
Transformation process

Transformation process - generally

- Transformation vs. reform
 - A transformation
 - Changes of the economic system as a whole
 - In the Czech republic – changes from the central planned economy to the market oriented economy
 - A reform
 - A partial changes inside the existing system
 - Reform of taxation system
 - Reform in pension system, etc.
 - The main question
 - What was the aim of Czech (Czechoslovak) transformation?
 - Does not exist of exact answer.
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Transformation process - generally

- One of the aim: get near to developed market oriented countries.
 - Several types of market oriented economies
 - Depending on
 - government interventions in the economy
 - The level of social system and policy
- Problem of setting future economy as a whole:
 - Free market economy - liberal approach
 - Market oriented economy with social attributes
 - A compromise between free market and central planned economy

Public Opinion in 1991	Economic system before 1989	Free market	Market with social attributes
Popularity in %	5	48	47

Possible forms of economy system

- Free market
 - Representatives: Klaus, Dyba, Dlouhy
 - A limited role of government, limited interventions in the economy
 - Priority: the low rate of inflation
 - Market economy with social attributes
 - Representatives: Zeman, Komarek
 - Base on Keynes's ideas
 - The policy bases on interventions, strong role of government
 - Priority: low level of unemployment
 - Compromise
 - Increase the role of market in central planed economy
 - Establishing of competition between companies
 - Limitation of state aids to ineffective companies
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Main changes of system from central planned to market oriented economy

- Prompt reform steps
 - Price liberalization
 - Liberalization of foreign trade
 - Free establish of business
 - Elimination of state aids for companies
 - Set of capital and financial market
 - Liberalization of proprietorship
 - Long-term tasks
 - Legal framework
 - Changes in justice
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Approach in transformation process

■ The gradualism

- Slow pace of reforms
- All negative factors could be limited by the slow pace of reforms
 - Optimism about situation in business companies
 - Afraid of social pressures

■ The shock theory

- Quick pace of reform
- Basic reforms in short time horizon
- Accompanied by stabilization policy and withdrawal of government interventions
- The main ideas based on expectation that in society there will be a will for victims
 - The will to reforms will be declining to reforms

Political development

- Political development was initial for the whole process of transformation.
 - After the communism coup in 1948 in Czechoslovakia was communism government till 1989.
 - After mass demonstration in Nov 1989 led demission of government and set cabinet of National Unity that governed till first free election.
 - At the same time at the end of 1989 was elected Vaclav Havel as the first president of Czechoslovakia.
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Political development

- First free election was in 1990
 - Referendum about the previous political regime
 - The winner of the election were representatives of reforms ideas
 - In Czech Republic won Obcanske forum (The Civil Forum) – organized group of reformers
 - In Slovakia won Verejnost proti nasili (The Public against violence)
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Political development

- Government coalition split in 1991 when Civil Forum was left by future members of *Obcanska demokraticka strana* (ODS).
 - First two years of transformation was characteristic by disputes between representatives of Czech and Slovak Republic
 - Dispute about a “dash”
 - Czech and Slovak Federative republic or
 - Czech-Slovak Federative Republic
 - Slovakia representatives rejected V. Havel as a president
 - Disputes about competences
 - Which competence will be at the hands of federal government and which at the hands of national governments.
 - In 1990 was decided about next election in 1992.
 - The winning coalition got public permission for quick continuation of economic reforms
 - This coalition gained 150 chairs from 200 in House of Parliament.
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Political development

- The winning was a success of reformers because in a lot of former communist countries in 1992-1993 won political parties that rejected or slowed down next reforms.
 - In Slovakia was situation different because there won left oriented party.
 - It means that representatives of particular republics had different opinions about future transformation and reforms.
 - There were divergence tendencies in both countries.
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The important political-economical topic

- Army industry
 - Army industry was concentrated in more in Slovakia (60 %)
 - Weapons was produced in more than 100 companies and there was employed about 70 000 employees.
 - The boom of Czechoslovak army production was in 1987 it is volume was 29 billion of CSK.
 - Army production represented 3 % of the total production and 10-11 % of the total industry production.
 - In the 1980's 70% of production was exported
 - 60 % in communism countries in Europe
 - The rest in the countries of the Third World (bad debts)
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Army industry

