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Original Citation

Benesova, Hana and Anchor, J.R (2015) Corruption, Social Trust and Transition: the Case of the Czech Republic. In: 18th Annual Irish Academy of Management Conference, 2-4th September 2015, National University of Ireland, Galway (NUI Galway). (Unpublished)

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Corruption, Social Trust and Transition: the Case of the Czech Republic

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Abstract

The purpose of this paper is to propose research into corruption and social trust and their effect on businesses in transition economies with special reference to the Czech Republic. The literature review discusses the concepts of corruption and social trust and provides an explanation of how these can be used, in the case of the Czech Republic, when investigating the influence of these two phenomena on businesses operating in this environment. The discussion is augmented by a preliminary analysis based on secondary data obtained from Transparency International, the World Values Survey, the World Bank and the Polity IV project. This suggests that the assumptions derived from the literature review are valid. The paper concludes by proposing a methodology for further research.

1 Introduction

The transition economies of Central and Eastern Europe (CEE) have been explored extensively in the academic literature since the fall of the Iron Curtain. The scope of this research varies from macroeconomic studies aimed at mapping and forecasting economic development to studies investigating the nature of government and public opinion with regards to the transition process and the quality of life during and after transition. Although the former area of research is still prevalent in the literature, there are new concepts emerging which map the quality of institutions and their effect on society from different perspectives. For example, there have been studies aimed at investment in transition economies (Popov, 1998; Budina et al., 2000; Rizov, 2004; Cuervo-Cazurra, 2008), the quality of the business environment and the ease of doing business in those countries (Johanson et al., 2000; Meyer, 2001; Bitzenis and Nito, 2005) and also the quality of democracy and standard of living in transition economies (Letki and Evans, 2005; Puchalska, 2005; Lokar and Bajzikova, 2013).

The majority of studies focus on either the social or the institutional aspects of transition (Svejnár, 2002; Chu, 2004; Pournarakis and Varsakelis, 2004; Beck and Laeven, 2006; Fischer and Sahay, 2008; Johanson, 2008; Shinkle and Kriauciunas, 2010; Marangos, 2011; Tridico, 2013; Askarov and Doucouliagos, 2015) or the economic and business aspects (Martin et al., 1996; Peng and Heath, 1996; Peng, 2000; Redek and Susjan, 2005). There are a handful of studies where these two perspectives meet and their primary focus is usually social, rather than economic and business, such as the level and nature of corruption (Holmes, 1997; Kaufmann 1997; Goel and Budak, 2006; Koyuncu et al., 2010; Iwasaki and Suzuki, 2012; Alon and Hageman, 2013; Libman and Obydenkova, 2013), the effect of transition on civil society (Letki and Evans, 2005; Lewandowski and Znoj, 2008; Zakaria, 2012), developments in and the quality of social capital (Svendsen, 2003; Letki, 2006; Vodrazka, 2009; Marangos, 2011) or the extent of the communist legacy on both institutions and societies in countries which have undergone transition (Holmes, 1997; Sajo, 2003; Libman and Obydenkova, 2013).

The majority of the studies referred to above make use of secondary data and therefore serve well to make generalizations but are likely to omit specific issues which require investigation by means of qualitative analysis. Given the distinct nature of transition in CEE, this is a significant omission as there are likely to be hidden treasures in terms of specific practices and experiences of agents which might bring new and exciting views of issues which have

been discussed for more than two decades. Therefore we propose qualitative research targeted at business managers operating in the environment of a CEE country; namely the Czech Republic. The choice of this country will be explained below in greater detail.

We propose a study of corruption and social trust and their effect on businesses in this region. Since the research is still in its infancy, we will not be able to present any primary data but the literature review will include a number of graphs and figures based on secondary data included in Transparency International's Corruption Perception Index (CPI), World Value Survey's questions on social trust and various indicators of the quality of democratic regimes in CEE. A comparison of all CEE countries will be provided in order to position the Czech Republic within the region.

2 Literature Review

Corruption has been identified by many researchers as one of the major issues in CEE countries (Kaufmann, 1997; Bjorvatn and Soreide, 2005; Karklins, 2005; Goel and Budak, 2006; Knack, 2007; Cuervo-Cazurra, 2008; Moller and Skaaning, 2009; Koynucu et al., 2010; Denisova-Schmidt and Huber, 2014). From the many lenses one can apply to the issue of corruption we choose to build our argument around social capital and in particular the social trust lens. This is a popular research context of corruption with many studies having already been conducted using this approach (Richey, 2010; Kubbe, 2013; Uslaner, 2013; Semukhina and Reynolds, 2014; Serritzlew et al., 2014).

