

GOVERNMENT FAILURE AND CORRUPTION

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Abstract

The article presented herein responds to the nature of corruption typical for the Czech Republic. Corruption in the Czech Republic concentrates into the sphere of the public sector, the allocation of public means, into the murky sphere where interests of political parties, state administration and business merge and overlap. Guided by the theoretical context of the public choice theory we focus on a partial issue of interactions between state failures and corruption – in other words, the issue of maximising the usefulness of bureaucracy. Using the model of corruption balance the problem of accelerating corruption is analysed and discussed in the other part of the text. In conclusion we note, that the level of corruption and its probable development in a certain society (sphere) depends on the ratio of numbers of persons who are willing to participate in corrupted transactions and persons who are not willing to do so.

Key words: corruption, the public sector, governmental failure, the public choice theory, the Czech Republic

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Introduction

Corruption and inefficient state bureaucracy represent in the reality of the contemporary Czech Republic factors that pose the most serious obstacle to the development of business and economy in general. Up-to-date surveys of corruption in the Czech Republic¹ agree on the observation that *corruption in the Czech Republic concentrates into the sphere of the public sector, the allocation of public means, into the murky sphere where interests of political parties, state administration and business merge and overlap*. The main problem is becoming the system-based corruption. Everything seems to point to the fact that the anti-corruption policy of the government has failed and the importance of anti-corruption campaigns

¹ This means especially the survey “the Study of national integrity“ created by Transparency International in 2011 (available at <http://www.transparency.cz>) and the results of surveys of the working group to fight corruption of the National Economic Council of the government (NERV) from the same year (available at <http://www.vlada.cz>)

organized by non-governmental and civil activities, as well as by the private sector, is growing in the Czech Republic. One of the examples of such activities is the project “Reconstruction of the state”,² in which thirty non-profit organizations participate, being supported by private entities.

The nature of corruption in the Czech Republic confirms that the interaction between the governmental failure and corruption is a multidimensional problem. In the text of this article we will focus, within the context of the public choice theory, on the issue of bureaucratic maximising of the profit, which is mostly demonstrated by accepting bribes. Using the corruption balance model we will analyse and discuss the connections behind the acceleration of corruption within public institutions.

1 Market failures versus state failures

The thesis about the market failure was formulated by neoclassical welfare economics already in the first half of the 20th century. According to Jackson, Brown (1990, p. 28) this is “ ... *such situation in which conditions necessary for the achievement of a solution efficient from the market viewpoint do not exist or are disrupted in one way or another*“. As a result of the market failure economic entities do not achieve socially optimal results in their activities (which means that deviations from the Walras balance occur with the non-pareto optimal outcome). Some of the manifestations of the market failure may be “remedied” within the framework of self-regulating abilities of the market mechanism (e.g. through internalization in the case of externalities), however others become the subject of the so-called allocating function of the government (e.g. in the case monopolies or public assets). Although interventions of the state into the market mechanism may be justified in the cases of market failure we should not ignore, while assessing the interventions of the state, that reasons behind the state’s interventions in the economic environment often have not much in common with the market failure in the economic sense. According to G.S.Becker (1995, p.15) „*it is often said that the state has to use its visible hand to remedy failures of the invisible hand of market. However these failures would not occur in most cases at all if the state fulfilled its obligation and protected the market, that is, the free market*“. We can say that even at the beginning of the third millennium the market failure remains the most influential integrating

² The project „State Reconstruction“ is a joint project of anti-corruption organizations, a number of renowned experts, firms and regional supporters. It represents a plan of enforcing 9 laws that will contribute to a significant limitation of corruption in the CR within this term of office. Details available at: <http://www.rekonstrukcestatu.cz>

thesis that contemporary economists and politicians use to argue from the scientific point of view in favour of state-operated market regulations – this thesis often becomes the very basis for the explanation of the existence of the public sector (or the state) as such. Peková and coll. (2012, p.23) state for example that „*The existence of the public sector is a consequence of market failure. ... Both sectors, the public sector, which does not generate profit, and the private sector, which does, mutually complement and influence one another. If one of these factors fails the other one stands in its place. The failure of the private sector leads to the development of the public sector.*“ It is obvious that the market failure concept is a priori based on the assumption of the positive function of the state (public sector), the objective of which is the public good as the state is able to temper, if not eliminate, imperfections of market.

