



MASARYK UNIVERSITY
FACULTY OF ECONOMICS
AND ADMINISTRATION

The Way From The Centrally Planned Economy To The Free Market Economy

Ondrej Castek
castek@econ.muni.cz

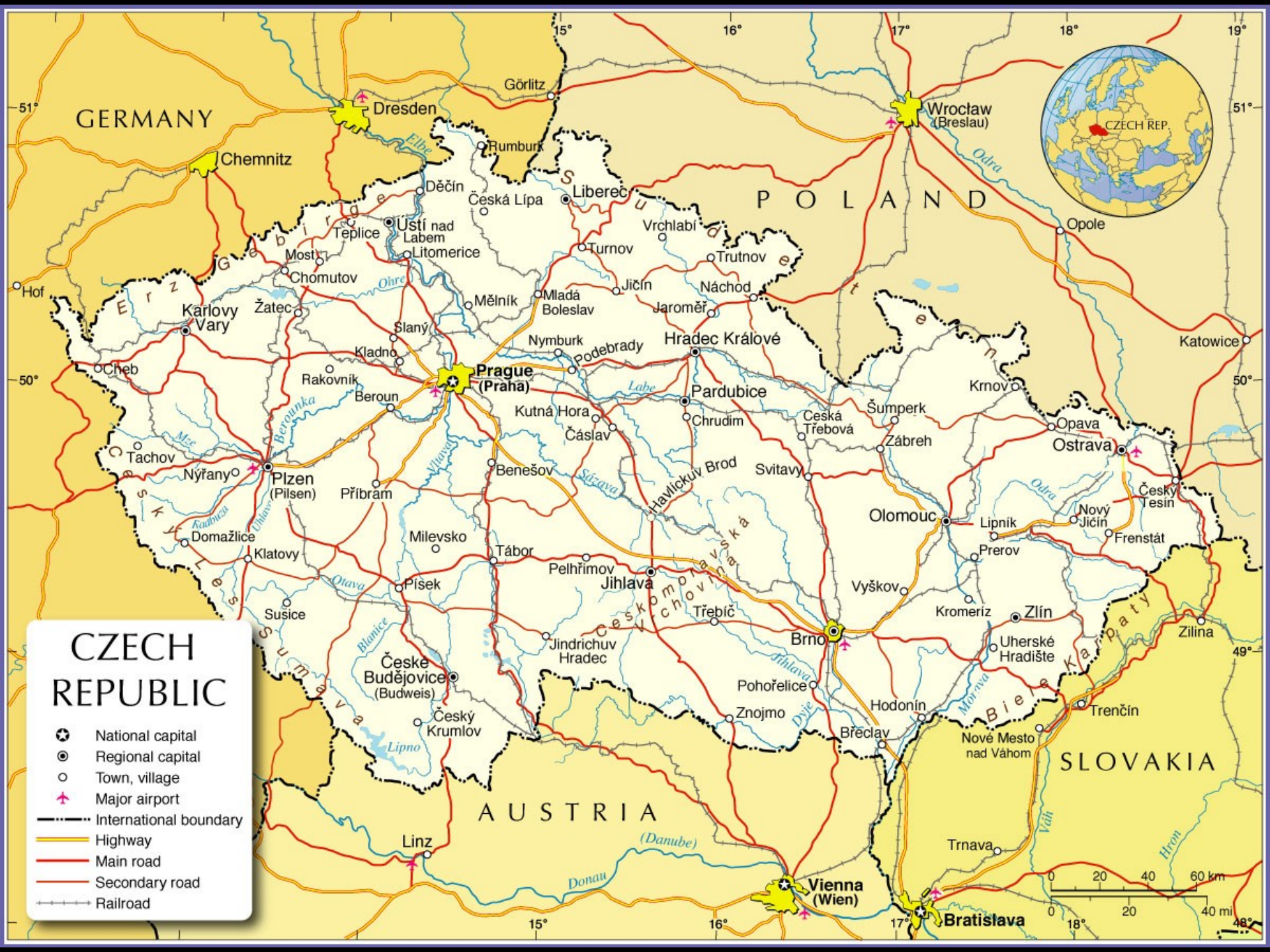


What can you expect

- The starting position of the Czech Republic
- Objectives of the transformation
 - Privatization
 - Restructuring
 - Free price mechanism
 - Convertibility of the currency
 - Foreign trade liberalisation
- Conclusion – Achievements, Failures







GERMANY

POLAND



CZECH REPUBLIC

- ☼ National capital
- ⊙ Regional capital
- Town, village
- ✈ Major airport
- International boundary
- Highway
- Main road
- Secondary road
- +—+— Railroad

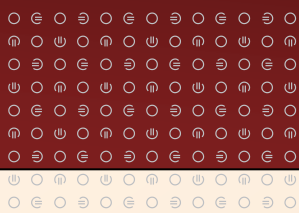
SLOVAKIA

AUSTRIA

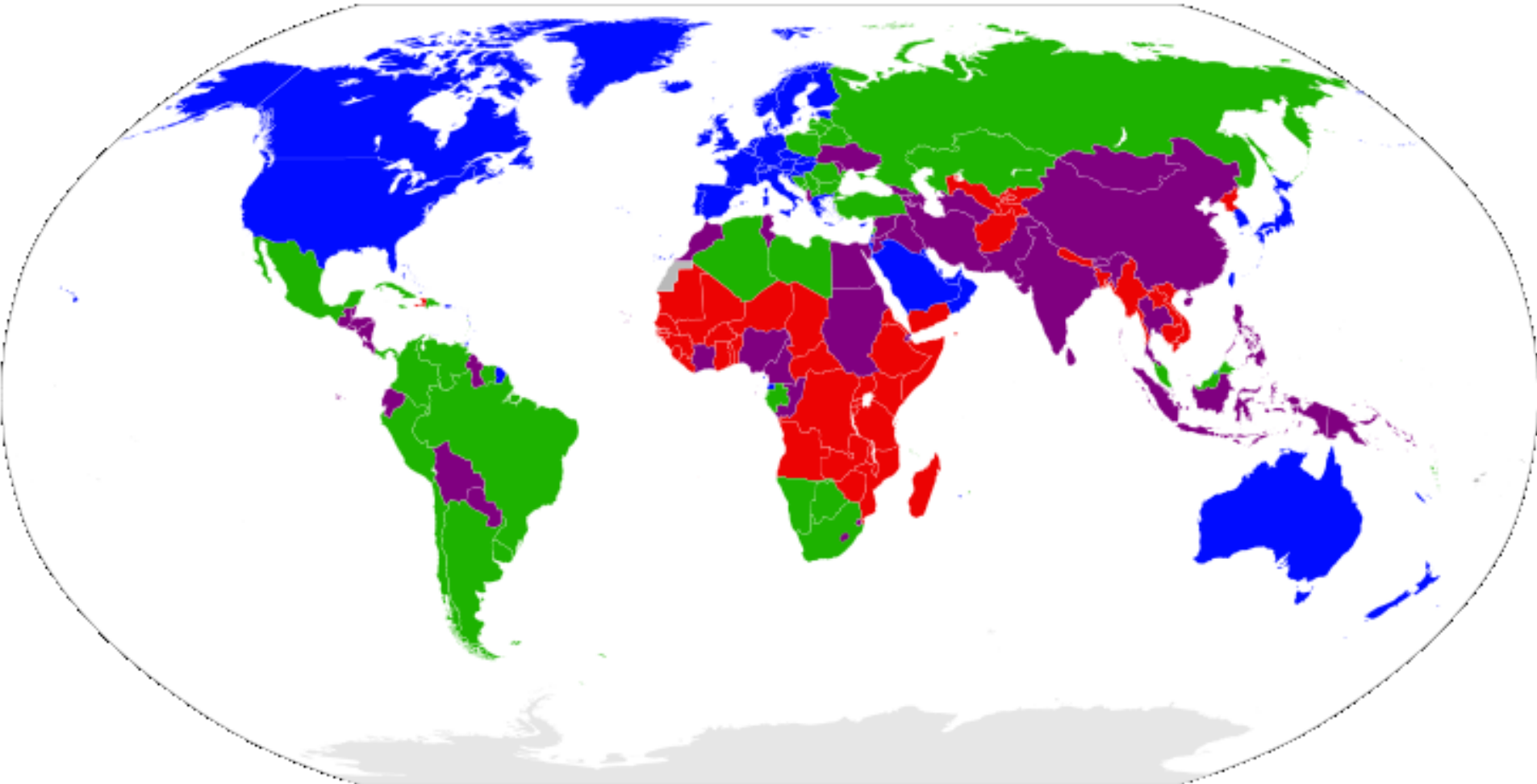
0 20 40 60 km
0 20 40 mi

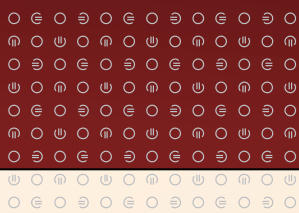


Motto	In god we trust	Truth prevails
Area	3,794,066 sq mi (9)	30,450 sq mi (122)
Lowest point	Death Valley -282 ft	Elbe River 377 ft
Highest point	Mount McKinley 20,335 ft	Snezka 5,256 ft
Population	307,212,123 (4)	10,211,904 (81)
Population density	80/sq mi (180)	341/sq mi (77)
Religion unaffiliated	12.1 %	59 %
Education expenditures (% of GDP)	5.3 (57)	4.4 (94)
GDP in 2008 US dollars	\$14.26 trillion (2)	\$265.2 billion (43)
GDP per capita	46,900 (10)	25,900 (52)
Currency	US Dollar, USD	Czech Crown, CZK
HDI	0.95 (15)	0.897 (35)
Infant mortality rate (deaths per 1000 live births)	6.26 (180)	3.79 (211)
HIV/AIDS - adult prevalence rate	0.6% (68)	less than 0.1% (161)
Drinking age	21	18
Driving age	16	18
Suffrage	18	18