Social capital has a long tradition in the academic literature, dating back to Jane Jacobs' book (1961) on urban life. Bourdieu (1983) established the concept of social capital which was later popularised in academic circles by Coleman (1988). However, it was not until Putnam (1993; 1995) that the concept of social capital became popular and used widely by many researchers in various academic disciplines. The concept of social capital is used by the World Bank as well as by other agencies. Although the main focus of this research is the relationship between social trust – a social capital component – and corruption, it is the effects of these two phenomena on the business environment which is expected to be the final outcome of our research. However, as already mentioned in the introduction, this is a theoretical paper, and therefore the following discussion will build up our understanding of the relationship between corruption and social trust in the transition context rather than provide any particular hypotheses.

There are numerous points of view concerning the definition of corruption. The definition generally presented and mostly agreed by economists is misuse of public office for private gain (Treisman, 2000). However the link between corruption and social trust is more apparent in another perspective - that corruption is a breach of the power entrusted to a government official or a bureaucrat (Karklins, 2005). Indeed according to this view a corrupt act would include three parties: one that offers a bribe (or one that is willing to pay a bribe when requested by a corrupt official) and one that accepts it and the public whose trust has been breached (Karklins, 2005; Kiernan, 2006). Moreover, it is not unreasonable to argue that there is a direct link between corruption and social trust, since corruption generally decreases social trust as the public will see corruption as a betrayal of their trust (Uslaner, 2013).

An important issue highlighted by Uslaner (2013) is the direction of this relationship. Is it corruption that decreases social trust or does a low level of social trust result in an increase in corruption levels instead? Elster (1989) and Barr and Serra (2010) suggest that officials who are perceived negatively do not have much to lose as the moral cost argument made in some studies (Drugov et al., 2014) is not valid in this case and that the potential cost of engaging in a corrupt act goes down to official legal sanctions equal to the extent and scope of a country's punishment for those who engage in corruption. It is also possible that social trust might increase the chances of making corruption transactions more comfortable for those who engage in them since trust will also increase the level of interpersonal trust between those who engage in a corrupt act. The most plausible explanation that the literature offers seems to be built on the two main types of social trust: generalized and particularized.

Generalized trust relates to the public and society as a whole. Of course, one might argue that there are a number of factors that influence social trust, ranging from cultural, societal and moral issues to economic factors, and that corruption is only a small issue in the whole social trust question but as previous studies indicate, corruption and social trust seem to be much more interconnected than seems obvious at first sight (Letki and Evans, 2005; Richey, 2010; Kubbe, 2013; Uslaner, 2013; Serritzlew et al., 2014). In addition, corruption and social trust take different forms in transition economies than in most of the Western countries and those that are classed as developing or emerging ones. Moreover a distinction needs to be made between institutional trust and generalized social trust given that this study seeks to shed light on how the issue of decreased social trust through increased levels of corruption affects businesses and the quality of their activities and the business environment. Institutional trust is aimed directly at the government and official bodies of a state (Chang and Chu, 2006)

whereas social trust is aimed at people regardless of what they think about the government and gives more emphasis to the quality of interpersonal trust in general (Letki and Evans, 2005; Letki, 2006; Vodrazka, 2009).

Particularized trust is statistically more likely to positively influence the levels of corruption as it increases the level of trust between a corruptor and a corruptee (Gambetta, 1993; De Graaf 2007). Particularized trust would fit with the importance of keeping corruption away from the eyes and ears of the public and therefore by enforcing the strength of in-group trust (Goel and Nelson, 2010). Additionally, since particularized trust is closely linked to family ties, political relationships or special private and/or public sector connections, the chances are that particularized trust within these groups is likely to increase the level of nepotism or bureaucratic corruption between friends, family circles and a bureaucrat, as well as the level of grand corruption and the level of corruption in private sector activities and projects in cooperation with the public sector respectively.

In modern democracies politics matter significantly as they represent the views and preferences of the whole societies. This has implications for the ‘greasing versus sanding wheels’ argument which indirectly implies that corruption increases political trust of public as well as their loyalty to a government by promoting efficiency through the creation of a bidding environment (Bayley, 1967; Huntington, 1968; Merton 1968; Lien, 1986). Indeed more recent studies show that the level of public trust is more likely to be shaken rather than strengthened by corruption (Lewandowski and Znoj, 2008; Kubbe, 2013; Uslaner, 2013), and as Chang and Chu (2006) mentioned that this relationship holds firmly “even after taking into account the endogenous relationship between corruption and trust” (p. 259). This suggests that both political and social trust are both adversely affected by corruption.