- In the 1980's Czechoslovakia 7th largest exporter of weapons.
 - Federal government in 1991 decided about cutting of army production about 85-89 %.
 - Cutting of army production in Slovakia about 90 % was negatively perceived.
 - Slovakia regarded with cutting of army as a unreasonably direction from Prague with all negatives that impacted in Slovakia.
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The important political-economical topic

- Other problem was a position of Slovakia in the federal republic.
- There were different opinions about the role of federal government and national governments.
- Slovakia pressed for the higher level of independency.
- Negatively relation between both countries affected the transformation process
- Negative impacts of transformation were more significant in the Slovak Republic
 - 1991 unemployment in Czech republic 4,1 % in Slovakia 12 %.
 - In Slovakia increased voices that wanted slowed down reforms.
 - Differences
 - Czech Republic aim: to finish reform process
 - Slovakia aim: to resolve all social impact of reforms

The important political-economical topic

- Slovakia representatives wanted
 - Slower pace of privatization process
 - Less restrictive economy policy
 - Abandon of voucher privatization
- Slovakia was supported by financial transfers from the Czech Republic
 - To limited social differences

	Slovakia	Czech Republic
Satisfied with reform	57 %	77 %
Gradualist reforms	64 %	36 %
Radical reforms	48 %	52 %

Political development

- After election in 1992 in both countries were set strong national governments and the role of federal government was limited.
 - The situation led to splitting of countries that was executed on 1st January 1993.
 - But in 1991 only 9 % of Czech and 15 % of Slovak citizens wanted splitting of Czechoslovakia.
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Economic context of Czechoslovakia splitting

- In the process of country splitting was also necessary splitting of the federal property.
 - There were two criterias
 - Territorial – primary criteria
 - Number of inhabitants – if primary criteria could not be used
 - The most of the property was split in rate 2:1 (primary criteria)
 - From army technologies to federal debts
 - Assets and liabilities of bank were divided according to the bank headquarter.
 - Problems were related with
 - Airport
 - Some public buildings in Prague or
 - 7,5 tones of Slovak gold from Slovakia Republic during WWII
 - Main problem
 - Property of State Bank of Czechoslovakia
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Economic context of Czechoslovakia splitting

- After the splitting of the balance sheet of the State Bank of Czechoslovakia and the splitting of federal money in circulation
 - arose debt of National Bank of Slovakia in volume 26 billion CSK in the face of the Czech Republic.
 - As a guarantee for settlement the Czech Republic froze Slovakia gold.
 - The debt was doubted by Slovakia for several times although international auditors confirmed it.
 - The dispute was solved in 1999. There was signed record about transfer and receiving of Slovakia gold.
 - Slovakia debt against Czech Republic
 - that has never not been admitted by Slovakia
 - was paid off by symbolic 1 CZK.
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Political development

- The role of Czech government was strong till the end of 1996.
 - Opposition was weak
 - first labour unions protests against government was not till 1994.
 - In next elections in 1996 was elected right oriented coalitions but new government was weak
 - Only 99 chairs from 200.
 - This government was not able to continue in reforms.
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Political development

- There was a lot of disputes inside coalition and disputes pointed after monetary tremor in 1997.
 - Government was modified by several times and a lot of pro-reforms ministers left.
 - Weak government ruled till autumn 1997 in that time had been very significant economic recession.
 - After government failure there was “care government“ till early election in 1998.
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Sum up of political progress

- The whole time period can be divided in two parts.
 - Till 1997 general support of transformation process.
 - But the enthusiasm was declining gradually and government established in 1996 was weaker than previous governments.
 - There is a question if this political development and long term of government was to the benefit for the transformation process as a whole.
 - Long term government led to quick privatization but did not prevent corruption and setting of some political problems.
 - On the basis of Poland experience alternating of governments during the transformation process can speed up this process as a whole.
 - In the second period governed left oriented government of Milos Zeman that continued in some right oriented reforms
 - The privatization of banking sector
 - The sale of state companies
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First years of transformation of financial system in the Czech Republic