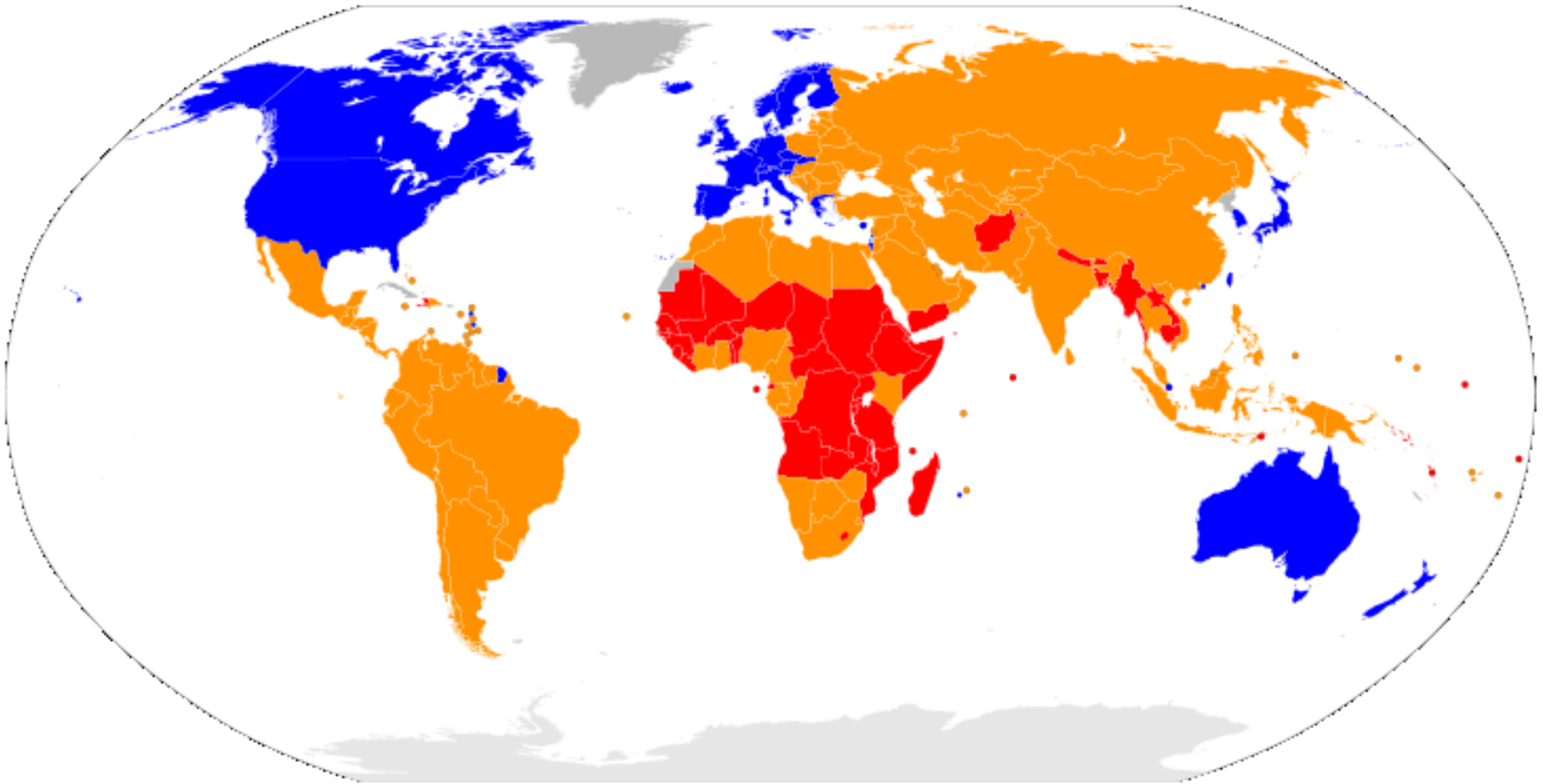


Income groups





Advancement of Economies



GDP composition (%)

	USA	Czech Republic
Agriculture	1.2	2.3
Industry	19.2	37.6
Services	79.6	60.1

The starting point

- One party political system (The Communist Party)
 - Now multiparty
- State owned means of production (98 %)
 - 1989: 98%, 1990: 80%, 1999: 12%
- Inefficient and inappropriate industry composition
- Absence of free price system
 - 1989: 100% of GDP. 1991: January 15%, June 10%, December 5-6%
- Absence of suitable legal system
- Foreign trade fully under state supervision, currency not convertible

Privatization

- Ownership structure in 1989: 87% state, 10% collective farms, 2% private owners
- Vital issue: fast or slow?
- 3 forms:
 1. restitutions
 2. „great privatization“
 3. „small privatization“
- „Great“ = „coupon“ privatization
 - Czechoslovakia specific
 - 2 rounds: 1992 and 1994
- „Small“ = auctions
- Unfinished

Privatization – assets confiscation risk

Asset confiscation – managerial „tunneling“

Tunneling is a specific kind of financial fraud. A group of major shareholders or the management of a company orders that company to sell off its assets to a second company at unreasonably low prices. The shareholders or management typically own the second company outright, and thus profit from the otherwise disastrous sale. Tunnelling differs from outright theft because people who engage in tunnelling generally comply with all of the relevant legal procedures; it is thus a subtler scheme than simply writing checks from a company to a private bank account. While people widely agree that tunnelling is unethical, penalties for tunnelling vary widely; some states impose criminal sanctions, whereas other states provide either for civil suits only, or for no sanctions at all.

