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.

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

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

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.

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)

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.

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.

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)

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.

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 let 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.

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 seat.
- Problems were related with
  - Airways
  - Some public buildings in Prague or
  - 7,5 tunes of Slovak gold from Slovakia Republic during WWII
- Main problem
  - Property of State Bank of Czechoslovakia

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.

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.

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.

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

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)

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.

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 Komercni banka (in the Czech Republic) and Vseobecna uverova banka (in Slovakia) were established.
- These banks together with Investicni banka and Investicni a rozvojova banka taking over all commercial activities of SBCS.
- These bank were established as a state financial companies.

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 cautions in this new and non-standard environment and focused mainly on solvent or foreign clients.

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

Transformation into a two-tier system and liberal regulation

- The expansion of existing bank’s business networks and products
- A range of new small banks with Czech capital entered the market because state banks were not able to satisfy rising demand
- The entrance of these small banks was originally welcomed as a effort to establish a competitive environment in financial services.

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.

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

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

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)

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

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.

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.

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

Public capital market

- The new environment required new market institutions, such
  - Prague Stock Exchange, Center for Securities, Commercial Registry, clearing centers, etc.
- These institutions helped to revival capital market in the Czech Republic.
- The Czech Stock Exchange has roots in the 19^{th} century its tradition was interrupted by
  - WWII
  - Communist regime

Public capital market

- Modern history of PSE started in the early 90's when the Preparatory Committee for the Foundation of the Prague Stock Exchange was set up.
- On 24th August 1993 a new company composed of eight banking houses, was transformed into an association.
- Upon adoption of the Stock Exchange Act, the association was later converted into the Prague Stock Exchange.
- The Stock Exchange started to work fully on 6th April when first trading session took place on its trading floor.

Non-bank financial institutions

- At the beginning of the transformation the number of non-bank financial institutions was limited.
- Life and asset insurance businesses were concentrated in the monopolistic Ceska statni pojistovna.
- Their premium revenues that can invest transferred mostly to the treasury and they were not acting as a institutional investors.
- In case of social and health insurance the payments flowed directly into the government treasury and these flows were included directly into budget revenues and expenditures.
- The rapid development of non-bank financial institutions was influenced by factors outside the financial sector.
  - Privatization
  - Sale of state enterprises

Thank you for attention