Transformation of the Czech (or Czechoslovak) Economy

Abstract

Analyzing the transformation of the Czech, or Czechoslovak, economy presents a multifaceted challenge. Initially, the analysis includes a concise introduction to the centrally planned economic system, exploring its operations, benefits, and the significant shortcomings that emerged prominently by the late 1980s. The Czechoslovak economy occupied a unique position among COMECON countries, characterized by dual exports, minimal indebtedness, and a robust industrial foundation. The discussion of the transformation process begins within an international framework, noting that economic transformations have historically unfolded in diverse settings and have been marked by varying economic strategies. It is essential to recognize that the transformation of the Czechoslovak, or Czech, economy occurred against the backdrop of globalization and within the framework of the neoliberal doctrine, as articulated by the Washington Consensus. Key components of this transformation included the privatization and liberalization of the domestic economy and trade. These aspects receive significant attention and highlight that transformation marked a critical juncture in socio-economic development and established the
trajectory for future growth. The decisions made in the early 1990s continue to exert influence over the Czech economy, affecting aspects such as the ownership structure and exchange rate settings. Overcoming these influences poses considerable challenges. The lessons from the transformation period extend beyond mere resignation to the outcomes of that era. They serve as vital insights, particularly in a context where it is evident that the model reliant on the influx of foreign capital has reached its limits and that the current international environment significantly differs from that of the 1990s.

**Keywords**

Transformation, privatization, trade liberalization, fixed exchange rate, neoliberalism, Washington Consensus, voucher privatization, foreign trade enterprises, central planning, unqualified market economy

**A Closer Look at the Centrally Planned Economy**

The centrally planned economy represented a historically meaningful attempt to create a functional alternative to the capitalist economy. At its core was a politico-economic-social nexus articulated through a central plan, dominant state ownership, and management according to quantitative indicators.

From a historical perspective, it is evident that the centrally planned economy was capable of mobilizing resources and the economic potential to achieve rapid post-war recovery. However, like with capitalist economies, once the post-war recovery momentum was exhausted by the end of the 1960s; the centrally planned economy encountered difficulties and inevitably led to a slowdown in dynamics and a search for alternatives. The Prague Spring, an attempt to reform the system “from within” that included some elements of a market economy, was a modest effort that was crushed at its inception in August 1968. “Perestroika” in the late 1980s arrived too late, and the confused attempts at political and economic transformation simultaneously were doomed to fail.
The following table illustrates the growth rate development in selected periods after World War II for economies with a central plan and for a group of countries in “Western Europe” with a capitalist economy.

It is clear that in the 1970s, both the centrally planned economies and the economies of Western Europe faced challenges as the growth rate significantly slowed down. The explanation lies not only in the completion of post-war reconstruction but also in a series of major changes in the global economy, including, but not limited to, two oil shocks, the collapse of the Bretton Woods system, and the completion of a structural shift in Western countries where services became the largest sector of the economy. For countries with a central plan, the model based on quantity reached the limits of its functionality.

Table 1
Average Annual Growth Rates in %, 1950–1990

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<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Czechoslovakia</td>
<td>3.09</td>
<td>1.38</td>
<td>1.12</td>
</tr>
<tr>
<td>Hungary</td>
<td>3.60</td>
<td>1.32</td>
<td>0.85</td>
</tr>
<tr>
<td>Poland</td>
<td>3.45</td>
<td>0.39</td>
<td>-0.25</td>
</tr>
<tr>
<td>USSR</td>
<td>3.35</td>
<td>0.99</td>
<td>0.75</td>
</tr>
<tr>
<td>Western Europe</td>
<td>4.05</td>
<td>2.07</td>
<td>1.99</td>
</tr>
</tbody>
</table>

Source: Myant, Drahokoupil, 2013, p. 52.

The central plan intended to fulfill many tasks: it was meant to serve long-term planning, thereby anticipating and facilitating structural changes. It aimed to efficiently utilize resources and avoid socially destabilizing phenomena such as high unemployment, homelessness, poverty, etc.

In this context, the market was perceived as a potentially destabilizing and risky factor. The role of quantitative indicators was significant and aided post-war recovery, especially in heavy industry. However, logical as these indicators may have been during the period of post-war reconstruction, they hindered the transition to
quality, manifesting in the underestimation of the service sector, light industry, innovation in consumer goods, and often in the application of new technologies in these segments.