Since the possible links between corruption and trust have been discussed above we can now move to examine the experience of businesses with regard to these two phenomena. There are studies available on the issues of trust and business interactions and the ease of doing business under strong or weak trust (Brenkert, 1998; Smyth et al., 2010; Paliszkievicz, 2011; Jarratt and Ceric, 2014; Gerbasi and Latusek, 2015) but these studies usually focus on the issue of trust in either management (Brenkert, 1998; Paliszkievicz, 2011) or the interactions between individual business agents or groups of them (Smyth et al., 2010; Jarratt and Ceric, 2014; Gerbasi and Latusek, 2015). To the best of our knowledge, none of the studies investigating the issue of trust and its importance for businesses take into consideration social

trust – neither generalized nor particularized – and therefore we are attempting to fill this gap through adding to the existing discussion on the link between corruption and businesses, businesses and society and society and corruption. Figure 1 outlines the context of our proposed study in the academic literature.

Figure 1: Positioning of study in the academic literature



Source: Developed by authors

Studies on the effect of social trust and/or social capital on the economic growth of a country usually conclude that there is a positive effect of social capital and social trust on economic growth through the increased quality of economic output due to the ease of cooperation and business activity as well as a lower misallocation of resources since the economies reporting higher levels of social trust usually also report lower levels of corruption (Zak and Knack, 2001; Serritzlew, 2014). The following section will discuss how transition economies perform in terms of corruption, social trust and the quality of democracy and their business environment and will provide some transition specific characteristics which are distinct from those of other countries.

2.1 Transition, Corruption, Social Trust and Business

The focus of the previous section was on the theoretical definitions of corruption and social trust. The purpose of this section is to provide more detailed information on the nature of

these two phenomena in transition economies. Some preliminary analysis has been done by means of secondary data on corruption, social trust, ease of doing business and the level of democracy. These were obtained from Transparency International, the World Values Survey, the World Bank and the Economist Intelligence Unit. The main focus of the discussion will be the Czech Republic as this is the target country selected for this research and the remaining CEE countries serve the purpose of contextualising the Czech Republic in this region. For the purpose of this comparison the following countries are considered: Belarus, Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Poland, Romania, Russia, Slovak Republic and Ukraine which is generally in line with earlier studies of this region (Letki and Evans, 2005). The inclusion of Russia is for historic reasons and due to its influence on this region.

The Czech/Czechoslovak post-communist economic transformation after 1989 was driven by a desire to move the economy from a centrally planned system, marked by a lack of incentives and a distorted system of price and quantity allocations, to a more efficient, market – orientated system based on competitive forces. This was pursued by a series of rapid legal, institutional and economic measures, particularly in the sphere of micro economics (Svenjar, 1989). In order to maintain macroeconomic stability while introducing a market economy, restrictive monetary and fiscal policies were pursued, as well as strict wage controls. By contrast, the micro economic policies included price liberalisation of most goods and an opening up to international trade. A fixed exchange rate regime along with internal convertibility was chosen for the currency – the Czech crown (Svenjar, 1995).

Privatisation of enterprises was undertaken via a variety of measures. Restitution to the original owners of property which was nationalised after the Communist takeover in 1948 was undertaken. Small scale enterprises were privatised via auctions and government subsidies to companies were reduced and large state –owned companies were broken up and subsequently privatised. The mass privatisation programme which was implemented for large scale enterprises was based on the distribution of vouchers to Czech citizens. These vouchers could then be exchanged for shares in enterprises or in investment funds. Following two waves of mass privatisation, the Czech Republic, which was virtually 100% state owned in 1990, had, by early 1995, privatised about 80% of its assets (Svenjar, 1995).

The traditional institutions of a market economy also had to be created from scratch. The Central Bank was separated from commercial banks in 1991 and a “bad” bank was set up to

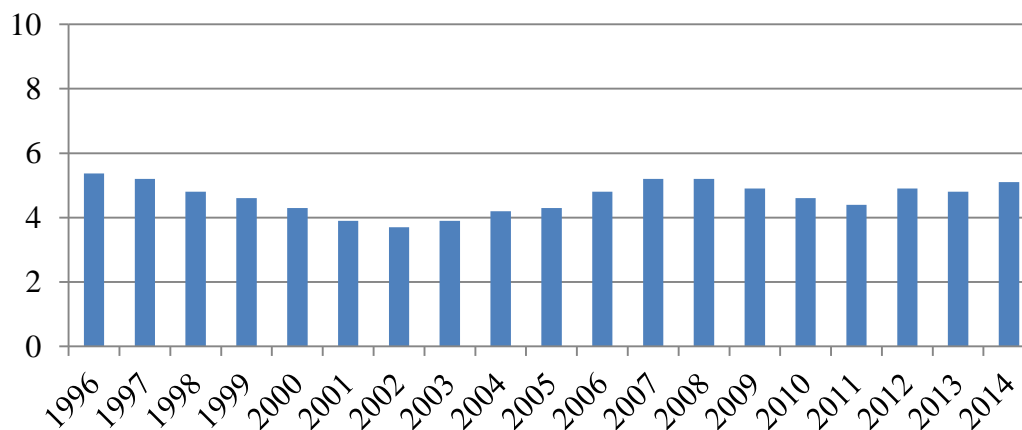
deal with the liquidation of bad loans. The Prague Stock Exchange was set up in 1992. A social safety net was also established, which introduced unemployment and social security benefits with the originally generous benefits becoming less so over time (Lavigne, 1999).