Privatization – conditions to meet

1. On a micro-scale, the enterprise has to be sold off and management control and ownership have to be firmly rooted in the private sector.
2. Privatization works best if it is carried out in a competitive environment so that the SOE has to cope with liberalized markets-in which barriers to entry are minimized-for its products.
3. State subsidies and policy loans should be eliminated.
4. The SOE (state owned enterprise) monopoly prices have to be regulated with a pricing formula that keeps pressure on management to improve efficiency.
5. The markets that surround the SOEs on the output and input sides must be liberalized at the same time.

Privatization – three steps

- **Corporatisation** creates a new separate legal entity for the firm by converting an SOE into a joint-stock company (JSC) all of whose shares are (initially) held by the State Treasury.
- **Commercialisation** implies that the new JSC, unlike the former SOE, will be run as a profit-seeking business.
- **Privatisation** entails divestiture of (some of) the JSC's shares by one or a combination of various methods, such as initial public offerings, public tenders, management and employee buy-outs, and auctions of shares for vouchers distributed free under a mass privatisation scheme.

Privatization – coupon (voucher) privatization

Every adult citizen ages 18 and older was given the opportunity to buy investment vouchers - 1,000 points of investment money with limited maturity - for a registration fee of Kčs 1,000 (U.S. \$34), representing approximately 25% of the average monthly wage. These vouchers, in turn, entitled Czech citizens to bid for ownership shares of any company privatized by the voucher method or to allocate their shares to an investment fund that would make investment decisions for them.

First round (wave), 1992: 93 % of offered shares were sold

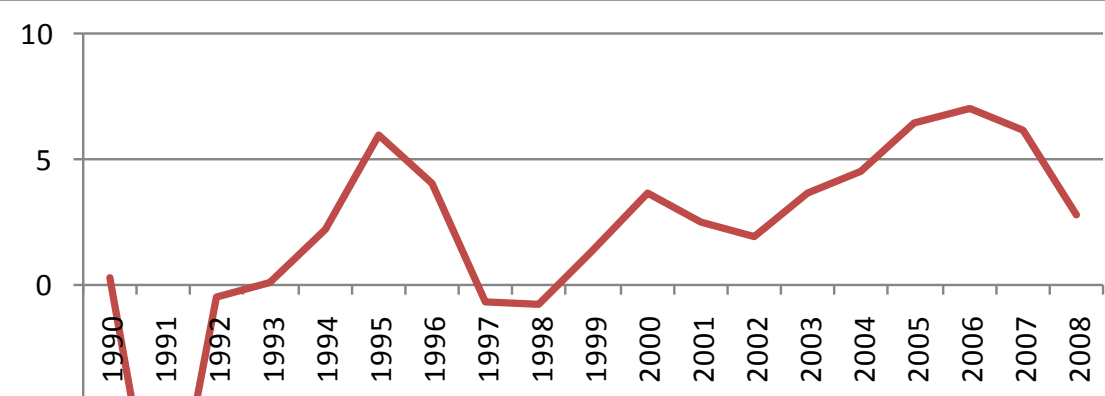
In 1995, after the end of 2nd round: 80 % of the economy privatized.

Middle class has been created.

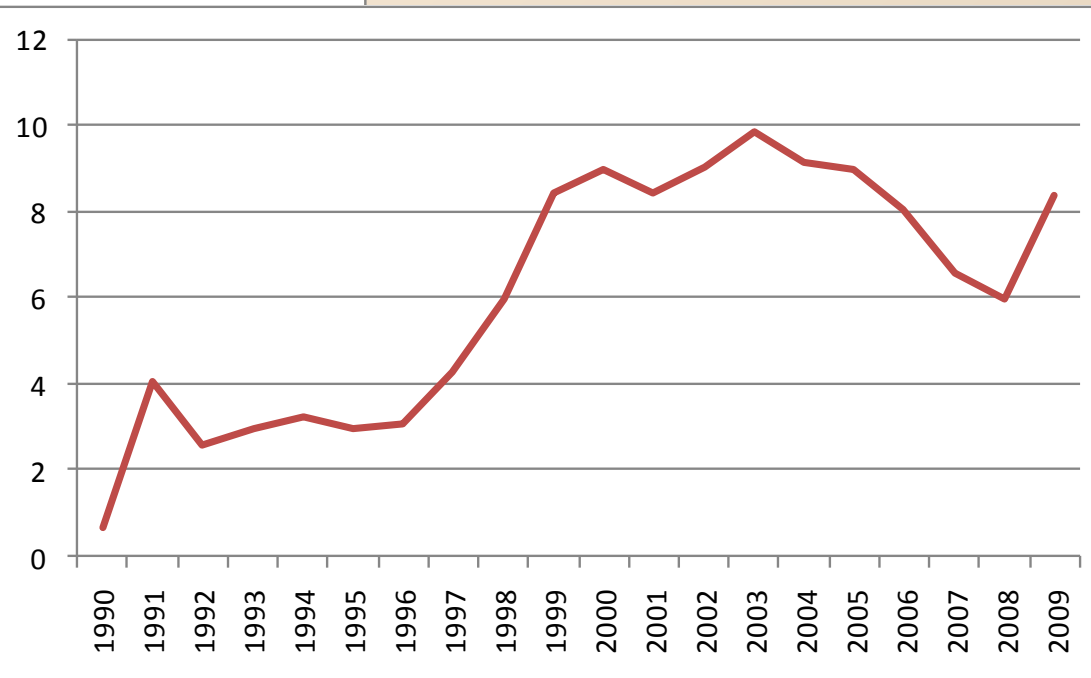
Free price mechanism

- 1989: The prices were set by the government for 100% of GDP. 1991: January 15%, June 10%, December 5-6%
- Barrier: monopolies
- Slow in some areas: telecommunications, energies, public transport, education, health system, social care system