Negotiations over plan fulfillment could lead to the concealment of actual capacities, making it much easier to “greatly exceed the plan.” The central planning system did not utilize price signals, leading to shortages of various consumer goods, emblematically represented by pervasive queues, under-the-counter goods, and the black market.

In Czechoslovakia, the centrally planned economy was closely linked with the idea of national economic universality, i.e., relatively weak specialization but a broader base of industrial production, as well as infrastructure development. Foreign trade could easily become problematic for central planning, as it disrupted the planned balance of production and consumption in the domestic economy. The necessity to acquire foreign currency also meant incorporating some form of “exchange rate” into the centrally planned economy, which was a decently large challenge outside the price signal system. This issue became a focal point of reform efforts, particularly regarding the exchange rate, through various recalibration coefficients aimed at aligning Czechoslovak price signals with global economic trends.

Czechoslovak exports had a dual character. On one hand, Czechoslovakia (along with the GDR) was the most advanced country of the former CMEA. It was capable of exporting advanced machinery, including the highest form of exports – investment units, to these and developing countries. On the other hand, in relation to Western economies, it played a significantly smaller and lower-quality role, often exporting goods with a lower degree of processing.

Nevertheless, the structure of foreign trade enterprises represented an excellent opportunity for concentrated penetration into foreign markets, and it is one of the major mistakes of the transformation period that these useful structures were destroyed.

In terms of structure, the Czechoslovak economy was predominantly oriented towards industry (especially heavy industry). In contrast, the production of consumer goods and the service sector were quite underestimated, linked to the inability to capture
improvements in services or technological parameters in quantitative indicators. The Czechoslovak economy was materially and energetically demanding.

It is also essential to mention the emphasis on the social stability of the society at the time, on building infrastructure, which the Czech Republic benefits from today (housing construction, roads, highways, power plants, the beginning of some focus on nuclear power, etc.). Further notable achievements include the modernization of the countryside, the ability to achieve self-sufficiency in key commodities, and the development of social infrastructure (kindergartens, schools, hospitals, healthcare centers), etc.

**Political Normalization After 1969 and Its Economic Consequences**

The political normalization following April 1969 did not allow (and strongly opposed) the adaptation of the economic system to its natural evolution. As a result, stagnation and decline were inevitable. Nonetheless, Czechoslovakia entered the transformation process in a relatively better condition than its neighbors, with whom it is often compared across many categories to this day. Unfortunately, as we will see later, this advantage was quickly squandered, and today, the problem of the current political elites’ inability (and unwillingness) to modify the long-inadequate economic model is resurfacing. Let’s examine the situation before the start of the transformation process.

**Table 2**

<table>
<thead>
<tr>
<th>GDP per capita as % of Western European countries (= 100%)</th>
<th>1950</th>
<th>1973</th>
<th>1989</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Czechoslovakia</strong></td>
<td>76.5</td>
<td>61.7</td>
<td>55.3</td>
</tr>
<tr>
<td><strong>Hungary</strong></td>
<td>54.2</td>
<td>49.0</td>
<td>43.5</td>
</tr>
<tr>
<td><strong>Poland</strong></td>
<td>53.4</td>
<td>46.8</td>
<td>35.8</td>
</tr>
<tr>
<td><strong>USSR</strong></td>
<td>62.1</td>
<td>53.1</td>
<td>44.8</td>
</tr>
</tbody>
</table>

Source: Myant, Drahokoupil, 2013, p. 53.
The Czechoslovak economy had a lead over the other countries listed in the table, and it managed to maintain this lead, even though its decline compared to Western European countries exceeded 20 percentage points.

Czechoslovakia entered the transformation process (unlike Poland and Hungary) with low foreign debt and minor macroeconomic imbalances.