3 Czech Republic: Distinct nature of corruption and social trust

This section provides information on some specifics of corruption and their historical development in the Czech context, as well as offering some insights into social trust and the current perception of the Czech business environment. A comparison with other CEE countries will also be made, although no particular explanations of the differences between countries will be offered (Myant and Drahokoupil, 2011).

Although corruption was an issue in almost all the countries of CEE during the transition period and remains a major concern, its characteristics in the Czech Republic are unique due to the distinct nature of the Czech transition; particularly in the context of the voucher led privatisation of state assets (Svejnar, 1995). Indeed, during the privatisation period a ‘window of opportunity’ opened which allowed corruption to thrive and made it much easier than it would have been in a stable and well established economy (Kaufmann, 1997; Bjorvatn and Soreide, 2005; Koyuncu et al., 2010).

Figure 2: Transparency International’s Corruption Perception Index for the Czech Republic: 1996 - 2014

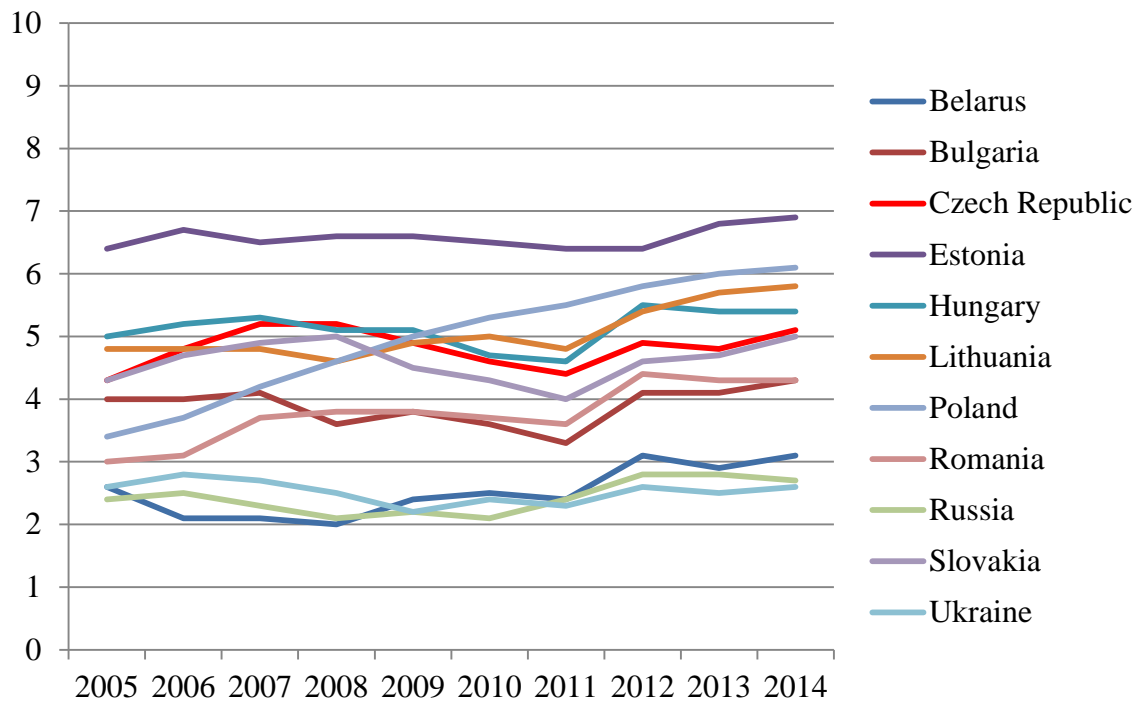


Source: Transparency International: CPI

It can be seen in Figure 2 that the perceived levels of corruption in the Czech Republic are relatively consistent in terms of their absolute value, ranging from 3.7 in 2002 to 5.37 in 1996. This is a particularly interesting pattern in the corruption experience. The exception is the decline in corruption in the early years of this century which was linked predominantly to the attempts of the Czech Republic countries to join the EU (Vachudova, 2009). The plausible explanation of the increasing levels of corruption might be the issue of the role of perceptions in the Corruption Perception Index which has been raised by researchers a number of times (Olken, 2009; Donchev and Ujhelyi, 2013). This suggests that corruption perceptions have long been underestimated due to the enthusiasm and high expectations of survey participants with regards to the outcome of the accession of the Czech Republic to the EU and that these expectations dropped immediately after accession. Additionally, there have been corruption cases since the accession which are directly linked to EU subsidies and also political fractionalisation and increased investment in the country (Jum and CTK, 2013). Whichever is the case, the issue of corruption is becoming more publicised and discussed than it was a decade ago; however, based on our previous research, there has been no evidence of an improvement – on the contrary, the results suggest that the level of corruption in the Czech Republic is worsening (Benesova, 2014).

