

Carnegie Council\DRT International Privatization Project

The Political Economy of Privatization in Czechoslovakia



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The Carnegie Council\DRT International Privatization Project has been made possible by a generous grant from DRT International.

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May 15, 1991

Dr. Ladislav Venys

Ladies and gentlemen, I certainly feel very privileged to be invited to this forum. When I looked at the list of participants I was very impressed and even more privileged than you think, that I can address you and tell you something about one aspect of development in Czechoslovakia. I'm certainly not going to go back to the history of The Velvet Revolution, because you have heard about it many times, I'm sure. But I would like to give you a little background on the political and economic events in Czechoslovakia very recently, and on the basis of this background, I will try to develop some thoughts concerning the process of privatization, which is the most important process in our economic transformation. I'm using the term "transformation" on purpose, because we do not intend to have any kind of perestroika in Czechoslovakia. No economic reform is intended in Czechoslovakia—but a total transformation of the economy. We tried perestroika a long time before Gorbachev tried it, in 1968, and we failed, for reasons which you know very well, and we want now not to reform the socialist (or as you would call it probably, communist) economy, but we want to transform it completely. That's why you may hear from such people like Vaclav Klaus, who is our Finance Minister, and actually the chief economic leader, that he would not talk of reform, but he would talk of transformation. I just wanted to alert you to this particular aspect, and we are very sensitive about terms like "plan" and "reform" because they somehow remind us of times we do not like to remember, for obvious reasons. What we have done recently in the economic transformation of the country is, in particular, we tried to liberalize both retail and wholesale prices. We did it in January 1991 and that was the first shock treatment of our economy, and also a tremendous shock for the population, because before, we never had anything so radical. Prices had grown extremely slowly, and all of a sudden there was this shock, where 88 percent of all prices were liberalized virtually overnight. Only 12 percent of prices have remained under government—not control—let's call it regulation. Our parliament approved a very important law last fall on small-scale privatization, which means privatization of small enterprises, and that particular privatization also started in January of this year. Another great event in our economic transformation was the convertability of Czechoslovakian currency. It's not a complete convertability; it will take many years, maybe ten,

before we can speak of full convertability, but it's a domestic partial, or limited, restricted convertability, which applies not to ordinary citizens, as you may think, but only to entrepreneurs, and only to those entrepreneurs who do business with western companies. So it is very limited, and will remain limited for a long time, because Czechoslovakia does not have enough foreign reserves to be able to have full convertability. There are, of course, many other reasons why we cannot do that. Also, the fourth thing which occurred in January of this year was that we withdrew, virtually also overnight, subsidies. For example, all food subsidies were eliminated, which, of course, created a number of shocks as well. A very strong, very restrictive fiscal policy was

introduced by the Ministry of Finance and we have started what we call liquidation of old structures, but we have really only started and haven't proceeded very far until now.

Since January 1991 we have approved a second law on restitution. The first one was passed in October of last year and it concerned only small enterprises and houses which had been confiscated, expropriated

by the Communist government, after 1948. The second restitution law was approved in February, and it concerned large-scale enterprises, especially industrial companies, which were nationalized, or expropriated, after 1948. A very important law which was passed in February, and which is now coming into effect, is the so-called large-scale privatization law, which complements the small-scale privatization law I've already mentioned.

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The State of the Union

What is the state of our union at the moment? The economic situation in Czechoslovakia is, very briefly, that the restrictive fiscal policy has enabled us to control inflation. Surprisingly enough, inflation went up 26 percent in January, but in every month since then it's been going down. In February it was seven percent, in March five percent, and now, as of the end of April, only four percent. So, our total inflation in the past four months is 40 percent. Compared to Poland's inflation two years ago, which was 400 percent, we are doing fairly well, we think, because we are learning from certain mistakes of our neighbors. Prices have gone up only 40 percent in the past four months, and they don't seem to be growing substantially at the moment. We have created a total of 2,900 joint