- First step – establishing of new banking system
 - Prior the 1990's – so called mono-structure banking system
 - Although there was several banks with different function the major role was played by the central bank called the State Bank of Czechoslovakia (SBCS)
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First years of transformation of financial system in the Czech Republic

- Except for standard central bank functions like:
 - Monetary policy
 - Managing circulation of money
 - Tax collections
 - The SBCS was also responsible for:
 - Granting of financial and state organizations
 - Maintaining of their accounts
 - other roles as a commercial bank
 - All decisions on granting credits were the subject of the state plan.
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Transformation into a two-tier system and liberal regulation

- In 1989 first step were taken to abandon the mono-bank system.
 - As a reason on 1st January 1990 Komerčni banka (in the Czech Republic) and Vseobecna uverova banka (in Slovakia) were established.
 - These banks together with Investični banka and Investični a rozvojova banka taking over all commercial activities of SBCS.
 - These bank were established as a state financial companies.
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Transformation into a two-tier system and liberal regulation

- Rules for establishing new banks were liberal and the law lacked basic elements of prudential banking.
- The minimum basic capital required for establishing new bank was originally only 50 mil CSK.
- Banks could be (and were) established from
 - a loan granted by a single company and
 - could grant a higher loan (then shareholder's capital) to the same company (exposure limits were missing at that time).
- The law allowed banks to exit in the form of
 - State financial institutions
 - Joint-stock companies
 - Co-operatives
 - Joint venture

Transformation into a two-tier system and liberal regulation

- Basic conditions for establishing a banks with foreign capital were similar to the conditions of domestic banks.
 - A subsidiary of foreign banks had to be established in the form of joint stock company and had to follow the same rules as Czech banks.
 - Foreign banks were usually very cautious in this new and non-standard environment and focused mainly on solvent or foreign clients.
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Transformation into a two-tier system and liberal regulation

- Originally the role of commercial banks had been only the collection and redistribution of available financial resources.
 - The transformed commercial banks lacked well-trained staff of loan officers, risk assessment system, etc.
 - Liberal framework provided strong growth of opportunities:
 - Rapid development of private sector through small- and large privatization -> strong demand for bank products, esp. credits
 - Massive growth in number of opened accounts and
 - Increase in payment and clearing
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The economic environment

- Characteristics of environment at the early the 1990's
 - Improper legal framework
 - Ineffective law enforcement
 - Missing market institutions – stock exchange, security exchange commission or registry
 - As a reason of non-existence of a security market the demand for financial services was mostly based on loan finance.
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Problems with loan

- Assessing of financial health of loan applicants was seriously hampered by:
 - Non-existence of past company data
 - Establishment of new companies
 - Changing business of original companies
 - Vague auditing and reporting standard
 - Uncertainty about business activities in new environment
 - Needs of new business relations
 - Together with massive development of banks and their services negative phenomena appeared on the market. Including financial crime
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The new role of central bank

- The main goal of the central bank – monetary stability – was incorporated into new Constitution in 1990 (1993 after split-off CR and SR again in 1993)
 - In addition new central bank took the leading role in
 - Bank licensing
 - Partly in supervision
 - Provide of activities beneficial to the entire banking system
 - Development of clearing and settlement mechanism
 - Capital market – particularly stock exchange
 - Bank training and education
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Split of Czechoslovakia

- After the split of Czechoslovakia in 1993 State Bank of Czechoslovakia was transformed into
 - Czech National Bank
 - Slovak National Bank
 - The transformation was no problem-free
 - The allocation of former federal assets and liabilities could not be fully equitable
 - Leaving some assets and liabilities as unresolved
 - (transferred into KB and CSOB)
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First steps of central bank

- Establishment of standard monetary tools (deposit, lombard and repo rates, open market operations, obligatory minimum reserve)
 - Establishment of an interbank payment system
 - Establishment market with short-term debt instrument
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Other financial market institutions

- Market for Short-term debt instruments
 - The short term instruments market started its operation in 1992.
 - The system has been used for:
 - Registration of debt instruments issued in book-entry form with maturities up to one year
 - Settlement of trades with securities
 - Securities trading on the market have a form of
 - Short term instruments issued by Ministry of Finance (T-Bills)
 - And by CNB (CNB - bills)
 - Short terms instruments of banks and non-banks approved by Security Commission.
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Other financial market institutions