**The External Environment: The Rise of Neoliberalism and the Washington Consensus**

The success of the transformation process relies on a) a fundamental analysis of the functioning of the given economy, its strengths and weaknesses, potential, institutional functioning, sector analysis, knowledge of internal and external imbalances, etc., b) an understanding of the workings of the global economy, and the overall political and economic environment. Particularly when the topic is the transformation to “re-engage” or intensify involvement in the external environment, it is necessary to have a well-analyzed understanding of how this environment operates, who the dominant players are, and what risks and opportunities it presents. An analysis of the country’s position in terms of key parameters of this development is also essential. The last part involves creating a plan for the transformation process based on this comprehensive analysis, along with the main “actors” who will implement this process, a timeline, individual priorities or milestones along the way, and the final goal of the process. This final goal can be represented in various ways, such as convergence in the area of economic and/or wage (i.e., catching up with more developed countries, which must also be defined in terms of the dynamics of their development), the creation of strong competitive sectors, or the approach to its technological development (such as Made in China, including a time horizon), etc.

This section’s contents are devoted to the development of the external environment, which proved to be immensely important for the transformation process of centrally planned economies.

In the 1970s, both capitalist and centrally planned economies were completing post-war recovery, necessitating a change in their
growth models. While the reform efforts of the Prague Spring in Czechoslovakia encountered a political impossibility for change, the multiple crises of the 1970s in capitalist economies created the groundwork for a radical departure from Keynesian ideas towards a neoliberal approach in economics.

The capitalist economies of the 1970s underwent a challenging period, including two oil shocks and the related phenomenon of stagflation—a combination of stagnation and high-cost inflation, a new economic phenomenon. The breakdown of the Bretton Woods system also had a destabilizing effect. It is also necessary to mention the structural change—the service sector became the largest sector in the economy, both in terms of GDP share and employment. Under the pressure of new challenges, new socio-economic approaches, now collectively referred to as neoliberal policy, emerged. These included a return to a smaller role for the state, a greater role for the market, accompanied by policies of liberalization (not only in trade but also in finance), deregulation (including the reduction of union influence), and privatization. Politically, this direction was embodied by the New Right, which first gained prominence in the United Kingdom and the USA. Along with modern labor-saving technologies, container shipping, and efforts to reduce costs in capitalist economies, the process of globalization began forming.

Although there are various views on the concept of globalization, including its historical anchoring, from an economic perspective, its genesis can be traced back to the 1970s. The purpose of this section is not to delve into this process in detail but to demonstrate that the transforming economies were “incorporated” into the environment of neoliberal globalization.

Multinational corporations became and remained the dominant players in this process. While not a new phenomenon (recall the oil corporations forming the cartel known as the Seven Sisters), they represent a qualitatively new economic and political force. This is evident both in their number and in the influence, they can acquire in a neoliberal economy. They become the main force determining the nature of the international division of labor.

Multinational corporations operate not just on the basis of sourcing (e.g., oil extraction and processing in the country where the
resource is found). The main slogan of globalization becomes efficiency. Production or parts of the production process are therefore moved to countries that offer certain advantages – especially cheap labor, low social standards, etc. The fragmentation of the production process necessarily involves deep specialization and an increase in dependence between the various links in the chain or between subsidiaries. A condition for smooth operation in such an environment is cheap and efficient transportation (secure sea routes, container shipping). It is into such a world that the economies beginning to transform in the early 1990s were integrated.

Besides the objective situation, the ideological anchoring of neoliberalism plays a role, epitomized by a key document of the time (written in 1989), the so-called Washington Consensus. In addition to the three pillars already mentioned (liberalization, privatization of state enterprises, deregulation), the document implicitly entails a minor role for the state–manifested as fiscal discipline, tax reforms (pressure to lower marginal tax rates), and competitive (i.e., massively undervalued against purchasing power parity) exchange rates. There is no mention of changing the structure of the economy and its modernization. Such endeavors would require industrial policy, a concept that was virtually taboo in the 1990s. This is particularly paradoxical given that the countries hosting the largest multinational firms, which direct the international division of labor, used industrial policy tools (including protectionist measures) for their growth, and built their lead on them (the USA is now appreciating its first Secretary of the Treasury Alexander Hamilton, and Japan’s post-World War II policy is known for its state influence).