ventures with foreign companies. It's true that most of these joint ventures are very small, but we are still proud of the fact that we have allowed at least some foreign capital to come to the country through these joint ventures. We have about half a million entrepreneurs in Czechoslovakia, which are registered with the magistrates of city halls where they live. But only one third of them (and this is something your newspapers do not tell you, all of them say there are half a million entrepreneurs in Czechoslovakia) are really practicing entrepreneurs, are really doing something. And only ten percent of the half-million are people who are simply entrepreneurs, because all the others are people who have other jobs, and they are consulting, interpreting, etc., only now and then, so it is not their main income. Only for ten percent or about 50,000 people, is entrepreneurship their main income. This indicates that we're far away from really changing the structure of our economy—state-owned enterprises, state-owned businesses, even very small businesses and shops—into private enterprises and private shops.

While small-scale privatization seems to be very well underway, large-scale privatization will start only toward the end of this year. At the moment we're paying a great deal of attention to conversion of our arms industry, which is very large. Czechoslovakia is the seventh biggest exporter of armaments in the world. I wish we were the seventh largest exporter of something else, but that also has a very long way to go. So this is a very brief summary on the state of the Czechoslovak economy, and now let's go quickly to the political situation, because you will certainly be interested in what the political background is for all the new developments.

All is relatively quiet on the Czech front, but on the Slovak front, it is quite explosive. The situation in Slovakia seems to be a little dramatized in your press, as far as I can see, but certainly it deserves quite a lot of attention and it should not be underestimated. As you may know from your press, eight Slovak ministers, actually the prime minister and seven other very important ministers, have withdrawn and changed from the government in Czechoslovakia. There have also been minor changes in the government structure; several deputy ministries have been changed. And there is a restructuring of the existing governmental structure of Czechoslovakia, but it is an extremely difficult process. We have sixty ministries; we

are a country of 15 million people, and we have sixty ministries with 11,000 bureaucrats. Even if we cut it by half, that would not be enough. But what we are doing at the moment is we're changing names of ministries and transferring people from the old ministries to these new ministries, so actually the bureaucracy remains the same all the time. But there is now a very serious attempt to start restructuring our government, and to diminish the number of people in various ministries.

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There has been a split in both major political movements in the country. Both Civic Forum and also Public Against Violence in Slovakia split, first Civic Forum. It was done in a relatively peaceful manner, while in Slovakia it was a little bit more explosive. That's the nature of the Slovaks, and we have to take it into consideration and deal with it. However, in Slovakia, it has had several serious repercussions. There is some political chaos in Slovakia at the mo-

ment, not terribly serious, but worth considering, and certainly worth solving. In the Czech lands, the political situation seems to be relatively quiet, because Civic Forum split into the Civic Democratic Party, which is led by Minister Klaus and the Civic Movement, in which the major figure is the Minister of Foreign Affairs, Mr. Dienstbier. We have a big problem with the immaturity of our parliament; and of our parliamentarians. It is a new parliament, and the people are really new people. Even though some of them have been accused of collaborating with the old system, with the Secret Police, it's a minor problem, because there were only about ten out of 600, so it is not really serious. But they're learning how to act in a democratic society, and it's a very difficult problem, which we're trying to solve. My center organized a



Ladislav Venys speaking at a private dinner for corporate executives.

Photos by Larry Lettera.

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big seminar for the Czechoslovak Federal Parliament, the Slovak National Council, and the Czech National Council last month where we invited people from sixteen parliaments in Western Europe and also in the United States, who were debating various problems with our parliamentarians, and because I was present at that seminar, I must say that our parliamentarians simply sometimes are not able to communicate and to understand what people from other parliaments are talking about. They're really just learning, and this will be a long process, and we have to be very patient. That's why all the laws take such a long time to pass and why we're accused by the Western press, some politicians, and some scholars, of moving very slowly. It's a revolutionary process—although it is actually very slow—and revolution is represented in this process by a certain chaos. There is chaos, both politically and economically, but we are confident that this chaos will be overcome, not in a month or two, but maybe in one or two years, and that would be a tremendous success. On the basis of this background, I would like to speak briefly on the privatization process.

