

A photograph of a modern building with a large glass facade. The glass reflects the sky and clouds. A blue banner is overlaid on the right side of the image.

# Lessons from Transition Masarykova univerzita Zdeněk Tůma



# Outline

- Institutional metamorphosis
- Property rights and access to capital
- Macroeconomic policies
- Central bank
- Banking sector



# Institutional metamorphosis

- From centrally planned economy to a market economy: from central directives to
  - Private financial intermediation
  - Rule of law
  - Corporate governance
  - Private property and its protection
  - Protection of competition
  - Capital market and its regulation



# Institutions and liberalisation

- Liberalisation
  - Price controls – liberalization of prices
  - Exchange rate: moving from the manipulated ER to the fixed ER, and finally to floating and inflation targeting
  - Free trade: moving from East to West
  - Liberalisation of capital account (OECD membership)
  - Foreign capital inflow
  - Restructuring of economy/industry



# Property rights and privatisation

- Coupon privatization (above 30% of privatized property)
  - Enabled concentration of property rights (people did not hold their shares and did not invest in capital market)
  - Investment funds:
    - History of PPF: První privatizační fond (PPF) founded in 1991 with the capital of 100.000 CZK
    - In coupon privatisation (1<sup>st</sup> wave): got 3% of all investment “points”, deposited by almost 200.000 people, holding shares in 202 companies (nominal value 4.9 bn CZK), another 45 companies in 2<sup>nd</sup> wave
    - Acquisition of 20% of Česká pojišťovna ...
  - Quite often: negative impact of inappropriate corporate governance, capital market regulation, rule of law
- Direct sales (40-50% of privatized property): various approaches in transition countries
  - To strategic (foreign) investors
  - To domestic investors (without capital, financed by banks)



# Macroeconomic policies

- Traditionally, responsible fiscal and monetary policies
- It held also in the first half of 1990s: high credibility internationally
  - Liberalisation of prices and very fast stabilisation of inflation as well as exchange rate
- It was changing after 1993: fiscal and quasi-fiscal expansion (income from privatization, expenditures related to consolidation of banking sector)
- Finally, these policies (and their inappropriate coordination) combined with insufficient structural reforms led to the crisis 1997-1998
- Tightening monetary policy, and later on also fiscal policy, did not avert pressures from financial markets