- The short term instruments market system was created as a segment of the financial market both for
 - Needs of Ministry of Finance – T-bills to adjust short term imbalances between state budget revenues and expenditures
 - Needs of CNB, which has used bill operations as a monetary policy instrument (for withdrawing and supplying liquidity via repo operations)
 - Needs of the interbank financial market – used for trading between market participants and with their clients.
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Other financial market institutions

- The short term instruments market system has never been public market
 - Participants
 - All domestic banks
 - All domestic investment companies
 - All domestic pension funds
 - And corporate sector or natural persons.
 - From foreign participants there are foreign banks or investment companies
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Preparation of transformation

- Year 1990 preparation of the “Strategy of the economic transformation” (published in September 1990).
 - Two parties:
 - Central planned economists from Ministry of Finance
 - Liberal economists from Academy of Sciences (Prognostic Office)
 - Final conception of Minister of Finance – V.Klaus
 - At the end of the 1990 devaluation of the Czech currency (for two times)
 - To face accelerating imports that were stimulated by preannounced expected devaluation.
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1991

- In 1991 in 1st January came in effects main package of stabilization measures:
 - Liberalization of bulk of prices (not included so-called regulated prices like electric energy, rent, medical care, etc.)
 - Liberalization of the foreign trade +internal convertibility of the Czech currency (obligatory surrender of foreign exchanges)
 - Last devaluation of the Czech currency 1DEM approximately 18 CZK
 - Setting of fixed currency exchange rate to 5 currencies, etc.
- The first steps of transformation were penetrative.

1991

- In the 1991 inflation rate rose to 56 % (the highest rate in the history)
 - It meant decline in real value of savings and wages.
 - Break up of RVHP led to massive decline in foreign trade and slow orientation in west European countries.
 - Because of all these inside and outside factors decline in GDP about 15 %.
 - These transformation decline was typical for all post soviet countries.
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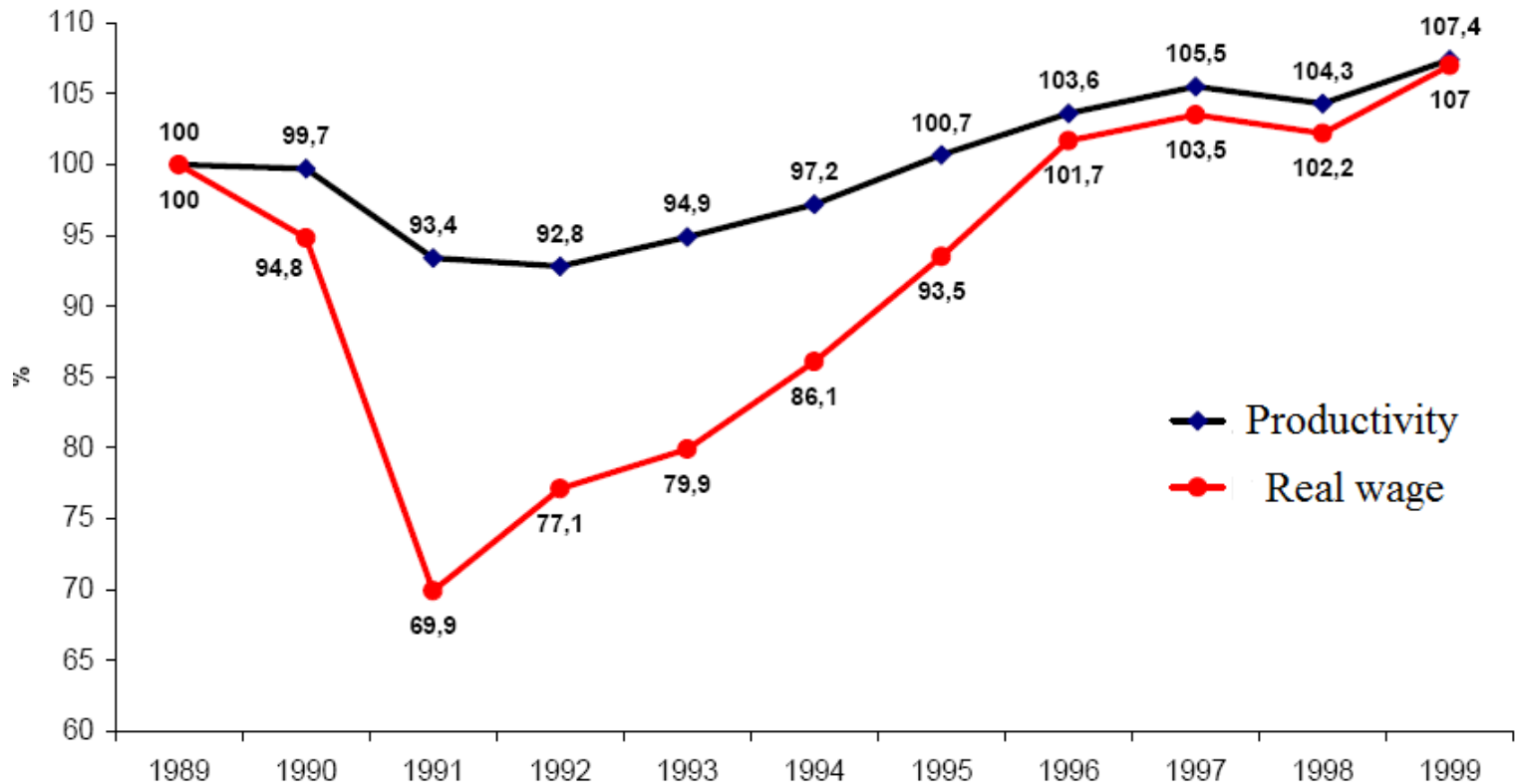
1992-1993

