons why the CPI is recently almost by one point lower for Slovakia compared to the Czech Republic, although the countries had the same starting point.

Constructing the Corruption Perception Index on a regular basis is only a small part of work that the Transparency International carries on to help fight corruption worldwide. The organization was founded in 1993 in Berlin, Germany, as an international organization to help to fight against the bribery and corruption. This non-governmental organization (NGO) aims to involve all components of civil society - state administration, the private sector, entrepreneurs, and individual citizens - in creating a multilevel system against corruption.

The National Chapter of Transparency International in the Czech Republic was founded as a civic association in June 1998. The main goals of this NGO are to facilitate the improved awareness of corruption-related problems and anti-corruption issues, to contribute to the proliferation of methods for transparent business transactions, to inform state institutions, representative groups, educational institutions and the public on how to contain corruption by perfecting legal codes, and to contribute to the development of civil society in the Czech Republic. 10th International Anti-corruption Conference takes place in October 2001 in Prague, the capital of the Czech Republic.

4. Anticorruption Program of the Czech Republic

In 1997 the Government of the Czech Republic assigned the Minister of Interior to “develop a concept of offensive methods for detecting corruption in civil service” (governmental decision No. 673/97 from October 29, 1997). Later on, the current administration defined a combat against corruption as one of its priorities. The original task targeted on corruption in civil service was extended and a complex concept of a Government Program of Combating Corruption in the Czech Republic was adopted (governmental decision No. 125/99 from February 17, 1999).

The great need to adopt the above measures was due to the past development under the old centralized economic system as well as a passive approach of the state administration during the first years of transition process. Indeed, such state of affaires can be illustrated by the attitude of the public towards to governmental responsibility to take effective measures to prevent corruption. Table 4 presents results of an opinion pool related to such matter.

Table 4

Question: Which government or governments, in your opinion, put through spreading of corruption and bribery in our country?

Government	Years	%
Communist Govt.'s. in the past	1948-1989	26
Federal Govt. of Mr. Čalfa	1990-1992	5
Govt. (Republic) of Mr. Píthart	1990-1992	4
Govt. of Mr. Klaus	1993-1997	26
Govt. of Mr. Tošovský	1997-1998	0
Govt. of Mr. Zeman	1998-present	3
None		34

Source: GfK - Praha, 1999, N = 1066.

It is understood that the concept of anti-corruption measures must be systematically linked with steps that deal with other social problems. Combating corruption should be conducted in an organized way with the aim to prevent any new sources of corruption to emerge. No abrupt solutions should be taken because they could be counterproductive or even threaten the economy or civil rights and freedoms instead of curbing corruption. Thus the goal of the Program of Combating Corruption is to:

1. describe the nature and objectives of combating corruption,
2. define its principal methods and means,
3. propose specific measures to be taken in respective areas,
4. define responsibilities and a time schedule, and
5. indicate the method of monitoring.

As stated earlier the priority in combating corruption is to focus on corruption in the public sector, among top civil service officials, judges, state attorneys, policemen, customs officers, officials collecting taxes, and state control institutions. Such corruption is most dangerous for stability of the country and could hinder an effective procedure against other forms of corruption and illegal activities in general. The Law on Civil Service would be a systemic measure that could complement the Program in combating corruption in this area. Such a law should define legal position and more elevated responsibilities of civil servants in aforementioned administrative bodies, including limitations imposed on their other sources of income and their disciplinary liability. While being on the agenda, the Law is still missing though.

Further targets of the Program are to deal with corruption in a private sector. Such corruption is considered to be most dangerous when it is prone to influence segments of public sector or to affect its function at national level, above all in education, health service, and media.

The program does not plan for any new institutions to be set up or new regulations to be adopted. Existing rules and institutions should be exploited instead, as well as potential of the Czech civil society. In that respect the program does not rule out possible cooperation of government with NGOs. If the situation calls for new institutions to be established, this would be based on a principle of minimum financial support from the state budget. The program aims to increase extent of power for financial and tax authorities, as well as for police forces that administer economic crime agenda.

4.1 Educational Program

In order to increase awareness about corruption and ability of civil servants to fight it the government introduced an administration wide educational program involving officials from various administrative bodies. Three ministries, Ministry of Justice, Ministry of Interior, and Ministry of Education, Youth, and Sports, were assigned to work out several educational projects to increase awareness of general public as well as the ability of civil servants.

The project of national training of civil servants is focused primarily on preventing corruption to happen. Within the framework of another project, education and discussion panels for policemen, state attorneys, and judges involved in corruption cases should be organized to provide them with detailed knowledge on corruption offences and relevant counteractions. More public oriented projects call for preparation of various types of guidelines on social causes and consequences of corruption and methods of combating it, as well as development of a guideline for civilian protection against corruption. As an ultimate goal these projects are aimed to increase the public awareness of the dangers of the corruption in any form and to locate the means to investigate and stop it.

Because the governmental program to combat corruption is of a relatively recent nature there does not exist any evidence about its usefulness yet. Therefore, we are unable to evaluate it properly and matter-of-factly at this time.

4.2 Governmental program “Clean Hands”

Czech political parties are connected with the economy in two principal ways. First, the members or persons affiliated with political parties form parts of management and supervisory boards in the companies where the state is able to control. Second way is through "loyal" persons that benefited from earlier phases of privatization thanks to their political connections.

The campaign “Clean Hands” was audibly launched in 1998 by the current government to deal with fiscal crime and corruption. So far it has drawn an enormous amount of bad reviews from opposition parties and media for its very limited success. Legitimacy and transparency of this campaign have been questioned when it was announced that the composition of the Investigating Committee would be secret. The campaign itself produced less than 50 cases so far with the former Finance Minister being subject of one of them. It was admitted, by the Prime Minister, to be a failure and terminated in early 2000.