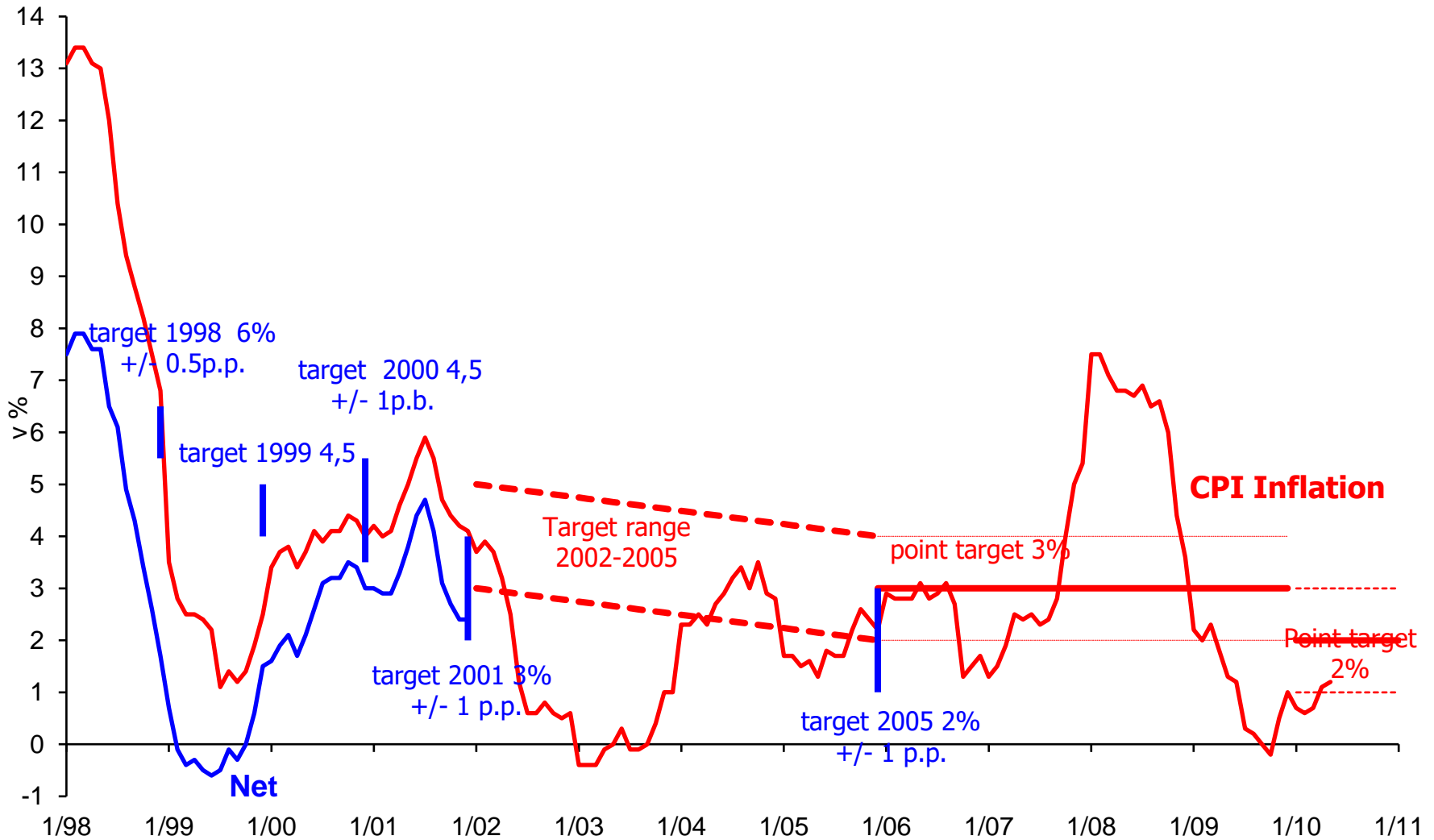




# Central bank transformation

- Closely related to arising banking sector
  - Moving from “monobank” to market-based financial intermediation
- Monetary policy
  - Fixed exchange rate collapsed during the “crisis” (1988)
  - Looking for a new nominal anchor: monetary or inflation targeting?
- Supervision
  - Banking supervision in CNB (since 1992)
  - Insurance companies, credit cooperatives, capital market – ministry of finance
  - Securities commission – since 1988
  - Integration of supervision over financial sector (2006)

# Switch to inflation targeting







# Banking sector

## Heritage from the past – lack of human & financial capital

- undercapitalisation of banks
- high share of bad, non-performing loans
- shortage of long-term funds
- inexperienced staff
- almost non-existent risk management
- defective legal framework
- absence of market-consistent regulatory rules
- weak, understaffed and inexperienced banking supervision



# Entry of small banks

- 20 new small private banks were established in the years 1990 – 1993
- political motivation to increase competition in the banking sphere vis-à-vis the four large banks
- liberal approach towards new start-ups
- loose (benevolent) licensing policy
- banks mostly undercapitalised; access to funds limited by their small size and small number of branches; higher borrowing costs to attract more depositors; had to take greater risks; problems of selection bias and moral hazard
- inexperienced staff and temptation of fraudulent behaviour and corruption in conditions of a defective legal framework and loose institutional supervision