The Washington Consensus policies might not have been so critical if they were merely an intellectual document. However, it’s important to see who stood behind this set of prescriptions in reality–powerful transnational institutions including the International Monetary Fund, the World Bank, and the U.S. Department of Treasury. All these points shared a significant caution towards the role of the state, yet it was precisely the state that proved to be necessary, even key, in the application of successful industrial policy. However, that was in a different time. While countries that
adhered to the Washington Consensus in the early ‘90s (led by the USA) had already gained a lead in the past by applying entirely different policies than those mentioned in the document, it is evident that the newly transforming economies, for which the Washington Consensus becomes a “cookbook” on how to proceed, did not have such a claim.

Timing is very important for the success of any economic policy. Transforming economies (i.e., economies with a central plan) are re-integrating into an ideologically conditioned world and a world with a clearly established hierarchy. This might not be anything specific – certain approaches to economic policy prevail in every period (see the post-war dominance of Keynesian approaches), and in every period someone dominates while others try to catch up using various tools. The key issue, however, is that the transformation process did not take this relatively clear fact into account. In many respects, the recommendations given to transforming countries seemed more as if the countries with a central plan were meant to integrate into a theoretical textbook, rather than into the real world.

Ignoring the modernization of the economy (in terms of technology and, of course, ownership) implicitly assumed that transforming economies would not pose competition to advanced capitalist countries. The intention was definitely not to make them competitors. Perhaps based on the presented GDP per capita data, countries with a central plan seemed overall behind (progress- and growth-wise). Such view is, however, overly simplistic and does not consider the diversity of economic structure and some technologically advanced processes or products that economies with a central plan had, not to mention world-renowned brands. In a neoliberal economy, there is no room for such fine distinctions. The one-size-fits-all policy, or one approach to economic policy for everyone regardless of starting conditions, aspirations, economic structure, etc., was extremely dominant in the ‘90s. The collapse of the Soviet Union and the defeat of real socialism created space for economic and geopolitical triumphalism, which the United States fully exploited.

Transforming economies were not given space for modernization of their economies, and it is repeated that advanced countries
definitely had no interest in creating new competitors. Instead, it was necessary to integrate them into their already established networks in the correct hierarchy, i.e., put them into subordinate positions as dependent economies. Precisely this happened to Czechoslovakia, or rather the Czech Republic. A combination of limited fiscal space, ignorance of industrial and technological policy, pressure for the weakest possible Czech koruna exchange rate, and suppressing of wages and salaries created the foundation for what is to this day the dominant “advantage” of the Czech economy – geographical proximity to Germany, cheap labor (low wages in comparison with economic performance), and certain political stability (unlike countries dominated by mafia structures). The foundations of this model were laid at the beginning of the ’90s, even though there was an attempt to keep companies in Czech ownership (coupon privatization). Because this attempt partially failed, as we will see in further sections, space opened up for direct foreign investments, which now mostly dominate the Czech economy.

It is also necessary to look at the development of the external environment from the perspective of advanced countries (led by the USA), which in the ’90s dominate both the world economy and the ideological narrative, precisely through institutions like the International Monetary Fund.

Transforming economies presented advanced countries with a practical laboratory where neoliberal principles could be tested in full force. Moreover, the pressure to weaken labor in accordance with neoliberal doctrine also applied in the opposite direction—pressuring unions and employees in advanced countries. The threat: “If you do not agree to lower wages, we will move production to the Czech Republic,” proved to be very effective. Transforming economies were easy prey—not only in terms of world-renowned brands, technologies, buildings, equipment, machines, or natural commodities.

Setting the main parameters of transformation is a critical moment because, especially for smaller economies, like that of the Czech Republic, change is quite difficult. The Czech Republic still grapples with the consequences of transformation decisions, as it is a textbook example of a dependent economy.
To conclude this section, it’s worth noting that at the same time, somewhat behind the scenes, the Chinese economy was undergoing a dramatic transformation. Its economic successes are undeniable – from a country facing a hunger problem at the end of the 80s, it became the largest economy by purchasing power parity in 2016, as well as a technological powerhouse. Unlike Central and Eastern European countries, China caught the beginning of globalization (its open-door policy began a decade before these countries’ transformation) and never followed the neoliberal policies outlined by the Washington Consensus. Instead, it applied industrial policy with clearly defined goals within its national interest.