In order to compare the Czech case to the rest of the region, Figure 3 provides an overview of the level of corruption of all CEE countries. The Czech Republic was ranked as 26th out of 31 European countries in survey results published by TI CPI 2014 which is a very negative result in this context.

Figure 3: Transparency International’s Corruption Perception Index for CEE: 2005 - 2014



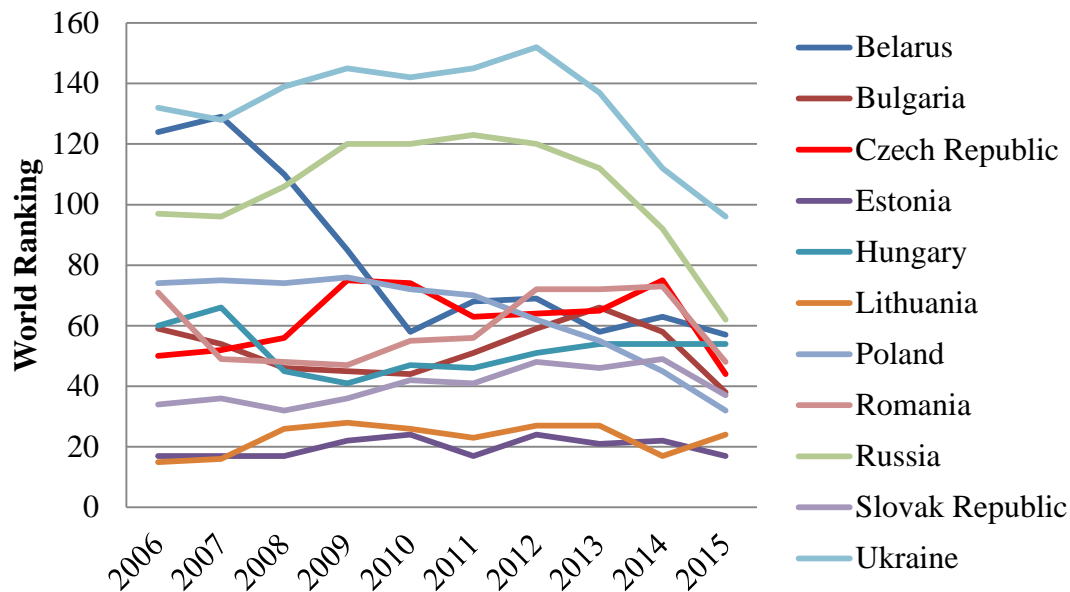
Source: Transparency International: CPI

It would be interesting to establish a link between the development of democracy in the Czech Republic and corruption levels. Corruption is likely to increase in fast democratizing countries due to frequent changes in their legislation (Bjorvatn and Soreide, 2005). Figure 4 below confirms that there might be a link as the Czech Republic holds the highest score when ranked on its level of democracy. However, although the ranking of democracy is high, and it has been stable over a number of years, the Polity IV project (CSP, 2014) suggests that the quality of Czech democracy has been destabilised due to fractured government threatening the – so far – positive development (see Appendix D for more detail).

In order to contextualise the issue of corruption and the quality of the Czech business environment, we use the World Bank’s ‘Ease of doing business’ which is a survey based indicator. In the indicator “[e]conomies are ranked on their ease of doing business, from 1–189. A high ease of doing business ranking means the regulatory environment is more conducive to the starting and operation of a local firm” (World Bank, 2014). As the graph below indicates, the status of the Czech regulatory framework does not work in favour of businesses in general, and therefore makes it difficult for businesses to ‘get things done’. This

would however support the idea of corruption as a ‘wheel-greaser’ when comparing the results of ‘Ease of Doing Business’ and levels of corruption – not as much in the rest of the region, which is an interesting observation – but certainly in the Czech Republic, and therefore would confirm Leff’s (1964), Leys’s (1965), Huntington’s (1968) and Meon and Sekkat’s (2005) justification of corruption as a substitute for inefficient government policies.