GDP y/y, %

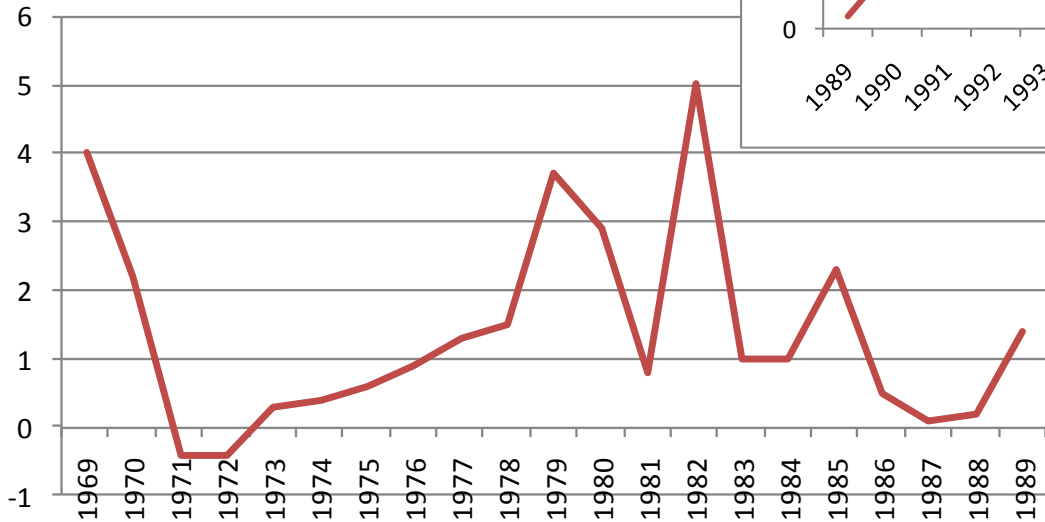


Unemployment, %

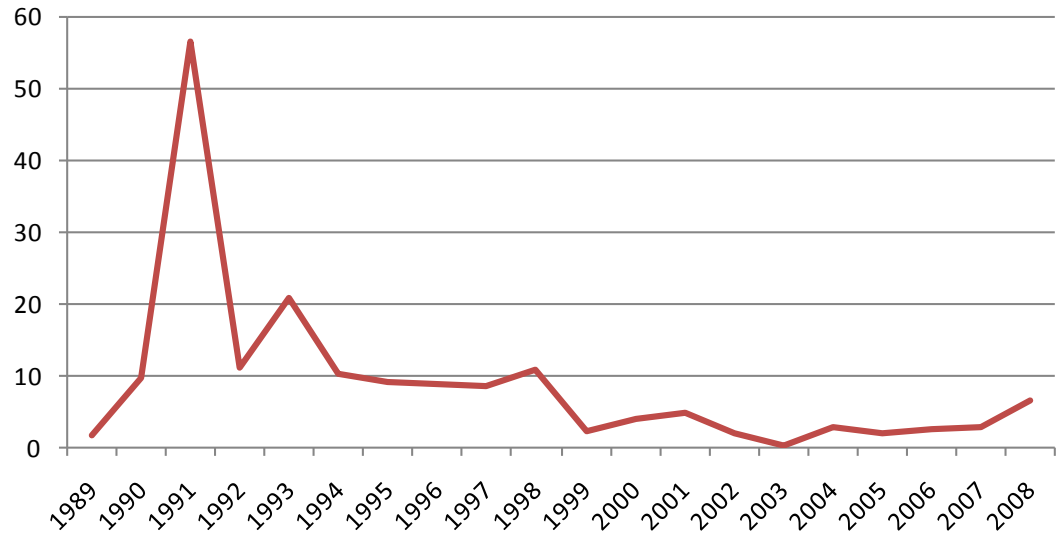


CPI 1969 - 2008

CPI 1969 - 1989