**Transformation as a Path to Neoliberal Economy**

Before we examine the course of the Czechoslovak, or rather Czech, transformation, we should briefly summarize the common features and context. The dominance of neoliberal doctrine, anchored not only in the Washington Consensus but also its intellectual influence through institutions like the International Monetary Fund and the World Bank, created significant restrictions for alternative thinking, such as a gradualist approach to transformation.

In Czechoslovak conditions, there was an emphasis on speed along with the notion that introducing a market economy is “easy.” It’s noteworthy that there was little talk of capitalism; instead, the term market economy was used (in opposition to a centrally planned economy).

The emphasis on speed is personified in the term “shock therapy”. This approach completely ignores the influence of institutions and past developments (a “path dependency”). The introduction of a market economy consists of just a few relatively easy steps, and all will be complete! This approach also applies the mix of instruments and objectives that is so typical of transition – the introduction of a market economy (which, as is well known, can take many forms, with the role of the state changing over time) was meant to be a tool to modernize countries and improve the living standards of the population. Instead, however, the introduction of a market economy had become the goal in of itself. The situation was even
more intense in Czechoslovakia, and hence in the Czech Republic with privatization, which also became a sort of ‘golden calf’ of the transition process.

Given that the neoliberal economy is fundamentally actually quite simplistic, it’s unsurprising that those who helped implement it thought, to put it mildly, in very basic terms. Regardless of the starting conditions of countries, regardless of institutions and their functionality/non-functionality, introducing a market economy is seen as easy because—typical of the neoliberal worldview—it’s considered natural, corresponding to the definition of humans as “homo economicus.” Since the United States viewed the collapse of the Eastern Bloc as its triumph, its position was substantially stronger than that of the then EEC (and later EU) countries, whose ideas of the welfare state were under significant neoliberal pressure in the early ’90s.

The supposed ease of implementing a “market economy” in fundamentally neoliberal globalized capitalism supported the speed of the transformation process, but this also raised high expectations regarding the easy and rapid achievement of goals. The embodiment of these expectations in the ’90s was the slogan “In five years we’ll catch up to Germany!”

The transforming countries also had to deal with the early dissolution of the COMECON (Council for Mutual Economic Assistance). In a short period, trade ties that had been built over decades were weakened or directly destroyed. Czechoslovakia, as we will see, which was strongly connected to the COMECON countries, felt this shock in a particularly strong way. Simultaneously, as an exporting country, it had to quickly reorient to entirely different markets, under different financial conditions. And so, it did, albeit in the most primitive form used by developing countries—under the situation of a deeply devalued currency and through wage labour.

**The Czechoslovak Transformation Path**

The first months after the “Velvet Revolution of 1989” were characterized by considerable civic euphoria but also by rather vague slogans
like “return to Europe.” However, we can identify roughly two main directions. One direction was proposals for a gradualist approach, including structural policy. Among the supporters of these directions were, for example, the outstanding Czech national economist Miloš Pick, or Valtr Komárek, who led the Prognostic Institute of the Czech Academy of Sciences. Yet, the spirit of the times favored the proponents of shock therapy and neoliberal approaches.

The politically strongest actor became Václav Klaus, an admirer of the New Right and particularly Margaret Thatcher. Václav Klaus became a very prominent figure in Czech politics for many decades—his career includes serving as the Minister of Finance, Prime Minister, and subsequently President. The foundational document was the Strategy of Economic Reform, which included four pillars: economic restriction, privatization, price liberalization, and currency convertibility.

Václav Klaus and his associates emphasized the speed of the transformation process, evidently also with the goal of creating new elites that would support the new political and economic regime. It was candidly stated that the beginning of the process would require “tightening the belt.” In the early ’90s, amidst general euphoria, the population’s willingness to make sacrifices was indeed significant. Václav Klaus was politically very skillful, confident, and charismatic, managing to garner substantial support for his vision of transformation—however, primarily in the Czech part of Czechoslovakia. Different approaches to economic transformation were one of the reasons for the dissolution of Czechoslovakia and the creation of the Czech Republic on January 1, 1993. It should be added, though, that the split of Czechoslovakia occurred peacefully, and the relationship between the two republics remains above standard to this day.