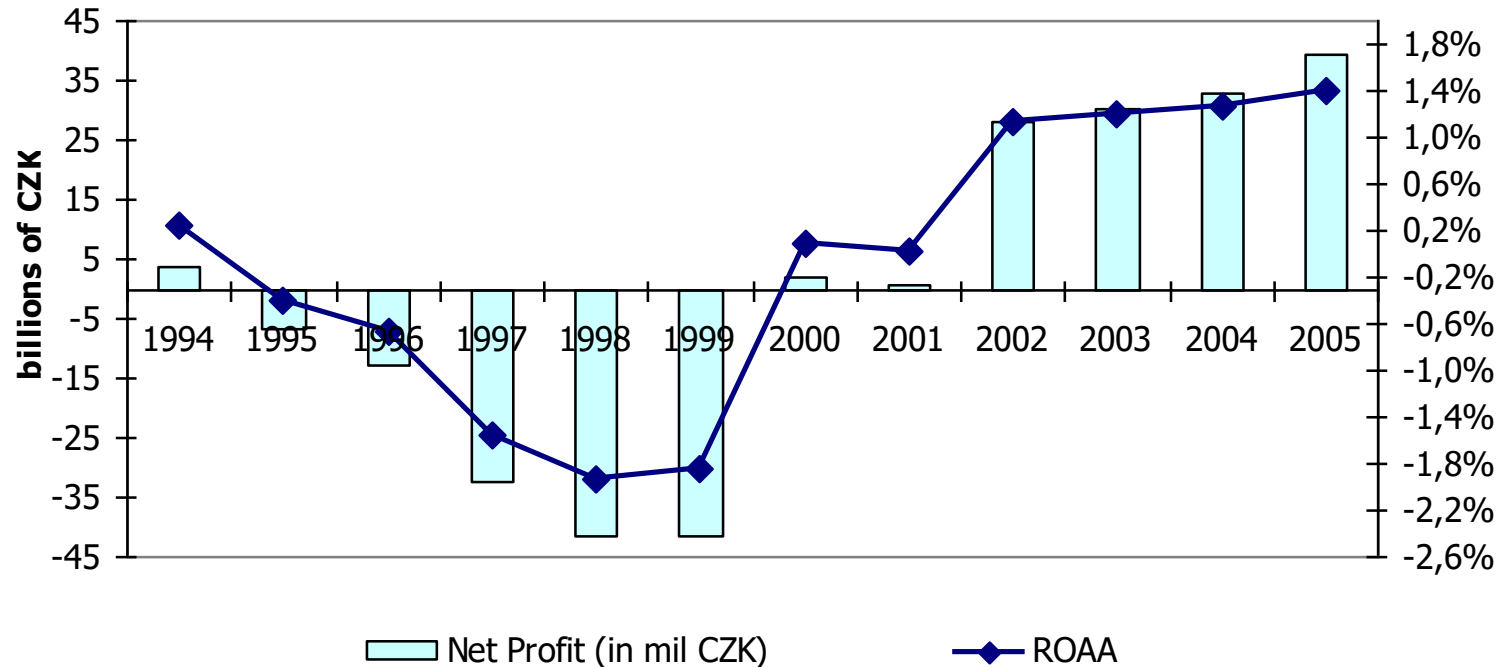


# Pragmatic steps to “consolidation”

- initial clean-up of large banks’ balance sheets and their recapitalisation in 1991, later dubbed Consolidation Programme I
- establishment of Consolidation Bank in 1991, later transformed into the non-bank Czech Consolidation Agency
- comprehensive programme of consolidation of small (private) banks in 1995–1996, prepared and implemented by the central bank (CNB), known as Consolidation Programme II
- Stabilisation Programme, declared under a Czech government resolution of October 1996, focusing again on the segment of small and medium-sized banks with the aim of reducing the risk of a liquidity crisis and promoting the overall stabilisation of the banking sector
- pre-privatisation assistance (recapitalisation) of large state-owned banks in 1998–2001

# Impact of “consolidation” and privatisation

## Profitability of the Banking Sector





# Impact of “consolidation” and privatization: non-performing loans