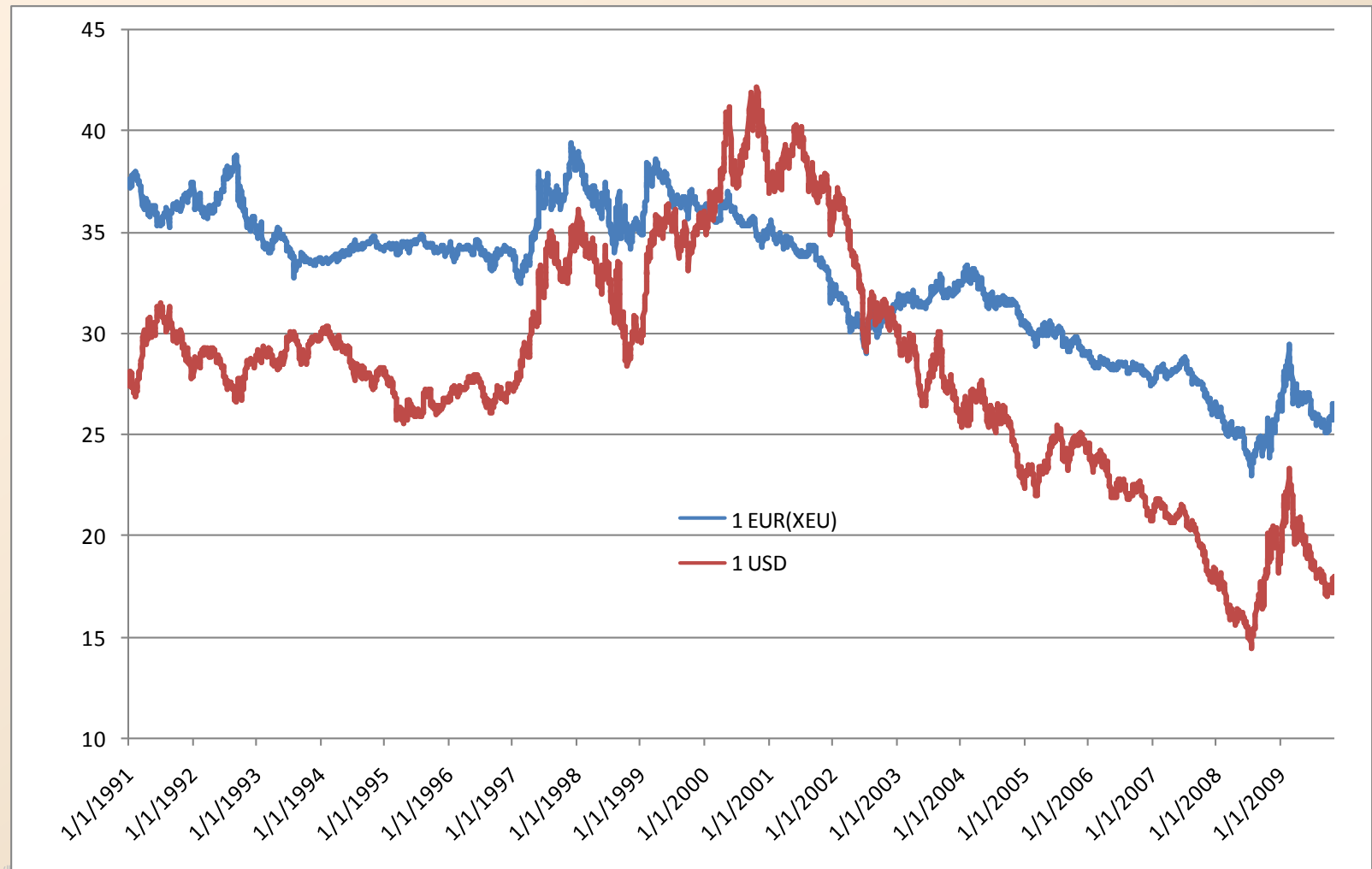
CPI 1989 - 2008



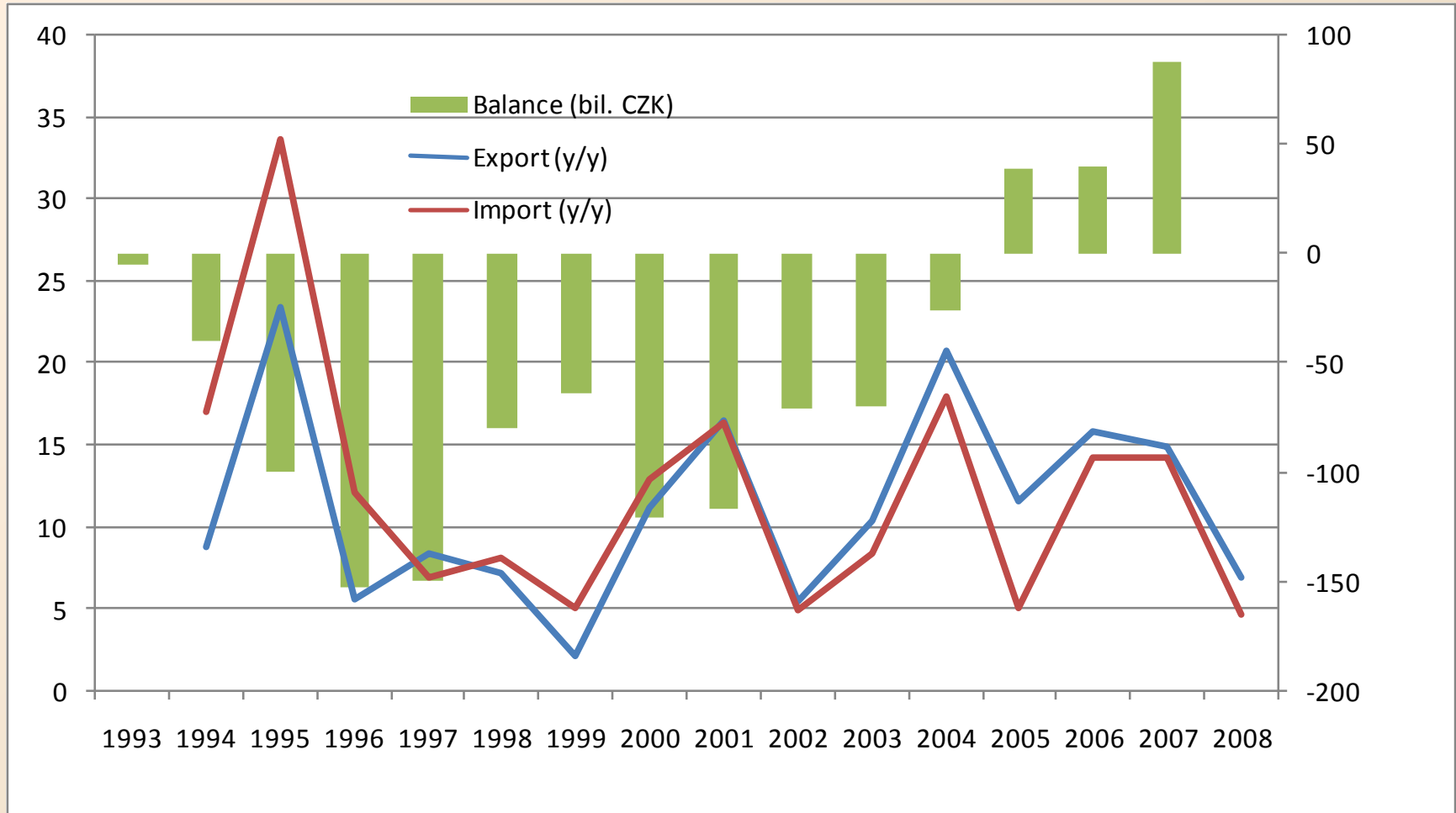
Convertibility of Czech Crown, foreign trade