- Initiation of small and later large privatization (voucher booklets, several rounds of large privatization waves (waves were only two!))
 - To 1st January 1993 splitting of Czechoslovakia, establishing of two central banks.
 - At the end February 1993 dividing of Czechoslovak currency and stamping of currency.
 - To 1st January 1993 tax reformation e.g. establishing of indirect taxes -> cutting down the inflation rate to 20 %
 - The year 1993 last year of large shocks in the economy and starting of economy recovery.
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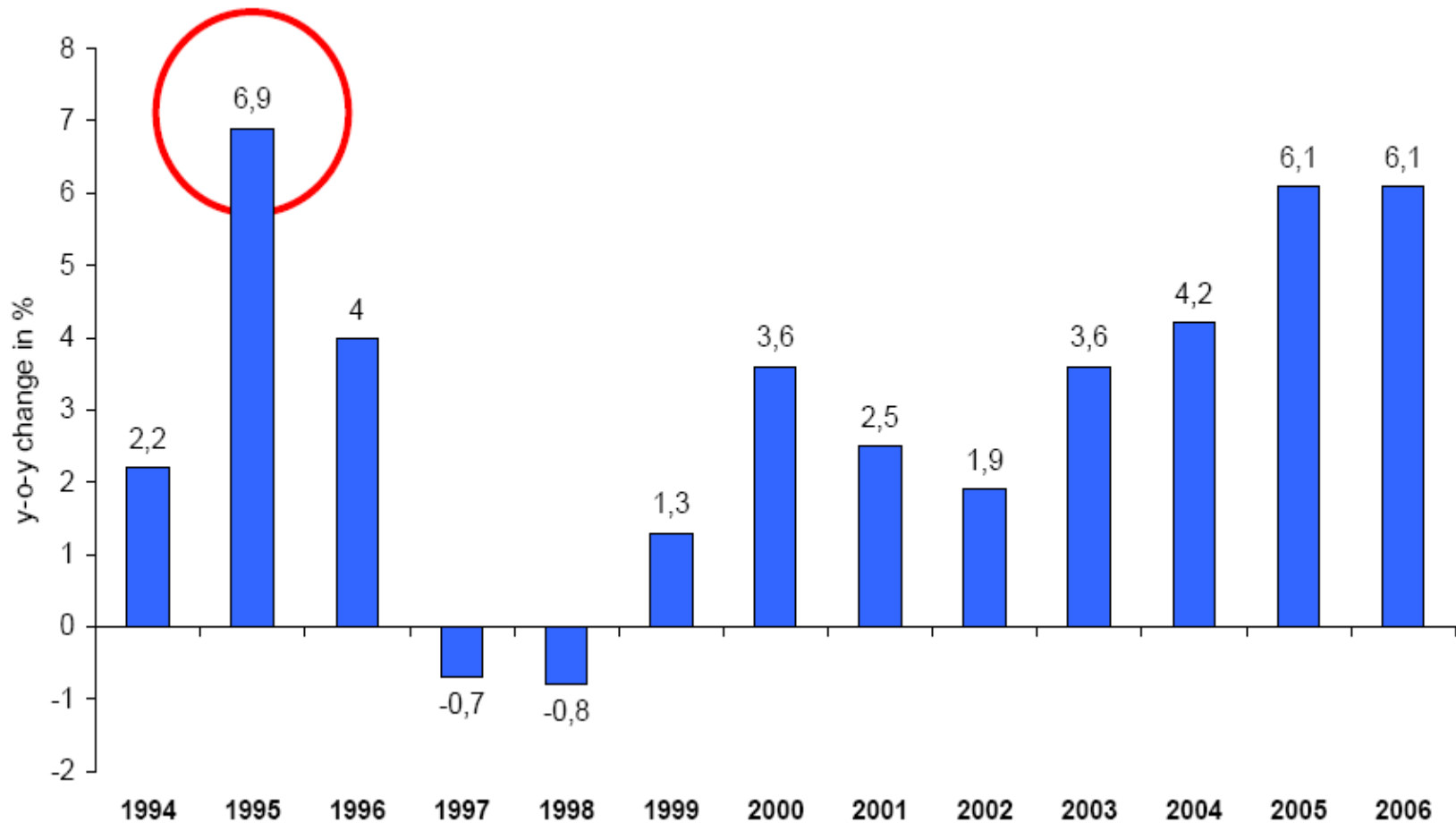
1994 - 1995