Small-Scale Privatization

Small-scale privatization began in January, when we started privatizing small businesses which belonged to the state. Every weekend since the end of January, there are public auctions all around the country, and a few hundred small enterprises are transferred to private hands. I say transferred, not sold, because only some of them are truly sold. Most of them (and this is also not very well known here, as far as I know) are simply, I would say “rented”, for a period of two years, because nobody knows at this moment whether somebody who lives, let's say in America, or in a small village in Slovakia, will claim those small businesses within the period that has been established for claiming ownership of small enterprises which were confiscated or expropriated after 1948. So small-scale privatization is slowed down tremendously by this very generous law which we passed in the fall of last year, which allows people who owned any kind of small business or house which was expropriated after 1948 to get it back. The claims are still going on even though the deadline for filing was in April, and it will probably take quite a long time. That's why this process has been quite a major obstacle in the restitution law. We should privatize about 100,000 small enterprises in the course of two to three years,

and at the moment, in spite of the slow pace, we are confident that we'll be able to do it. We think that we can privatize a few thousand enterprises every month, because now we have discovered how to do it and the method has been tried and it's going relatively well. There is, however a big problem with the lack of capital at the disposal of the people who would like to buy small businesses. Most people in Czechoslovakia who did not cooperate with the former regime or with the Secret Police, or who were not members of the—we call it Mafia, meaning black marketeers—simply do not have any capital at the moment. They were not allowed to make much money. So the new entrepreneurial class, at the moment, is formed mostly by people who were either black marketeers, or were associated with the ruling class, or who have rich friends or relatives abroad. They are not necessarily always the best entrepreneurs. Many of these people are probably buying these enterprises for speculation, not necessarily to run them well. That's a problem because it is not allowed by law to get loans for buying small enterprises, and everybody who wins at a public auction must pay in cash within thirty days entirely, there is no possibility of paying in installments. The people whom I just named probably form 50-60% of all those who have access to these properties. Of course, you may say, “How are foreign investors or buyers involved in this process?” They are in the background because the law does not allow foreigners to participate in the first round of our small privatization. But you see in the auction halls that there are elegantly dressed men or women sitting behind those who are bidding, indicating whether they can go up or down, and they are the guys with money who simply are buying property in Czechoslovakia illegally, but somehow it's tolerated. Nobody says anything. It's risky, of course, but they're getting, probably, the best items which are on the market at the moment.

Large-Scale Privatization

As far as large-scale privatization is concerned, a methodology for various methods of privatization is being prepared. We expect that out of 4,500 large enterprises, which should be privatized in the near future, about 300 will be privatized

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in one year's time. It's very ambitious, but we hope we shall be able to achieve it. We are using standard privatization methods: employee shares, the state keeps some shares, and foreign companies may be interested in shares; but we're also using a very unique, very controversial, non-standard method, which is called the method of investment vouchers. Every inhabitant of Czechoslovakia older than eighteen years will get virtually free a booklet with vouchers. There will be ten

vouchers each worth 100 points, so the booklet will be worth 1,000 points. They will have no money value, but will be used to obtain shares in companies which will be privatized. Voucher holders will get a list of all companies being privatized, a description of the companies, and also, the price of the shares, and they will be able to participate by buying with this investment money which cannot be sold, and cannot be transferred to anybody else. You can either use it or throw it into the wastepaper basket. There are many problems involved, the first being that this method presupposes that

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everybody's going to behave as an investor, which in a country like ours, is very unlikely. The second big problem is that this system is not going to generate any capital. But what it is going to achieve, and this is its major purpose, is that it will help us to change state ownership into private ownership. And then we say we shall worry about the details, such as money. Of course, we shall need such institutions as mutual funds and investment funds. Somehow we discovered this need only very recently, so we are now rushing, creating various mutual funds and investment funds, to be ready for this method to start. And we expect that we shall start distributing these strange booklets in September or October of this year. Most of us hope that it will be a Christmas present, so by the end of the year, the booklets should be distributed and then, soon afterwards, they will be used for obtaining, rather than buying, shares in various companies. Of course, the restitution law concerning large companies is also interfering. The deadline for claims in Czechoslovakia at the moment is October of this year, so by October all claims concerning large enterprises should be made, and then, hopefully, large-scale privatization could start in earnest.

Trade Problems

This is a brief overview of both types of privatization. I would like to conclude by saying that Czechoslovakia is coming through a very difficult and crucial period of its economic, political and social development. The total transformation of the economy includes a lot of things such as massive conversion of the armament industry, and of heavy industry, which will create large unemployment; in Slovakia much more than the Czech lands. At the moment, unemployment is growing relatively slowly, we have about three percent unemployment in Czechoslovakia: three and a half percent in Slovakia, two and a half percent in the Czech lands. But some of us expect—the politicians would not say so, Vaclav Klaus says that it will not be more than six percent, or seven percent—that unemployment may reach as much as twelve to fifteen

percent, within one year's period, so that we may have over one million unemployed, hopefully for only a short period of time.

To make the situation in Czechoslovakia and also in several other Central and Eastern European countries clear to you, I would like to stress that we have tremendous problems with our Eastern trading partners. Our Eastern trade, or trade with former partners, is collapsing. Our trade with the Soviet Union has dropped by 47 percent since the beginning of this year. We haven't got a single payment from the Soviet Union in hard currency, which we had agreed upon before. The Soviet Union actually declared one year ago that from the first of January, all trade must be done in hard, convertible currency, but they are the country that simply does not pay. Our former East German market has collapsed totally. We need to replace 50 percent of our trade. We don't have merchandise which could compete in Western markets. ECOMICON has stopped existing, the Warsaw Pact has crumbled, and we have to solve all these problems. Imagine that a Western European country had these problems, that it lost 50 percent of its partners, there was no NATO, and the Western European Common Market collapsed all of a sudden. Many countries would probably collapse. Or imagine that Japan lost 40 percent of its American trade. They would collapse in a few weeks. I don't say we will, but you should realize the magnitude of problems we are trying to tackle, and what we have to somehow cope with. We cannot blame the brave guys who are trying to solve the problems, and many of them will be sacrificed in the process. Vaclav Havel even says that all of them will be sacrificed, he says that this government

“There are many problems involved with the voucher system, the first being that this method presupposes that everybody's going to behave as an investor. The second big problem is that this system is not going to generate any capital.”

is the government of national sacrifice, and I think he's right. We need a lot of patience, understanding, and also a little bit of investment. That's very important. I hope it will come from the United States, because at the moment, the share of the United States in our well-being is two percent. That's not very much. The Germans and Austrians account for about 85 percent; they're our neighbors, that's true. But I would like to have illusions of American investment in Czechoslovakia. It is extremely low now, and the reasons are obvious. The climate is not ripe enough for American investors to come there. But it will come. And keep your fingers crossed for us, because we'll need it very badly. Thank you. ■

Questions and Answers

Q Are there large companies that were expropriated after 1948, which can be reclaimed by their previous owners, and you won't have any shares to sell?

A There are many of these companies, but many of them were nationalized after 1945, after the war, so they cannot at the moment be claimed. They are state-owned, and they will be privatized through one of the methods I mentioned. For each case, there are certain methods, which will be determined in the privatization project. Some companies will sell shares mostly to foreigners, if foreign investors are interested in that particular company, and maybe some to employees. Nothing will be sold to the state, and nothing through this investment voucher privatization, because Western investors do not like the idea that they would buy shares in a company in which 30 or 40 percent of shares are owned by 10,000 people. But everything will be determined in those privatization projects, for every single company.

Q What's going to happen to Czechoslovak agriculture under this plan?

A I wish I knew. That's a very difficult thing. We have been haggling over the problems of land law in the parliament for seven months. Ninety-seven different proposals had been filed by the time I left to come on this trip. There are over one hundred by now, I am sure, and the law, as far as I know, has not been passed yet, and it's a very, very important law. There's another important law which is the law on the property of towns and villages because some things simply belong to little towns and villages, because even that property was expropriated or state-owned. Ninety-seven percent of all the means of production in Czechoslovakia is owned by the state—97 percent. That's one of the highest percentages in the world, so you see the magnitude of the task of privatization.

Q Most of the public sector enterprises, particularly large-scale ones, were not profitable. How would evaluation of shares take place in such cases, particularly for foreign investors, who anticipate earnings per share as a method of evaluation?

A Many of our companies are not profitable. At the moment, 72 percent of large companies in Czechoslovakia have suffered from so-called secondary insolvency, which means that they are having tremendous financial problems, because they are not paid by their trade partners for the merchandise which they produced and invested in. We expect that a large portion of our companies will go bankrupt, unfortunately. The estimate is at least 30 percent, but some expect that as many as 50 percent of our companies will go bankrupt, and the state, or foreign investors, will have to take care of not only the property, but also the people, who will have no jobs. You

may say, "Oh, okay, no problem, these people can move somewhere else." But there's virtually no social mobility in Czechoslovakia. People do not change their residences as much as you do here. As far as I know, in Czechoslovakia everybody changes his residence maximum twice per life; in your case, it's about twelve times. People in Czechoslovakia simply build their house, or have their apartment, and they just stick to it. So this will be a problem. That's why job opportunity must be created virtually in the same district. We have already had some clear indications that there is interest on the part of Western investors, especially German, Austrian, and from other surrounding countries. So we hope that this will help. But we just don't know how big the collapse will be; how many companies will be affected.

Q My question is about price control—companies that go bankrupt because they're not profitable. Does this mean you control prices and do not allow the market to dictate prices?

A I've said already that we're trying to create mutual funds, or, you know, some portfolio system, some investment funds, and maybe we shall succeed in creating these institutions by the end of the year; we hope that we shall. But there are some problems concerning your question. The companies will not necessarily go bankrupt because they are not productive. I spoke of secondary insolvency, which means that they would be in a bad situation because somebody didn't pay them, it doesn't mean that they would not be productive. These companies will not go bankrupt, hopefully, because in those cases in which the state knows that these companies are only temporarily insolvent, it would definitely try to help them. There is a system of the so-called national fund, which is going to be created through the sale of shares of state companies. The money from the sale of shares in state companies will go to a certain fund, which is called the Fund of National Assets, and this fund intends to help companies which are temporarily in trouble, but those which deserve to go under will go under.

Q Could you give us an estimate of how much your GNP has already declined, and how long it might be before you see some kind of recovery?

A GNP has been declining since 1989 actually; immediately after the Revolution, it started going down. But it's not very serious. What is serious is that consumption has decreased by one-third in the past year. That's very significant. And the construction industry has decreased by over 40 percent, that's very serious as well. We expect that the standard of living which we had in 1989, before the Communist system collapsed, will be regained in Czechoslovakia not sooner than in 1993 or 1994.

Q One of the most difficult problems for a foreign investor looking at Czechoslovakia is to figure out who's going to make decisions on privatization. You have a national law which was passed February 22, but now you also have Ministries of Privatization to go through. There seems to be some question, at least in my mind, as to where the decisions will be made on the regulations that actually implement the privatization. Could you talk a little bit about that?

A Yes, decision-making in Czechoslovakia is a tremendous problem. Nobody wants to make decisions. We learned that in the past; you know, the communists never like making any decisions, so this has survived somehow, unfortunately. There are, as you said, two ministries, two national ministries of privatization, but the sort of main arbiter in privatization is the Ministry of Finance, as a federal body. Both the Ministries of Privatization are preparing a methodology of trying to deal with details of the privatization process. There is a problem at the moment and it is that the Slovak Minister of Privatization was removed very recently, and the new one doesn't know what's happening, so he's learning, from a Czech Minister. But the nationalists in Slovakia say, "No! Don't do it as the Czechs do. We have to do it differently." So don't be surprised if in this climate of chaos, nobody wants to make any decisions. It will probably last, as I said, until the end of this year.

Q You're saying that the two republican ministers of privatization have to submit their plans to the federal government for approval?

A No, I said "arbiter," which means that if there is a big dispute, they may go to the Ministry of Finance. Otherwise, the privatization process will become a spontaneous process very soon, as soon as the companies know how to prepare privatization projects. As soon as they learn how to value property, for instance, because we always calculated only book value, no commercial value, no business value. That's why we're inviting foreign firms to come to Czechoslovakia and help us. But as soon as the companies have learned how to do it, maybe a thousand companies can be privatized in a year, because the companies, according to the law which you have just cited, are fully responsible for the preparation of their privatization schemes. The Ministry of Privatization will approve it, but it's not approval, really it's just saying "Go ahead and do it." They will be glad to say "Go ahead" because there are 62 people working in the Ministry of Privatization, taking care of all these companies to be privatized at the small level and the large level. Sooner or later it will become more or less spontaneous, but decision-making is something we have to learn. That's the problem.

Q Would you describe in a little more detail the conversion of the military arms exporting industry?

A Yes, I will be glad to try at least. The armament industry in Czechoslovakia is very strong, and at one time 60 percent of our income from foreign trade came from the sale of arms. In the times of tremendous euphoria, Minister Dienstbier declared in January 1990 that Czechoslovakia is stopping the production of arms and that we'll convert our industry, but he did not realize what he said. Then he somehow mitigated it by several other statements, saying that it's in the process of being considered, etc. Now it's a serious problem, because we once said it, and we expected to do it, and we are actually being pushed very hard, especially by the United States, not to sell, for example, our tanks to Syria, and to Iran, because of your bad relations with Syria, and the embargo on the sale of arms to Iran. We say, "Unfortunately, we have to do it, because we need a lot of money, not the \$15 million dollars which is already being offered to us for conversion by one group in the United States. But we need maybe a hundred times as much." So now there is sort of a dispute between Czechoslovakia and the United States, with the United States saying "If we give you more money, will you consider stopping selling your tanks to Syria and Iran?" And we say, "What shall we do with the tanks? They're already produced." That's the secondary insolvency I spoke about. You know, they are there, and we hope to get some money for them, to use the money specifically for the conversion of arms. There are about 60,000 tanks which should be destroyed on the basis of treaties which we signed at the end of last year, but the production of arms goes on, and we're producing, and we expect to sell, so this is a tremendously complicated problem. That's why the Slovaks in particular are so belligerent at the moment, and they protest, and say "We have to do it differently, because we shall be affected more than anybody else. What shall we do?" It's an extremely complicated process, and it will cost a lot of money, in terms of billions of dollars, not in hundreds of millions.



Left to right: Ladislav Venys; Gloria Gilbert Stoga, Carnegie Council; and Steven Worth, DRT International.

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Q The Western European nations have been together years now, and they've watched over each other, taken care of each other's problems, and taken a more overall view on issues. Why don't you get together with Hungary, East Germany, and Poland, and see what you can do about your mutual problems? It seems like you're all doing it all alone.

A That's a very good question. I like it. But if you were forcibly married for 42 years you would probably hate whomever was with you for 42 years. And we just cannot get over this; it is very emotional. We should cooperate with them, but we don't. President Havel met with Lech Walesa only once in Hungary a few months ago, at a meeting, in which they agreed that they would basically do approximately the same thing, and that they would try to enter the European community, but separately, each country separately. We're not cooperating, and it is a mistake, in my view. That's why whenever my Center has a seminar or conference, we always invite people from Poland, Hungary, the Soviet Union, Bulgaria, and Romania, because we should—especially with Hungary and Poland—cooperate as much as possible. We can learn, we are learning from their experiences. Especially when they make a mistake, we say "We shouldn't do it the way Poland did it in '89." That's true. But we won't admit it, we won't quote them. ■

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These briefings are distributed free of charge to those interested in the topic. To order, please write to Gloria Gilbert Stoga, Director, Privatization Project, Carnegie Council, 170 East 64th Street, New York, NY 10021.