- Free trade since 1990, still high import duty
- „Internal“ convertibility until 1995
- Full convertibility since 1995
 - Too passive balance of trade since 1995
 - Cause of macroeconomic problems

Exchange rate CZK/USD and CZK/EUR(XEU)



Export and import y/y rates (%), balance of trade (bil. CZK)



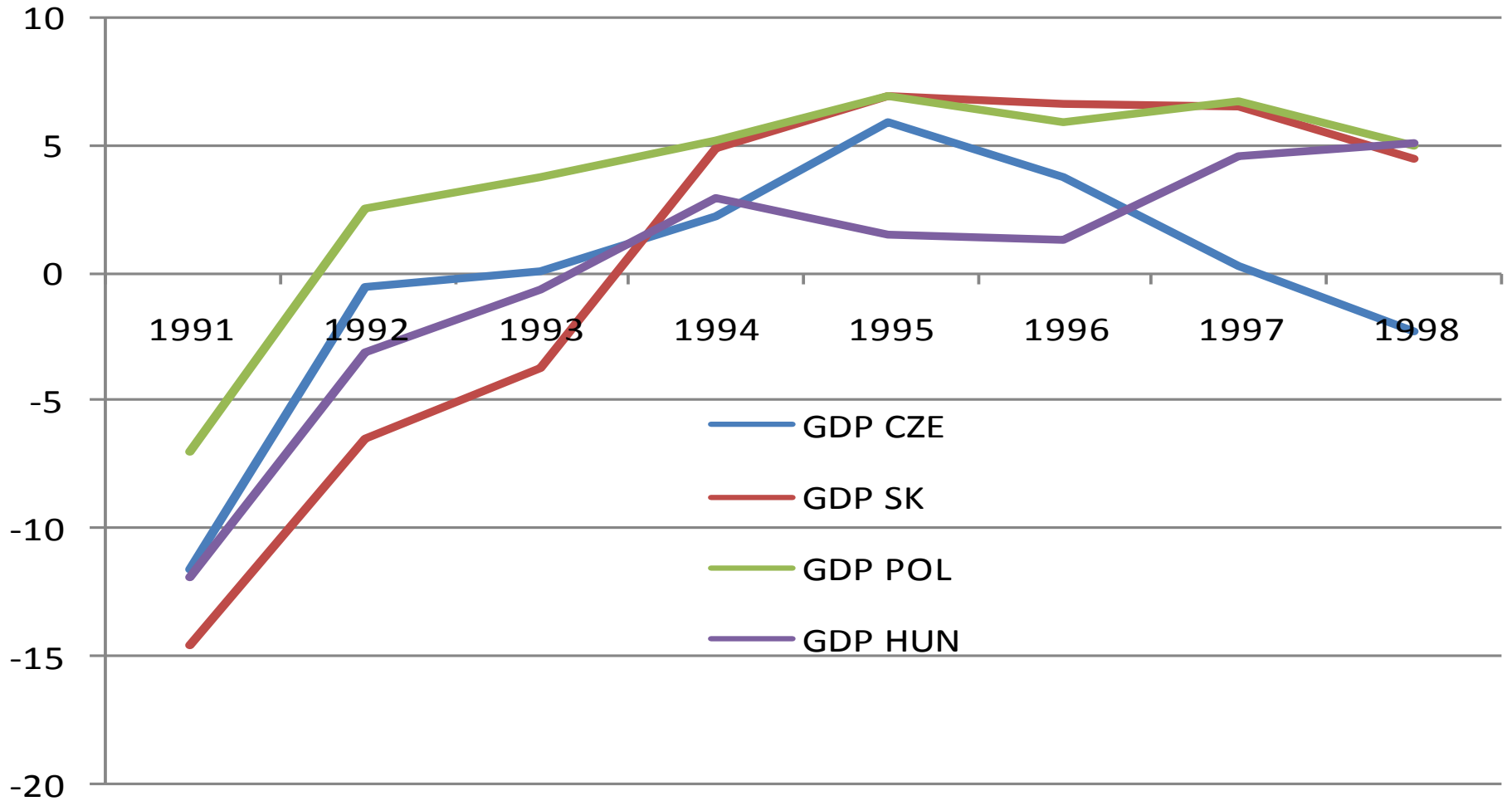
Achievements

- Macroeconomics: inflation and GDP
- Social state
- Open economy with active balance of trade
- Memberships: OECD, WTO, CEFTA, IMF, WB, EU

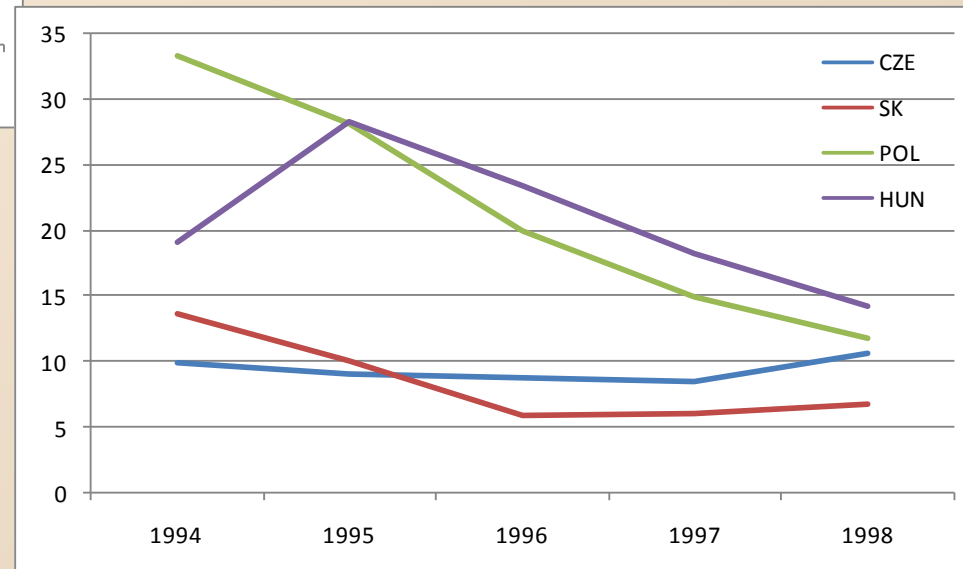
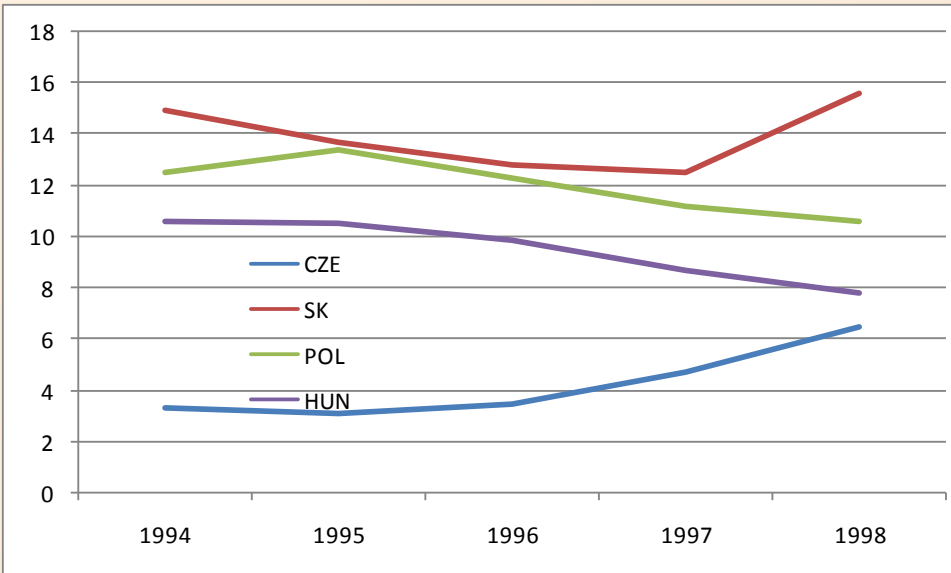
Achievements – CIA World Factbook Comment

The Czech Republic is one of the most stable and prosperous of the post-Communist states of Central and Eastern Europe. Maintaining an open investment climate has been a key element of the Czech Republic's transition from a communist, centrally planned economy to a functioning market economy. As a member of the European Union, with an advantageous location in the center of Europe, a relatively low cost structure, and a well-qualified labor force, the Czech Republic is an attractive destination for foreign investment.

Comparison – GDP y/y



Comparison – Unemployment, CPI (y/y)



Failures

- Tunneling
- Too many bad loans – many bankruptcies
- Late privatization of banking sector
- Slow implementation of legal system
- Unenforceable law in 90ies

Sources

Geographic Facts

CIA World Factbook

<https://www.cia.gov/library/publications/the-world-factbook/>