- The large privatization in proceeding.
 - In October 1995 entrance into OECD as the first post-communistic country.
 - Recovery of economic growth
 - Inflation rate 6 %
 - Unemployment rate 3 %
 - Despite of all economic progress in the financial market were emerged trends that led to banks and currency crisis.
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Difference - eliminated risk of demand pressure at the beginning of the 1990's



In 1995 according to GDP growth about 7 % but it was economy overheating



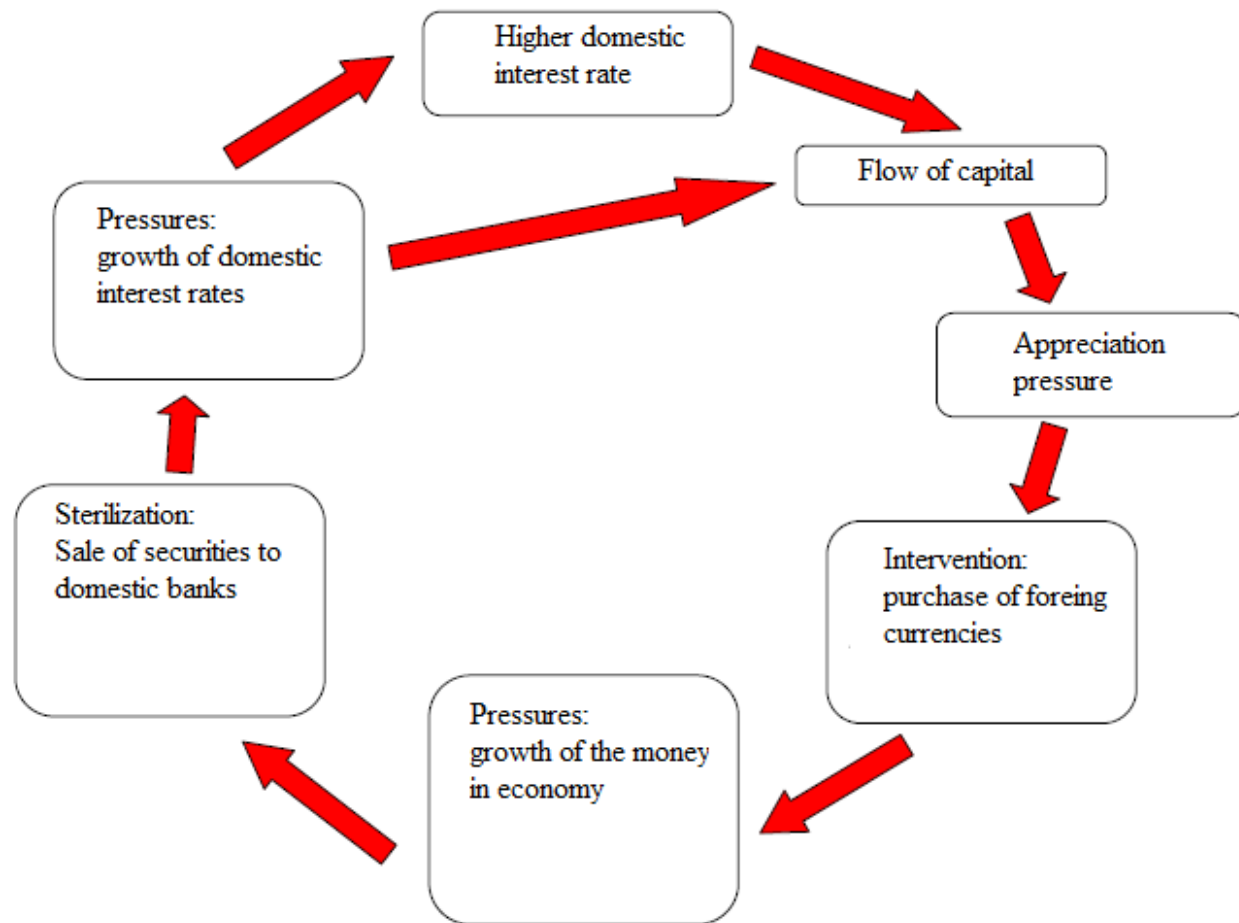
Overheating of economy in the half of the 1990's

- Fast growing demand
 - Fast growth of wages but slow growth of productivity
 - Fast growth of private and public investments (building of infrastructure)
 - Fast growth of credits
 - Fast flow of capital
 - Inelastic supply
 - Infirm markets
 - functionless law framework
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Monetary framework

- Fixed currency exchange rate from 1991
 - Several baskets
 - Originally to 5 currencies
 - Later only to USD and DEM
 - Liberalization of capital account
 - Establishing of Impossible Trinity –parallel existence of
 - Free flow of capital
 - Fixed currency exchange rate
 - Independent monetary policy
 - Liberalization of capital account destroyed coherence of monetary framework.
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Vicious cycle of monetary policy



Routing to CZK attack

- Fluctuation belt of CZK expanded from ± 5 p.p. to ± 7.5 p.p. at the end of 1996
 - Growth of repo rate from 11.3 to 12,4 (in 2011 0,75 %)
 - Growth of obligatory minimal reserves from 8,5 % to 12,5 %. (in 2001 2 %)
 - First attempt to stabilize Czech economy. Not successful.
 - In May 1997 after several days of fluctuation belt protection loss about 3 billion USD.
 - Leaving of fixed currency exchange rate
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Transformation – what was successful

- Stabilization of the Czech economy in the first phases
 - Splitting of Czechoslovakia and splitting of currency
 - Offers of wide range of privatization methods and transit of assets to private hands
 - Openness of the economy, establishing of competitive environment
 - Attractive of Czech economy
 - All transitive economies were more and less successful in some party of transformational process.
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What could be better

- Fast privatization of large banks (slow privatization was expensive)
 - Problems with Impossible Trinity – long time in fixed currency exchange rate and overheating of economy
 - Wrong law framework
 - Unfinished privatization (CEZ, CD, CSA)
 - Worse regulation of capital market
 - Low elasticity of labour market
 - No reform of pension, medical care, education system
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Thank you for attention