In the second half of the 20th century the thesis about the market failure became one of the most important motives for the creation of the public choice theory. The reaction of the economists supporting the public choice theory can be shortly summed up in these words: *the state may fail too*. In his normative implication J.Buchanan stated that “...*the public choice offers a theory of state failure fully comparable with the theory of state failure, which arose from the theoretic welfare economics of the thirties and the forties*“ (1979, p.11). The approach of the public choice theory has challenged the traditional conception of the imperfections of market and its tendency to produce failures that must be ‘remedied’ by the state. The theory of the public choice school is based on the contrary assumption and documents that “the public cure” mostly brings about damage rather than the public good.

2 The state’s failure and corruption

Corruption itself very often participates in “market remedies”, be it the regulation of monopolistic firms and the protection of economic competition, the assignment of public orders, provision of subsidies or the enforcement of fines and fees on the originators of externalities etc. In such cases the objective of corruption is obvious – maximising the profit from given opportunities, the avoidance of additional costs or minimising these costs. The sphere of the public sector and official transactions is perceived as the most susceptible to corruption not only in the Czech Republic but worldwide, and it is this sphere that associates with corruption in reality the most. It is an interesting observation that we make that while

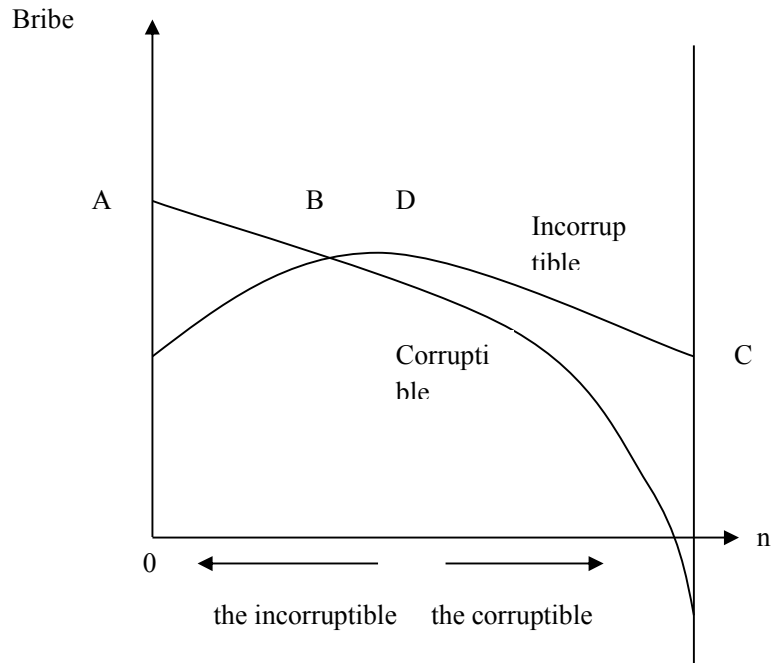
there are various levels of corruption³ in individual states, there are also significant differences in the corruption level present in various institutions, e.g. between various local self-governments, despite the similarities between available controlling means and incentives in the form of wages. It has been shown that even if the probability that corruption will be exposed is very low, surprisingly most civil servants act with integrity. It is possible to interpret this phenomenon, that is, the phenomenon that corruption may occur to various extents, by the fact that “*corruption propagates and corrupts others*“, in other words: the envisaged profit from the participation in corruptive transactions compared to the non participation in them *depends on the number of other people willing to participate in such transaction*. Complying with requests of one person depends on the acquiescence of others (if an individual decision depends on the action of others we have the so-called “*collective action problem*“). Since similar stimulating systems and institutions may result in varying levels of corruption the differences in the level of corruption among e.g. various authorities of the state administration can be explicated by the assumption that balance has been achieved at various levels of corruption – the balance can exist at high as well as low corruption. The balance is achieved at the moment when an individual civil servant has no stimulus to change his or her behaviour.

2.1. The corruption balance model

The following graph (Fig. 1: Corruption balance – Shelling’s diagram) depicts according to Andvig and Moene (1990, p.63) *the key bond for the explication of deviations in the level of corruption*. If we imagine e.g. a situation in one section of a municipal administration behind this graph, then the number of corruptible officials increases as we proceed from left to right along the horizontal axis of the graph. Every point along this axis represents a certain division of civil servants into corruptible and incorruptible ones. The bribe (as the profit from a transaction) is measured along the vertical axis. The “Corruptible” – “Incorruptible” line depicts a profit in the case of corruption for a single incorruptible official for all possible divisions of the other officials into these two categories. The “Incorruptible“ curve tends to decrease along the entire diagram, it depicts the profit of the totally incorruptible civil servant in an office with increasing corruption. His or her profit is higher than the profit of the corruptible official if the number of corruptible officials is low (to the left from point *B*).

³ Within the context of our article we define corruption in compliance with the definition of Transparency International as „acting on the part of representatives of the public sector that leads to unpermitted and illegal personal gains through the abuse of powers entrusted in them“.

Fig. 1: Corruption balance – Schelling’s diagram



Source: Andvig and Fjeldstad (2000, p.120), translated and modified by the author

The “Corruptible” curve depicts a situation when there is a secret agreement between people and the official based on bribe. It changes direction in point *D*: increasing number of corruptible officials makes corruption less rare and corrupting people may be willing to pay only smaller bribes for a provided service (to the right from point *D*). Looking at the structure of the graph we can assume that corruption has a negative public and social impact on the society represented by the fact that everybody is better off in point *A* than in point *C*.

The revenues of the corrupted official increases in the area to the left from point *D*. And there are three reasons that contribute to this increasing tendency of the curve (the “corruptible” line):

- (1) Increasing number of corrupted civil servants means declining intensity of qualms generated by corrupted behaviour.
- (2) Increasing number of participating persons decreases the significance of the loss of good reputation of the participants in the event that such case is publicly exposed.

- (3) If many persons are involved in corruptive transactions the probability of public exposure itself decreases.

The Schelling's diagram depicts three points of balance: *A*, *B* and *C*. In point *A* all officials are incorruptible and prefer this way of acting for future transactions too since their level of benefit is above the level of any official who gets involved in corrupted actions. The self government thus preserves the status of the incorruptible institution. On the other hand in point *C* all officials are corrupted because they believe that it does not pay off to be incorruptible. Finally in point *B*, none of the officials belongs strictly to any of the given categories. However the balance in point *B* is *unstable balance* if we assume that if another official becomes corruptible it will pay off to be corruptible. The same applies analogically if we assume that the one official in question will decide to be incorruptible. The model shows that if the self-government starts (e.g. due to historical reasons) with a higher level of corruption than point *B* it will gradually approach the stable level set by point *C*. However if it starts at the level lower than point *B*, it will head towards point *A*.

Even though it is very difficult to test empirically the significance of the given model, still the key subject of many anti-corruption campaigns is the very "shifting of balance" of the public administration from the sphere of high corruption to the sphere of low corruption. On the basis of Schelling's diagram we then may interpret monitored demonstrations of corruption in public institutions. We may especially monitor *varying levels of corruption within systems with the same institutional arrangement, wage structures, controlling and monitoring mechanisms*. Moreover we can see that if the public administration is in the vicinity of point *B*, any changes in the number of corruptible officials may have great impact on the level of corruption. If a short-term but consistent anti-corruption campaign manages to shift the public administration from point *C* to point *B*, the public administration will later head towards point *A* thanks to its own impetus. However if point *B* is located near point *A*, even minor shocks may make the public administration fall into the section of high corruption.

Conclusion

The attitude to the corruption issue and the possible acceleration based on corruption balance proves that the level of corruption and its probable development in a certain society (sphere) depends on the ratio of numbers of persons who are willing to participate in corrupted transactions and persons who are not willing to do so.

The presented model represents a partial contribution to the economic theory which is however by its very nature essential for the creation and implementation of real anti-corruption mechanisms. We may underline especially the fact that the success of anti-corruption policy is determined by its thoroughness. Short-term but thorough anti-corruption activities shall be organised repeatedly since corruption balance is very sensitive to changes near the limit numbers of persons (i.e. civil servants in our case) and the tendency towards corruption changes around these numbers in the given institution. We are of the opinion that the conclusions presented herein do not apply only to the public sector but may also be applied at a more general level.

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