The term reintegration into the world economy is not entirely accurate, as the Czech part of Czechoslovakia was relatively open even during the central planning era. Measured by the ratio of exports of goods and services to GDP at 45%, it was higher than in the Slovak part, Hungary, or Poland (see Myant, Drahokoupil, 2013, p. 93). For comparison, the current openness of the Czech economy is around 80%. The territorial structure corresponded to Czechoslovakia’s involvement in COMECON. The strongest trade
ties were with the Soviet Union, but the trade ratio with other Eastern European countries and EEC countries was almost balanced. Therefore, it is not entirely accurate to speak of reintegration, as the Czechoslovak economy was definitely not autarkic and was involved in international trade, though in a very different manner from today. Characteristic was so-called dual trade. For COMECON countries, Czechoslovakia functioned as a supplier of advanced machinery and equipment, but for capitalist countries, exports were dominated by simpler goods, intermediates, fuels, food, and chemicals.

The exchange rate played one of the crucial roles in the transformation process. It was even supposed to serve as a so-called nominal anchor – a fixed point in a period of deep changes. The exchange rate was set as fixed (initially pegged to a basket of five currencies, later two – the American dollar and the German mark). At the beginning of the transformation in 1990, the exchange rate was deeply devalued three times. Miloš Pick at that time vainly warned of the divergence between the purchasing power parity rate and this devalued rate. He stated that the large difference (indicated, for example, by the ERDI coefficient) corresponds to developing countries and that one deformation (administratively set rate during central planning) was replaced by another deformation (Pick, 2009, pp. 17–26). The strongly devalued crown rate predetermined future development – it facilitated economic reasoning in the category of cheapness, led to selling national labor below its value, its softness also did not create an incentive for companies to focus on higher added value and modernization of production. The exchange rate cushion, which was supposed to be a relief for companies, did not work for long, as higher inflation led to the real appreciation of the crown. Thus, the exchange rate cushion was gradually exhausted over time, and it became increasingly clear that even larger devaluations could not replace a systematic industrial policy.

The fixed exchange rate policy ended partly unsuccessfully. Relatively large current account deficits from 1996 indicated the unsustainability of the fixed rate. The dramatic situation was further supported by the very rapid introduction of internal convertibility (1991), but especially external convertibility (1995). The high interest rate differential began to attract speculative capital to the
Czech Republic in the mid-90s, which short-term pushed for the revaluation of the crown against the German mark, even though all fundamentals indicated otherwise. The dispute also had its political expression – the clash between then Prime Minister Václav Klaus and the governor of the Czech National Bank, Tošovský. In 1997, the Czech Republic was hit by a crisis originating in Thailand. After a futile struggle, the CNB had to let the crown depreciate under the flight of speculative capital and leave the fixed regime. Fortunately, the currency crisis did not fully develop into a financial crisis. Later, the central bank switched to a managed float regime and applied an inflation targeting policy.

Besides the nominal anchor in the form of a fixed exchange rate, privatization was supposed to be the showcase of the transformation process’s successes. Instead of a more thoughtful privatization process that would contribute largely to the modernization of the economy, it became a goal to privatize in itself. Some failed waves of privatization put the entire banking sector into significant trouble, creating a breeding ground for direct foreign investments, which subsequently almost dominated the entire economy.

Privatization on such a massive scale raises numerous serious questions. Is there a family silver, and if so, how do we define it? Are there strategic enterprises? How should privatization proceed? Will it be open to foreign entities, will it be done solely for instant funds? What criteria will need to be met to obtain bank loans? Many of these critical questions were addressed as they arose (here again we see an example of emphasis on speed, rather than on the quality of execution). We are still reaping the fruits of many quick decisions, such as the privatization of strategic enterprises including water infrastructure.

The dominant form of privatization became so-called voucher privatization. It should be mentioned that this form also matched Václav Klaus’s vision, who did not wish for strong foreign engagement in the Czech economy. Unfortunately, the failures of transformation during the ‘90s, which culminated in bank failures, laid the groundwork for the opposite. I believe it is a great pity that privatization by management and employees was not considered as the main method.
The voucher method was criticized already in the ‘90s, especially due to concerns about the highly fragmented ownership of companies. Consider that by the ‘90s, the hierarchy of the global economy, dominated by multinational corporations, was fully formed. The idea of the small shareholder/capitalist participating in company management might seem quaint at first glance. However, remember that the majority of the population of then Czechoslovakia had no experience with the capitalist economy. More realistically, the privatizers at the time were well aware that most citizens did not aspire to be small shareholders but would sell their shares, quickly crystallizing a layer of new owners. And this indeed happened, with significant contributions from investment funds.

