Overview of Czech Transition

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Socialism gets real: Czechoslovakia

• 1918 – 1938: „Western style“ democracy
• 1929: Stalinists win over Czechoslovak Communist Party
• „We go to Moscow to learn from Russian Bolsheviks how to wring your necks. And you know they are good at it!“ (Gottwald in the Parliament, 1929)
• WW2: Czechoslovak exile government in London, leaders of Czechoslovak Communists in Moscow
Communists take over

- 1946: Communists win elections, prime minister Gottwald
  - anti-Nazi rhetoric (Slavs vs. Germans)
  - “success“ of USSR
  - property manipulations
- 1946-1948: first „Two-Years Plan“ – beginning of centrally planned economy
- 1947: rejection of Marshall Plan
- 1948: „Victorious February“: takeover of government; elections – only candidates supported by Communists
Czechoslovakia in 1989

- Central planning in all spheres of life
  - "private" sector only 1% of labor force (x Poland, Hungary)
  - about 70% of export in CMEA countries
  - structural distortions – heavy industry, qualification of labor force etc. (60% I, 21% S, 19% A)
1989: Not the First Reform...

- **1958-61**
  - minor modifications of CP system— decentralization of industry, wage reform - FAILED

- **1963-68**
  - "3rd way" – "self-governing socialism" – not really a 3rd way as plan still above market, socialism with human face
  - though some market incentives introduced
  - similar reforms in Poland and Hungary
  - INTERRUPTED

- **1987**
  - "Perestroika" influence – INTERRUPTED

modification of system vs. systemic change
"Shock therapy" vs. "Gradualism"

- Time matters
  - formation of interest groups
  - erosion of political capital (popular support of reforms)
  - costs of state ownership of firms

- faster way: Poland (Balzerowicz's plan), Czechoslovakia (Klaus)

- slower way: Hungary (reformed communists)
Design versus spontaneity

- ČKD tatra 24.000 trams 1951 – 2004
  - Škoda (Plzeň)
  - Inekon (Ostrava)
"The Scenario of Economic Reform" - 1990

- team around Václav Klaus (then minister of finance)
- Close to „Washington Consensus“
- criticism: underestimating importance of economic institutions

- 3 main pillars:
  - I. Stabilization
  - II. Privatization
  - III. Liberalization
Timing of Transition – Main Steps

- 1990 – first free elections, "Scenario" passed in the Parliament
- 1991 – beginning of reforms – price liberalization, privatization; economic recession
- 1992 – second elections
- 1993 – Czechoslovakia split, tax reform, stock exchange established
- 1994-6 – "golden years" of transformation
- 1997 – second recession, corrective fiscal measures, exchange rate: managed floating, inflation targeting, end of "Klaus' era", reforms slow down
- 1998 – social-democratic government, reforms in most areas halted
Privatization

• private ownership necessary to obtain markets
• the state as the worst possible owner
• necessary for restructuring the economy

faster approach – pros and cons:
  + waiting creates uncertainty
  + "spontaneous" privatization, "tunneling"
  + getting the incentives right
  – "selling off" for lower prices
  – lack of institutional framework
  – finding a credible owner takes time
Main Stages of Privatization

- restitutions – property confiscated after 1948
  - rather moral than economic issue
  - 70-130 bil CZK

- "small scale privatization"
  - shops, restaurants, petty services etc.
  - based on auctions, relatively successful, finished early 1990's
  - 30 bil CZK

- "large scale privatization"
  - "voucher privatization" (40 % of property)
  - direct sales (foreign investor; insiders-managers, employees)
  - centralized – "Ministry of Privatization„
  - 626 bil CZK
Development of Private Sector

Source: Hanousek et al: Tale of the Czech Transition
Liberalization

- liberalization of domestic trade
- liberalization of foreign trade

→ importance of market prices for economic calculation!
  - deregulation of prices and wages (exceptions...)
  - legalization of private business

In 1991 – about 95 % of prices (incl. wages) liberalized
  - market prices – mere illusion?
  - most enterprises still state-owned
  - not really market incentives
Territorial Structure of Trade (% of trade with developed countries)

Source: Spěváček et al: Transformace české ekonomiky
Real GDP Growth Rates

GDP index constant prices (CZK 1995)
It was not that bad...

<table>
<thead>
<tr>
<th>Country</th>
<th>Transition period</th>
<th>Cumulative change in GDP (%)</th>
<th>Cumulative inflation (%)</th>
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</thead>
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<tr>
<td>Czech Republic</td>
<td>1991-93</td>
<td>-12</td>
<td>110</td>
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<tr>
<td>Hungary</td>
<td>1990-93</td>
<td>-18</td>
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<td>Poland</td>
<td>1990-91</td>
<td>-18</td>
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<td>Lithuania</td>
<td>1992-94</td>
<td>-41</td>
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Why do skodas have a rear wash wipe?
To remove the flies that crash into them.

Why does a Skoda have a double rear window heater?
To keep everyone's hands warm when they are pushing it!
Index of Institutional Quality 1997-8

Source: Spěváček et al: Transformace české ekonomiky
Economic Freedom Index

Source: Fraser Institute
Summary: