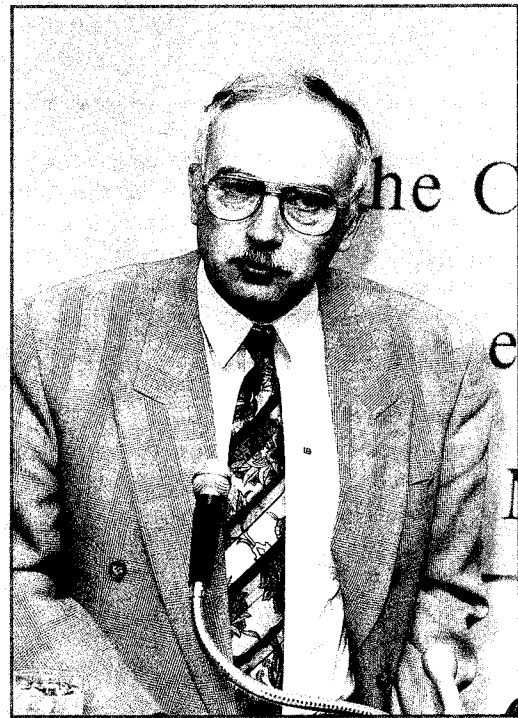


Carnegie Council Privatization Project

An Update on Privatization in the Czech Republic: The Economic Transformation After the Split



Minister Karel Dyba
Minister of the Economy,
the Czech Republic



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February 19, 1993

Minister Karel Dyba

I am going to say a few words, first about the politics and then the economics of the Czech Republic. We have a conservative government in my country, led by Premier Klaus, who was chosen by the people last year. We have a comfortable ten seat majority in the Czech Parliament which was freely chosen by the people last year even when we were warning of hardships for them, so they were reasonable enough to choose us and give us another chance. As you know, we have had a "velvet war" at the beginning of this year; we've been trying very hard to keep the country together, but our friends in Slovakia over time developed an idea that they would like to try it alone, so what can you do? You don't send troops there, that would be nonsense, and so we started thinking about the future. We wanted to tie both parts of the former Czechoslovakia together by means of all kinds of treaties, so that possibly after the split we can cooperate even better than before. Until recently, as you know, we had a common currency, and we hoped that it would last for at least six months, but fate wanted it otherwise, so 14 days ago we had a "velvet currency disunion"; very friendly, very matter-of-factly, no problems. This currency disunion was a major event, but press people do not report much about successes in my country. We have also recently reelected President Havel to be the first president of the Czech Republic. So all the major institutions, including the new constitution, are in place right now, so we hope that we can concentrate more and more on what is very important and that is the economic transformation. After all, people will judge us by what we've achieved as far as economics are concerned. If there are solid economics, then we will be able to focus on culture. We will be able to pay for it, otherwise it will be difficult.

Now let me say a few words about the economic policy we've been following in the past two years and which we deem to be rather successful. Since the beginning we have followed very strict monetary and very prudent budgetary

policies, so last year in the Czech Republic we more or less achieved a balanced budget. As far as monetary policy is concerned, the national bank is completely independent. The commercial banks got a little bit out of control during the reform. Just a few facts: there is a very wide margin between what they pay you for deposits and what they charge you when you want to borrow. We would love to squeeze them a little bit, but we cannot. The government is helpless these days. So we have to leave it at that and the only thing I can do is to talk to them, to persuade them that they should be nicer

towards business. But that's the way it is and we have to live with that.

As far as exchange rate policy is concerned, we've again been following very strong policy in this field; that is, we've succeeded in keeping the nominal rate stable, a basket of foreign currencies for more than two years now. It's helped to tune

down inflation and it has revived convertibility into our own currency. As far as micropolicies are concerned, there is a lot of talk these days about industrial policies. I see there is to be a small conference very soon at Columbia University by some economists here in the United States about what industrial policy means. I think for everybody it means something different. For us, the main event as far as industrial policy is concerned is, of course, privatization.

Privatization for us is extremely important and without privatization we could not have expected to transform. How far have we gotten with privatization? We have more or less finished what we call small-scale privatization; that is, two years ago there were no private shops in the Czech lands. Now about 60 to 70 percent of retail, trade, and services are back in the hands of private entrepreneurs. In two years' time all the small units, including very small factories, have been privatized mainly via auctions. This is also the case in the construction industry; more than 50 percent of construction is now done by private firms. Two years ago it was none. None. I think that's quite an achievement.

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As far as industrial enterprises are concerned, that's what we call large-scale privatization, and here we have been using a variety of approaches, including standard approaches, but we've felt that in order to really do it fast, we needed an invention, and so we more or less invented voucher privatization. The first wave has been successfully completed. I think more than 80 percent of eligible inhabitants participated in voucher privatization which is important, not only from an economic point of view but also from a political point of view, because by including people in the game you generate interest and participation which is extremely important when you want to really change something. But I don't think we are very doctrinaire, to tell you the truth, even though from time to time we carefully have to prepare by taking certain steps. For example, when we try to privatize coal, we will have to restructure it a little bit beforehand. So there is a pragmatic approach *vis-à-vis* some sectors, such as coal and telecommunications. We do have some policies to support small and medium sized businesses based on risk sharing and things which also enhance our competitiveness, but we do not have subsidies. We may have to insure credit institutions which insure exports of our enterprises, but that is what, as you all know, the Export Import Bank does here. These are what I would call industrial policies and we pursue them as well.

What have been the results? So far, last year the annual rate of inflation, as measured by consumer prices, was about 12 percent—which is incomparably better than any other former communist country with the exception of Slovakia. In Slovakia, inflation, as measured by consumer prices, was actually one point lower. We all hope that we might be pleasantly surprised by economic developments there, provided they follow Klausian policies without Klaus. But that might be part of the reason why separation took place, because anything which came from Prague seemed to be unacceptable



Minister Dyba speaking with Wendy Leurs, Charter 77, and to her left, Paul Balaran of the Ford Foundation.

I think external accounts last year showed very good results as well. As far as trade is concerned, we are a very good example of liberal policies because although we exported by about 20 percent more last year to the West in nominal terms, we imported by 40 percent more than in 1991. As you know, therefore, it pays off to the West when they allow us to enter Western markets, because we do it in order to import. It's extremely important for us to have access to foreign markets. We don't ask for anything, we only ask for fair treatment. Fair access to the markets. Whenever I hear talk about closing markets, such as with steel here in the United States and steel in the EC, because we face quotas in the EC, I realize they are closing their markets for our steel. For us it's a matter of life and death to have access to export markets. Two years ago more than 70 percent of our exports went to the Soviet Union and former communist countries. Now—in two years' time—more than 70 percent of our exports goes to the West. Unfortunately not enough to the United States; you all have to work at that, we all have to work at that. That's why I'm stressing so much the need to enter and compete in foreign

markets, and why it is extremely important for us to get the world economy working again.

Output went up last year in construction, in real terms, by about 20–30 percent (there is really a visible boom); retail trade rebounded last year as well; and while industrial production only leveled off, I think it was to be expected that af-

ter big changes there would be a drop in industrial production because they used to live in the outhouse and now they have to compete, and it is difficult.

What are the prospects for 1993? If it hadn't been for the split, I would have forecast solid growth for this year: 4–5 percent GDP growth as against last year. But the aftereffects

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there, unfortunately. So without Prague hindering their development, we hope that they will do more or less the same and we wish them well. It's extremely important for us that all these treaties function smoothly and the Slovak economy does well. One quarter of our exports go to Slovakia, and besides, I have a number of friends there.

of the split as far as trade is concerned are very difficult to predict, so this might be a disturbing factor. In addition, we have introduced a new tax system. We now have a VAT—a value added tax—and we have new insurance policies regarding health and pensions, so it will take time for the economy to digest these things. We will also hand out shares early this spring and this will be a big thing, and we can hardly predict how they will influence the economy. At the same time we will be allowing for bankruptcies. We have been working on the bankruptcy law and improving it a little bit in order to bring it under the control of the entire process.

Finally, very many things depend on what happens in the United States. If your economy revives, then the world economy will be working smoothly, and hopefully we'll give some good advice to the Germans, too, on how to run their economy, so the bad effects on us won't be there for long. ■

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Questions and Answers

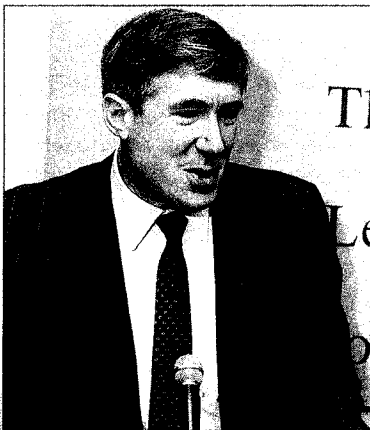
Q Mr. Minister, if I could take you back to the invention that you described and ask you to comment on how it's worked and how it may work in the future. As I understand it, some 400 investment companies or funds sprang into existence following the Harvard Capital Fund and I understand now that about 50 percent of the stock of the 1500-odd companies that were privatized are in the hands of nine funds. The question I'm asking is, assuming there is no violation of the law, is this the result you're looking for?

A I don't think that we could have known beforehand what might emerge because we looked for a spontaneous solution. That's why we distributed the vouchers and we allowed for these investment funds, and people had a free choice either to invest individually, or to invest into

these funds. That was all. It was their choice, with all the risks and the benefits it might bring. In Poland the original idea was to have only investment funds and people would own shares in these funds and these funds would then own shares in individual companies. In our country we let people decide from the bottom up and now we will see what will come out of it.

Q Regarding financial infrastructure, can you bring us up to date on what remains to be done in terms of setting up Western-style infrastructure, that is, everything from bankruptcy laws to wire transfers to being able to buy liens quickly?

A There is a bankruptcy law, so there is protection for three months before the procedure starts. In fact, the problem is that our courts are now overloaded with many cases; and we are afraid that if all the bankruptcies were decided by court decisions, there would never be one. So we are trying to amend the law in such a way that all the parties are forced to look for a solution. We have a government ministry to work as a catalyst in the process, so that we force all the parties to move ahead to bring about either improvements or bankruptcy. We also have created special institutions which might have some money to help those ailing companies which deserve to be helped. We also have a new Securities Act, which will be valid as soon as the stocks are distributed, and a second over-the-counter stock exchange will be opened shortly. So familiar infrastructure is there. The problem, as always, is implementation because people have to learn it. There is technical infrastructure sometimes missing as far as telecommunications are concerned, but we are working fast on improving that.



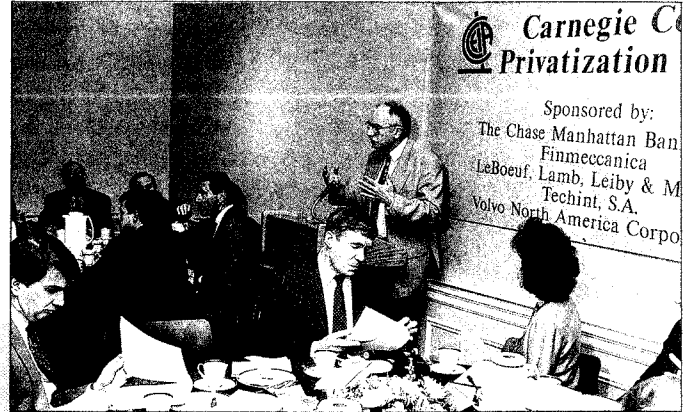
President Robert Hormats, vice chairman, Goldman Sachs, International, introduces Minister Dyba.

Q In your opening comments you spoke about the fact that there are certain sectors of the economy in which the government will remain involved prior to privatization. I'm assuming that one of those sectors is the energy sector. This past week there have been some developments regarding *Temelin* that have had a resounding impact on the coal stations in northern Bohemia. I'm wondering if you could speak about that situation and in specific how it will affect the privatization of *Ceske Energeticke Zavody*?

A *Temelin* is our new nuclear power station. As you know, energy is one of the sectors which deserve special attention because of technological and economic reasons; you usually have a monopoly situation and the government has to regulate the sector. This is what we have in my country as well. In the long run we will probably move towards more competition in the energy sector as well, but there is only one country in the world right now which did something along these lines, which is the United Kingdom, and the experience so far is mixed. So we should not experiment too much. We have, in the energy sector, a big experiment going on anyway, so we should not add to it more than needed. As far as nuclear power is concerned, this aroused a lot of controversy recently in my country. Economic ministers have discussed this issue very thoroughly several times. Because we don't have a regulatory office in my country, the ministers are playing the role of regulatory office (we happen to have some background in this field, so the discussion is not political, but very professional) and we have come to the conclusion that *Temelin* is the cheapest and safest energy for the foreseeable future. It will allow us to close some old factories—old power stations in northern Bohemia which run on lignite—so that we can improve significantly all kinds of pollution.

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Q Mr. Minister, I understand that after the abolition of the federal ministry of telecommunications, telecommunications came under your responsibility. Could you tell me in terms of government policy whether you are planning on introducing competition into basic telephone service provisions?



Minister Dyba addressing business executives at a Privatization Project breakfast.

A Our policy will be shaped, for the foreseeable future, by the fact that our telecommunications network is rather old and not modern enough, so introducing Western-style competition at this point in time would mean most likely for the state to pay for the modernization of whatever parts cannot be profitable. The amount of money which telecommunications will need in the foreseeable future is very big and we will probably have to offer investors some security as far as their investments are concerned. They ask us to view it this way, and we do; but it doesn't mean that they will get the tariff increases they sometimes ask for. We will have to watch telecommunications and the energy sector very closely.

Q What remains to be privatized in the Czech Republic now, since the use of the voucher system?

A About 40 percent of big industry, which is why we are planning a second wave of voucher privatization starting in the middle of this year, most likely, and that will probably be all. Then there will be individual cases, such as telecommunications, and maybe the energy sector. Incidentally, 30 percent of the shares of *Ceske Energeticke Zavody* are currently in the hands of people, including the Harvard Capital Fund, and I myself put Mr. Kozeny on the supervisory board for *Ceske Energeticke Zavody*, so that there is control by the owners right now regarding how the company is really being run.

Q Mr. Minister, what role does tourism play and what kinds of plans do you have for developing it further? I'd like you to speak specifically to the restoration of castles and restitution regarding the large manor houses.

A Tourism is extremely important. Last year we achieved more than US \$1 billion in revenue from tourism, and thanks to this revenue we don't have problems with a trade deficit. There is money to be earned in tourism in the Czech Republic, so I recommend that you think about investing in tourism in my country. Regarding restitution, we economists were reluctant, in fact, to introduce restitution—that is, returning physical property to people from whom it was confiscated forty years ago by the communists—as a means of privatization. But in the final analysis, it proved to be very helpful as far as the

development of towns and cities is concerned. People really have invested money and have done all kinds of improvements, although I also know about cases where it doesn't work. There are two nice hotels in Prague and the former would-be owners quarrel all the time about who is to get what and so the hotels do not work. This is the danger with restitution but, overall, I agree that tourism is extremely important. We just have to be careful not to ruin our cultural heritage when we do the restorations and when we offer restitution. ■

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