The voucher method allowed citizens to purchase a voucher book and invest in selected companies. Voucher privatization took place in two waves, with more than 70% of the population participating in both. The Harvard Investment Fund, with its slogan “a tenfold certainty,” caused a stir. It is quite unsurprising that a larger part of the population eagerly participated in voucher privatization, which served as a social cushion for them. However, the consequence was the selling off of national assets far below their value, as the slogan “a tenfold certainty” meant not much more than that national assets were being sold at least ten times under their actual value.

The true impacts of voucher privatization were revealed in the light of frauds, thefts and massive tunneling of companies, but also in the light of the collapse of the banking sector at the end of the ‘90s.

Václav Klaus’s then-associate, and later critic, Jan Stráský (HN, 2013), explained why banks were involved in the entire process; they provided loans, often based on political affinity, to newly privatized firms, even though at that time they were still state banks. It is no wonder that in this context, there is talk of banking socialism.

Jan Stráský stated,

We calculated that there was no other way than to involve the banks to lend to our people. Even if someone pays it back and another doesn’t. And a lot wasn’t paid back, with hundreds of billions written off. Around 1993, the banks were bailed out for the first time, as there were also old loans that had been made during communism. That was the first
roughly 50 billion. But then it turned out that in five years of capitalism, debts were made ten times larger.

Similarly, Tomáš Ježek, who was co-responsible for the course of privatization, began to express himself critically later on (see *Ekonom, 2013*).

After the end of voucher privatization, when the capital market was established, and privatization funds started operating. That’s where the problem lies. The key law on investment companies and funds from 1992 was intentionally flawed... And so, it happened that the management of the funds took control of the assets of voucher shareholders and started to manage them as their own. Petr Kellner and others received a generous offer... Moreover, and I want to emphasize this three times, it was not the state anymore, but citizens were robbing each other...

At first glance, it might seem that the real failure of transformation through voucher privatization were the problems in the banking sector. In reality, however, the problems emerged there but did not originate within the banking sector. It is symptomatic that the functioning of the banking sector was not given much attention within the transformation strategy. Banks became a collection point for bad loans, indicating not only poorly conducted privatization but also criminal activities in the form of asset stripping – parts of companies that were sold off cheaply and then the whole companies were shut down.

During the ‘90s, the share of so-called classified loans began to increase rapidly, starting to threaten the stability of the entire banking sector. Banks often financed dubious business plans, and there were also state pressures to keep certain companies alive. Social reasons also played a role – to keep large employers afloat. The worsening situation of the entire economy (evident, for example, in the increasing current account deficit), as well as the inexperience of new banking officials, contributed to the increase in the banking sector’s instability.

The situation was further complicated by a weak legal framework. This concerned not only bankruptcies but also proper banking
supervision. Supervision was perceived by some neoliberal economists as excessive state regulation. The vanguard of big problems was Agrobanka, whose losses were largely assumed by the Czech National Bank.

The most dramatic situation in the banking sector, however, had to be addressed by the Social Democratic governments, which came to power in 1998 based on criticism of the previous transformation approach. During this period, the share of non-performing loans dramatically increased (up to 38%). It was evident that the situation was unsustainable. Major banks: Česká spořitelna, Komerční banka, and Československá obchodní banka (whose situation was relatively good) were sold to foreign investors, while the Czech state and its citizens accumulated billions in losses.

At the same time, there was also a cascading collapse of cooperative savings banks, a sector with nearly a 150-year tradition in the Czech lands. The absence of banking supervision unfortunately led to the spread of many fraudulent practices and subsequently to the discrediting of a sector otherwise associated with the development of the local economy.

The consolidation of the banking sector cost over 300 billion CZK and resulted in an overwhelming majority of assets being controlled from abroad. It is precisely the Czech subsidiaries that significantly supply their foreign parent companies with regular massive profit outflows abroad.

The failure of the domestic attempt (state banks financing firms privatized by the voucher method, among others) opened the doors to an extremely strong engagement of multinational companies. This created conditions for the position of the Czech Republic as a dependent economy.

To conclude, let’s summarize the overall context of economic policy, which fully conformed to the Washington Consensus with its emphasis on repeated restriction. In this worldview, the growing current account deficit was caused by excessively high consumption (and partly by investments), and the reaction was to “squeeze” the economy down again. However, a more realistic interpretation was a supply-side issue – the underutilization of domestic capacities, both extensively and intensively. But, if the supply side began to be
discussed, the problem of failed privatization would necessarily have to be mentioned, and it would be necessary to start talking about structural and industrial policy. Therefore, these views were harshly rejected by the mainstream. It’s incredible, but this debate about the “overheating” of the economy continues in the Czech Republic today – with the only neoliberal solution being the suppression of economic expenditures (especially household consumption) to restore “balance.” The “patient” would be continually getting prescribed a treatment of depressions, somewhat like it was once expected that more leeches would cure the sick.

During the ‘90s, the Czech economy was restructured significantly. However, it’s debatable whether it was done in a desirable and beneficial direction. Agriculture was severely affected, losing a third of its workforce at the beginning of the transformation between 1990–1992 (see Myant, 2013, p. 54). Agriculture also experienced a massive increase in productivity but faced poor access to credit, ultimately creating a large space for imports and loss of food self-sufficiency.

Between 1990–1993, there was also a decrease in industrial employment, whereas employment in the trade sector increased, most significantly (more than double) in finance (Mayant, 2013, p. 91). Instead of deep restructuring, which could never be achieved through a focus on cheapness (i.e., suppressed wages and weak currency), companies focused on short-term survival, even if it meant through wage labor. The destruction of foreign trade companies further complicated access to final markets and went precisely in the opposite direction of the global economy, tending towards increasingly powerful multinational companies. Instead of adapting painstakingly built structures – in science, research, or foreign trade – to the new era, they were thoughtlessly destroyed. Concepts and plans were anathema to neoliberal thinking – the market was supposed to adjust everything by itself.

Furthermore, in the first half of the ‘90s (after the division of Czechoslovakia), there were no significant social unrests, nor did unemployment grow. The Czech Republic created several cushions – one being the exchange rate, which, however, could only function for a short time in such a way. For the population, there were other
cushions, such as the aforementioned “tenfold certainty”, bought at the expense of selling national wealth below value, and restitutions, which applied to about 15% of the population. Restitutions primarily took place for property that had been nationalized under communist unfreedom.

**Conclusion**

The Czechoslovak, or rather Czech, transformation path was a specific combination of influences from the neoliberal Washington Consensus along with an attempt to find Czech owners, especially through the method of voucher privatization. This attempt was not completely successful, most clearly evidenced by the collapse of banks at the end of the ’90s.

The chosen path of transformation confused goals and means. It did not lead to modernization and an increase in the country’s innovation potential but instead chose the path of repeated restrictions and policies of cheapness, in line with the Washington Consensus. This path brought the Czech economy into a position of a dependent economy, with extreme influence of multinational companies, and domestic deformations that include a wide range of categories – from a tax mix that burdens the lowest-income groups the most to insufficiently competitive markets and cartels permeating the Czech economy.

The transformation results were aptly summarized by the outstanding economist Miloš Pick (2009, pp. 91–92):

The Czech Republic entered economic transformation as a medium-developed industrial country... However, its productivity on average only reached about two-fifths of the level of then Germany (old federal states), with this productivity lag being greater, the more complex the product. The Czech Republic had a slightly higher economic level than the least developed EU countries (the level of Greece and Portugal was lower by 13%). Compared to other transitional countries of the Central European region, it even had a significant performance lead (the level of Poland was lower by 46% and Hungary by 25%). It had low foreign debt and relatively small imbalances in the
domestic market as well as very low inflation. Its long-term “comparative advantage” was the accumulated civilizational potential – the educational and qualification level of the population, characterized by a considerable degree of adaptability. These relatively favorable starting conditions of the Czech Republic, however, were not sufficiently utilized under the chosen transformation strategy, but to a large extent were wasted.

**Literature**


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