Figure 4: World Bank’s ‘Ease of Doing Business’ in CEE countries: 2006 - 2015



Source: The World Bank: Ease of Doing Business

The last remaining piece of the puzzle is social trust and its link with corruption and effect on businesses. Although the issues of social trust and corruption have already been discussed in ‘Life in Transition’ published by the European Bank for Reconstruction and Development (EBRD, 2010), which provides a very good overview of how these two phenomena work, the results are general, rather than country specific, due to the scope of the study and therefore do not give us enough evidence to conclude how this issue affects businesses. However, as acknowledged in the study, both societal and institutional trust are important pre-requisites for well-functioning markets. The Life in Transition Survey conducted in 2006 and 2010 (EBRD, 2010) reports low levels of both generalized social and institutional trust in CEE countries - lower than those in Central Asian transition economies.

Based on the data available from the World Values Survey (WVS, n.d.), Czechs seem to be rather more careful than trusting when dealing with others (see Appendix A) which, according to the theory on social trust and economic development is undesirable as it hinders business transactions and makes them more costly and time consuming. An indicator of particularized trust is WVS's question on trust in one's family which has a considerably higher value than generalized trust in others, which suggests support for the notion that there might be some space for nepotism as well as increasing the ease of corrupt transactions due to higher intragroup trust (see Appendix B where the question from the WVS on trust in own family was used as a proxy of intragroup trust). Additionally, when asked about their general opinion about the justifiability of bribe taking, also within the WVS, the majority of Czech respondents answered that bribes are by no means justifiable (almost 60%), and over 30% of respondents did not see bribe taking as justifiable, although they were not that strong in their opinion (see Appendix C, p.13). Although one might argue that these data alone cannot be taken as a proof of our proposed link between corruption and social trust, they are certainly a good indicator. Our hypothesis is most likely heading in the right direction and that when we look at this issue more closely by means of in-depth analysis, we might identify new patterns and we might even be able to draw some interesting conclusions.

To the best of our knowledge, an investigation of these two phenomena, with regards to the quality of business activities and ease of doing business in the context of transition countries, has not yet been conducted, although the 'Trust and Transitions: Social Capital in a Changing World', edited by Lewandowski and Znoj (2008), is probably the publication which is the closest to this issue. Since we have not been able to find more information on this subject, we propose that the issues of social trust, corruption and business activities be studied by means of qualitative analysis; thereby building on the already existing knowledge which mostly makes use of quantitative data from survey approaches.

4 Methodology

This study will use semi-structured interviews as the main data collection tool. There is a trust concern built into this study due to the nature of corruption; people are usually hesitant to consult with strangers, let alone complete a detailed questionnaire survey, and therefore this issue has also been considered when designing the most appropriate methodology (Renzetti and Lee, 1993; Gupta, 2005). We believe that after establishing a relationship with our respondents through personal contact, they will be more likely to open up and speak on

the issues of corruption and trust and the link between these two phenomena, as well as the influence on their businesses.

The overriding theme of this research will be a thematic analysis, using narrative as the research approach, in order to picture the issue in as much detail as possible (Riessman, 1993; Gubrium and Holstein, 2009). There is however also another rationale behind using narrative as a research tool in this context. The Czech Republic is characterised by a rich history of punishment for freely expressing one's opinion regarding the country's government which led to a development of a tradition of passing information anonymously through unofficial channels, which is still present (Crow et al., 2004; Killingsworth, 2010; Kopecek, 2010). This has also led to a strong tradition of oral dissemination or 'spreading the word' to peers with whom the witness was familiar and whom the witness could trust. Therefore, we believe it is desirable to investigate the issue of corruption by means of in-depth narrative analysis. By viewing the issue of corruption through the narratives of those operating in the business environment it would be possible to find out whether the argument of corruption being an effective vehicle compensating for government inefficiencies is a valid point in the Czech context and by presenting more detailed data and experience, this study will provide information about the nature of corruption and its influence on the day-to-day activities of companies operating in the Czech environment.