In any event, the government in line with the promises made in its election program set up an inter-ministerial commission in September 1998. The major task of this body was to coordinate anti-corruption policy. Within a year the Commission was given more than 3000 cases of possible corruption to inspect. So far more than 200 complaints were filed with the prosecution. Police has inspected about 70 complaints out of these and only 20 of these have been handled in the criminal proceedings (EC, 1999).

The police refuses to prosecute a vast amount of the filed cases since the quality of the dossiers is questionable. Also sometimes there is no clear evidence whether particular behavior is prosecutable since it is not explicitly prohibited by the law although its nature might be “criminal” according the common sense.

4.3 (Dis)improvement of legal system and proposed changes

As the results of the new anti-corruption program are questionable and the governmental actions are lacking co-ordination, personnel and equipment resources, and appropriate legislation, the government decided to move in an easy direction. It proposed, and got approved in February 1999, an amendment to the Civil Code that increased the prison sentences for bribery from five to eight years.

Although the anti-money-laundering legislation is compatible with the internationally required standards, there are several issues that need improvement. The tasks are divided among several agencies and Ministries and there is an obvious lack of sufficient coordination.⁸ The Czech Republic has neither signed the Council of Europe Criminal Law Convention on Corruption of January 1999 nor ratified 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions yet.

The proposed changes in the economic legislation comprise of property statements, changes in the monopoly regulation, further continuation of privatization and reform of public financing and financing of political parties. Additional changes include, for example, prescribed wire transfers above certain amount. The extent of the new legislation is still a subject of political debate since it can substantially affect the citizens’ rights.

Since the Czech Republic has a minority government and all legal changes require a majority support in The Parliament, there is a limited possibility for improvement. According to the 1998 European Commission report the achieved legal changes were unsatisfactory. Similar appreciation can be found in the 1998 World Bank Country Study on the Czech Republic. The European Commission went on to cast doubt on whether the Czech Republic would be able to reach the required legal standards in time to maintain its place in the group of “fast-track” accession countries. The reports of both institutions for 1999 were more favorable.

⁸ A case can serve as an example. A suspicious transfer of 1 billion CZK was reported by an involved foreign bank to the relevant supervising agencies with a question whether the highly unusual transfer is legal and should not be stopped. Since the permission was issued, shareholders of investment fund which management was at the same time under inspection whether it committed embezzlement suffered an unrecoverable loss.

Nevertheless, the proposed changes are moving along the track of increased regulation and deterrence with high penalties leaving the current discretion nature of economic regulation. Moreover, the intended changes would make the system less transparent, more complicated and, hence, increase the scope of possible corruption. As of now, there still exist special commissions at the Ministry of Finance and at the Ministry of Social Affairs and these commissions are allowed to forgive any penalties previously imposed at their discretion. These actions are completely unregulated - which openness a space for a high-level corruption.

The governmental assessment of suggested remedies to corruption is based on old concepts of deterrence and does not involve the assessment of potential hazards introduced to the system nor the analysis of the existing ones and their elimination by a simple change. Therefore, we are quite skeptical on the positive effects; we expect that implementation of all suggested enhancements would create even more problems with corruption than solutions.

The Parliament also passed a Free Information Act. This act shall allow access to all state information with the exception of the classified data. On the other hand, the current practice is that the bureaucracy is asking excessive “processing” fees to prevent the reveal of the information.

In the summer of 1988 and 1989 the Institute of Business Research performed studies measuring the gray economy of the inefficient socialist society at that time. GfK-Praha, Ltd obtained the similar sets of data in 1998. A comparative analysis of two time-separated data sets suggested interesting findings that instances of corrupt behavior are declining. The Transparency International (1999) published the detailed comparison in the analysis “The State of Corruption after Ten Years”. Despite such findings, the area of (government) clerical services have become the most corruptible institutional environment in the eyes of Czech citizens.

However, we should not be overly optimistic because, as the report states: “The transformation of corruption from the sphere of general services and sales to state clerical services, together with the socially differentiated nature of the evaluation of the necessity of bribery, signals a change in the social function of corruption. Earlier, corruption primarily assured a better level of services and a supply of shortage goods. Today, a category of people is crystallizing for whom corruption is a working tool necessary for professional success. The current common trend is towards the concentration of corruption in the state administration and the creation of a group of people whose existence is strongly dependent on corruption.”

5. Concluding Remarks

It is widely acknowledged that corruption has negative impact on economy and society, however, it is very difficult to measure such impact as well as an extent of corruption itself. Transition process in the Central and Eastern Europe (CEE) has uncovered very nutritious soil for corruption to flourish. After formally abandoning a centralized economic system the CEE

countries boarded the transformation process towards the market system. Rich agenda of tasks to perform general overhaul of society and economy further enhanced environment where people, being only humble humans, have took opportunity that corruption offers. Consequently, appropriate steps had to be taken against such behavior.

We attempted to document the state of corruption in the Czech republic and the measures introduced to fight it. We divided sectors of society and economy into four groups according to their importance in the prevention of a corruption and a consequential hazard to the society. We provided possible means of corruption but there was little of hard evidence in a form of the criminal prosecution. Therefore, we included major known cases as illustrative examples where possible. We also described the governmental concept of anti-corruption measures and outlined achievements and failures of such a program.

The overall impression favors persistent presence of corruption within the society and economy in the Czech Republic. Numerous comparative studies, however, suggest that corruption is more prominent feature in other transition countries with economies of the former Soviet Union leading the pack. Nevertheless, the state of corruption in the country, measured by the Corruption Perception Index, presents a serious problem since the index does not improve as transition process advances. We believe that the institutional framework to prevent and fight corruption is improving, though.

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