5 Research Contribution and Limitations

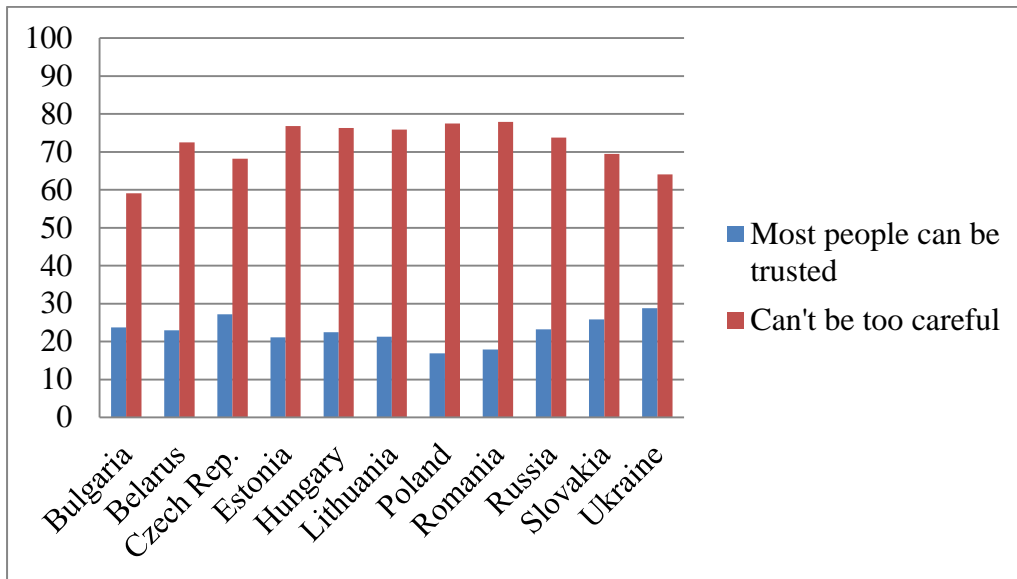
There are theoretical concepts underlying our research into the issues of corruption and social trust and their effect on businesses in transition economies, with particular reference to the Czech Republic, our research population. Although there are some limitations to the extent of the information, we believe that it provides a clear idea about the links between these phenomena. We expect corruption to decrease generalised social trust, and particularised social trust to be the catalyst for corruption. Although not mentioned in great detail in this paper, and serving as rather a tentative hypothesis at the moment, the quality of the business environment and the quality of cooperation between its agents is expected to be decreased due to increased levels of corruption and decreased levels of social trust.

As much as investigating this issue by means of in-depth, qualitative analysis is seen by the authors as a major contribution, it brings some limitations as well. The main drawback of this approach is its limited level of generalizability and therefore its inability to provide a comparison with the situation in other countries. Nevertheless qualitative data will shed some

light on issues which have long been hidden under the veil of survey and secondary data analyses and therefore might bring some fresh perspectives to the discussion of corruption and trust and their effect on the business environment.

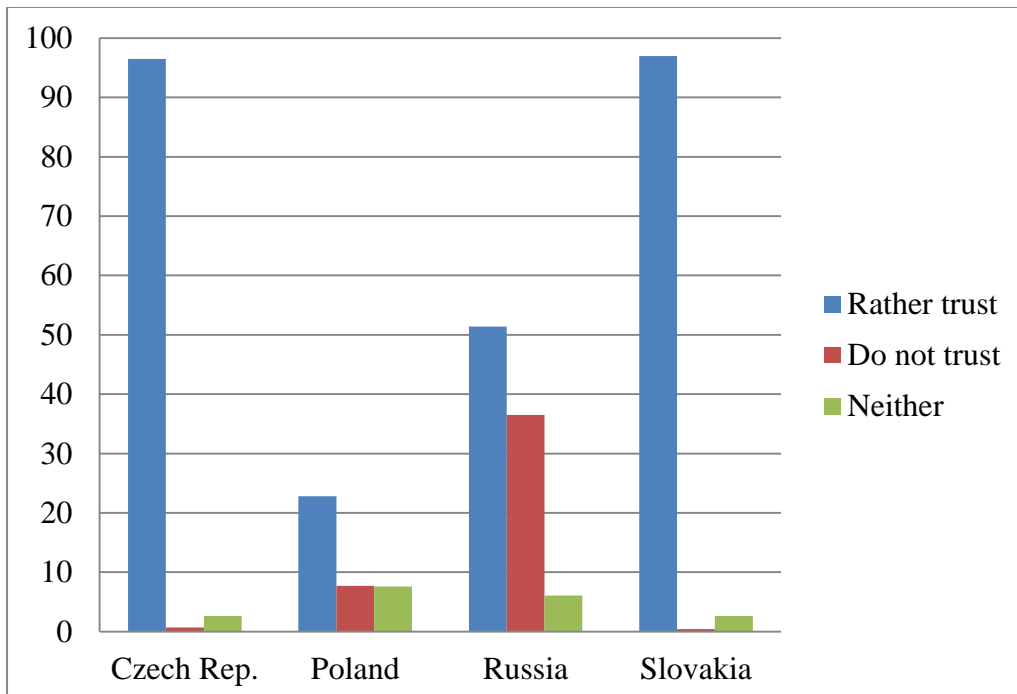
Appendices

Appendix A: WVS: Trust in People Question in CEE (1995-1999)



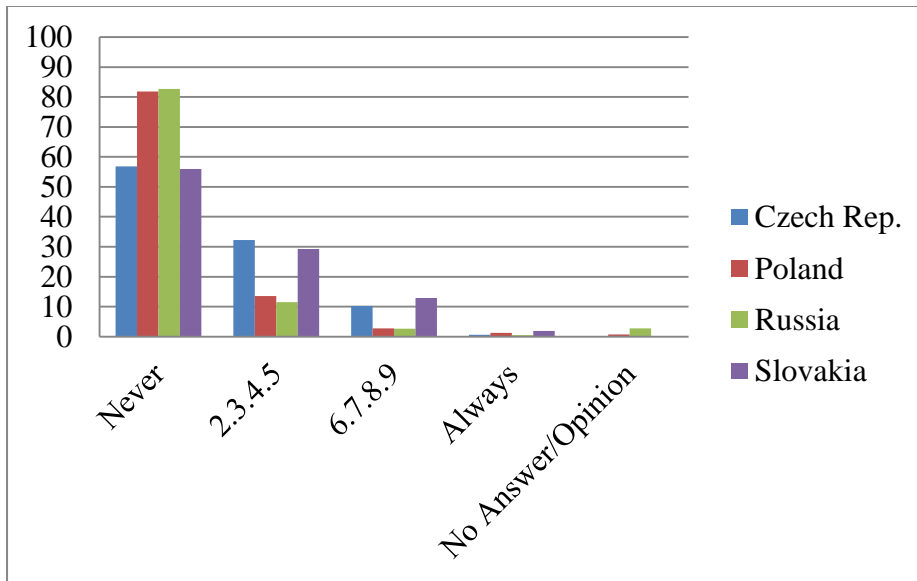
Source: The World Values Survey (n.d.)

Appendix B: WVS: Trust in Family Question in CEE (1995-1999)



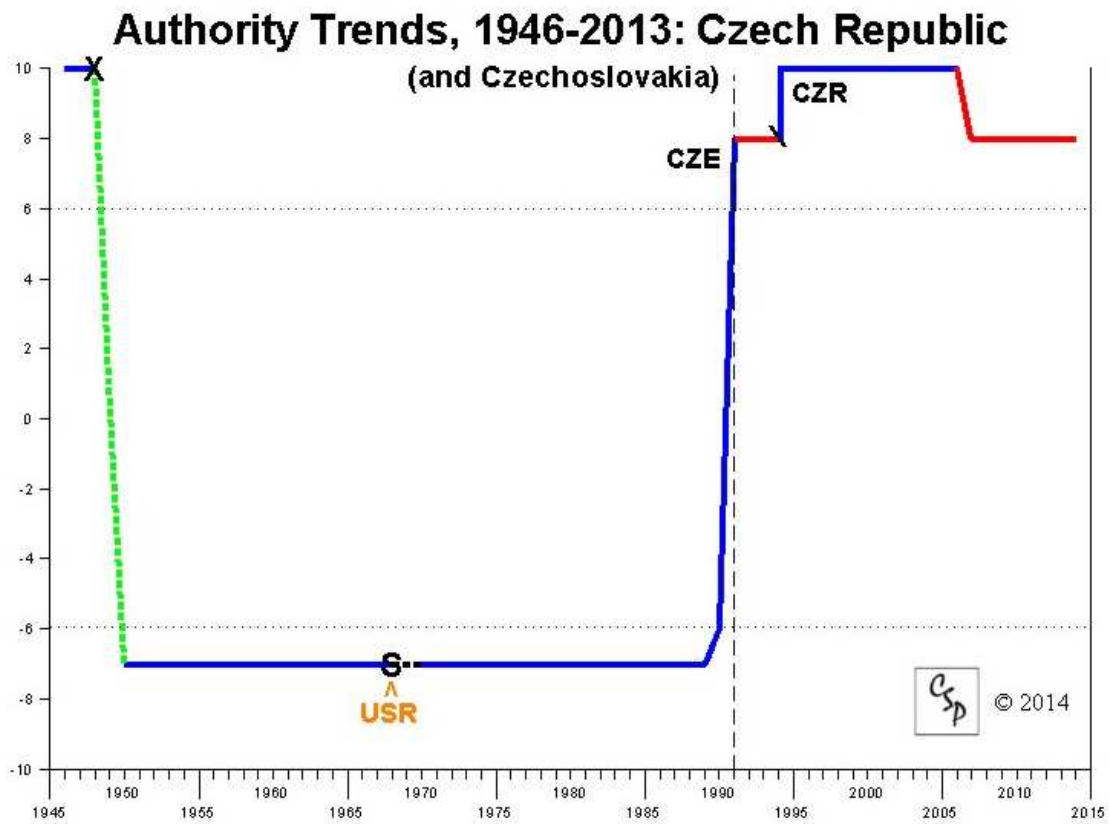
Source: The World Values Survey (n.d.)

Appendix C: WVS: Justifiability of Bribe Taking Question in CEE (1990-1994)



Source: The World Values Survey (n.d.)

Appendix D: Polity IV: Czech Republic



Source: CSP (2014)

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