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THE CZECH REPUBLIC: ON THE ROAD TO EUROPE

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ABSTRACT

Of all the East Europeans, one can argue that the Czechs have made the most successful efforts to date in moving towards a multi-party democracy and market economy. However, in their haste to 'return to Europe' the Czechs have been obliged to sacrifice their union with Slovakia.

The reasons for the Czechs' success lie in the historical traditions of the region, its high level of economic development prior to 1948, and its close proximity to Germany. Also, paradoxically, the Czechs were helped by the fact that they did not experiment with market socialism in the 1970s and 1980s. This meant that unlike Poland and Hungary they were not saddled with foreign debt, high inflation and aggressive trade unions.

Vaclav Klaus' government has overcome its major political challenge: overseeing the break-up of the federal state. Given the successful completion of the first wave of large-scale privatization, and assuming that the economic upturn which began in October 1992 continues to strengthen, one can expect further consolidation of Klaus's political position. This paper provides a short review of the political and economic situation as of March 1993.
Introduction

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Politics

The newly reborn democracy in the Czech Republic has quickly settled down into a stable pattern, which should persist for the next several years. The broad coalition which emerged from the November 1989 revolution, Civic Forum, split in February 1991 into a left and right wing. The latter named itself the Civic Democratic Party, and emerged as the largest single party in the June 1992 elections under the leadership of Vaclav Klaus. Klaus managed to convince the voters that his policy of monetary stabilization and rapid privatization offered the best chance for a decisive break with the socialist past.

The CDP only won 76 of the 200 seats in the Czech parliament, and therefore must rule in alliance with three other parties: the libertarian Civic Democratic Alliance, the Christian Democrats and the Liberal Social Union (14, 15 and 16 seats respectively). Klaus's coalition has 105 seats, which gives them a narrow majority. The Communist Party and their allies in the Left Bloc, together with the Social Democrats, form the opposition (with 35 and 16 seats respectively). The extreme-right Republicans managed to secure 14 seats. Other smaller parties were kept out by the rule requiring parties to gain 5% of total votes cast before being eligible for seats in parliament.

One can expect Prime Minister Klaus's coalition to stay in power at least until the next elections, scheduled for 1996. Although there is always the threat of defections from the
governing coalition, no particular controversy is brewing at present. Even if unemployment takes off and the economy stagnates, this would only increase the pressure on the smaller parties to stay in the Klaus coalition, for fear of opening the door to a left-wing government.

The major political challenge facing the Czechs was managing the separation from Slovakia. Czechs and Slovaks had totally different historical traditions (under the Austrians and Hungarians, respectively), and were only united in a single state for the first time in 1918. Under communism, Slovakia was industrialized, but its large defence plants were ill-prepared for the collapse of the USSR and the challenge of a market economy. Unemployment rose to 13% in Slovakia, while it stayed at 3% in the Czech Republic.

In the three years after 1989, Czech and Slovak politicians engaged in seemingly endless rounds of negotiations over the status of the federation. The Slovaks sought symbolic assurances from the Czechs that they were equal partners, while Czechs accused Slovaks of siphoning resources from the federal budget to prop up their ailing economy. Nevertheless, polls indicated that Czech and Slovak citizens remained committed to the idea of a federation. Things changed after the June 1992 elections, which saw the victory of the Movement for a Democratic Slovakia in that republic. The Slovak leader, Vladimir Meciar, claimed that all he wanted was a new confederation, but Klaus concluded that protracted negotiations with Meciar would cause great uncertainty and could endanger the market reforms.

Klaus and Meciar agreed that a split was inevitable, and presented their parliaments with a fait accompli. By November the polls were indicating a majority of Czechs favouring separation - although only 40% of Slovaks wanted the split. Fortunately, there were no sizeable pockets of Slovaks living in the Czech lands (or vice versa), which could have caused the sort of problems seen in Yugoslavia. The two republic parliaments approved the 'velvet divorce' arranged by Meciar and Klaus, which went into effect on December 31st, 1992. However, some crucial economic aspects of the separation were left unresolved. (See below.)

Apart from the split with Slovakia, the two other principal questions facing the Czech political system are the role of the President and the creation of a second parliamentary chamber.

Vaclav Havel was elected President of the Czech Republic on January 26, although
his relationship with Klaus is rather tense. Havel tried to bolster the powers of the president under the federal republic, but all of his constitutional initiatives were rebuffed. However, this antagonism between Klaus and Havel was rooted more in personal rivalry than policy disagreement. On key political issues, such as market reform and a Western-oriented foreign policy, they are generally in agreement. In the new Czech Republic the president has the power to select the prime minister, to negotiate treaties and to dissolve parliament, and plays a prominent role in foreign affairs. However, Havel will no longer have the right to propose legislation, and his veto over new laws can be overridden by a second parliamentary vote with a simple majority.

The major political parties are divided over how to fill the new 81-person upper house. (Under the old constitution, the Czech parliament was unicameral). Complicating the debate is the presence of the Czech deputies from the now disbanded Federal parliament, who want to be appointed to the new senate. Whatever the decision on their role, the new upper house will probably be given few powers relative to the lower assembly, and will be elected from larger constituencies representing the main provinces of the republic. Ironically, the potential threat posed by the regional Movement for Self-Government of Moravia and Silesia has receded since the sobering example of the secession of Slovakia.

As for foreign policy, the first post-communist Foreign Minister, Jiri Dienstbier, tried to steer a middle course between East and West. He promoted the Visegrad triangle with Hungary and Poland, and called for a new Marshall Plan to rescue the former USSR. The Civic Democratic Party are firm advocates of a pro-German, pro-Nato policy, and their new foreign minister, Josef Zieleniec, has made a decisive break with Dienstbier’s approach. Klaus has been openly contemptuous of the Visegrad triangle, and rejects the idea that the Czechs must wait to join the European Community until the Poles, Slovaks and Hungarians are also ready to join. He has suggested that the Czechs may attain the level of economic stability and openness required for EC entry within five years.

Economics

After 1989, the new government moved decisively to dismantle central planning controls and open the economy to foreign trade. Price controls were lifted in January 1991,
causing a 50% surge in inflation, but since then the rise has been held to 12-14% a year. Klaus, who was Finance Minister between 1990 and 1992, pursued a tight monetary and fiscal policy, although the government deficit crept up from 2 to 4% of GDP. The trade unions, politically weakened by their association with the old regime, meekly accepted a 23% drop in the real wage in 1991, in the hope that this would minimise lay-offs. Indeed, unemployment has stayed below 3%, although it is likely to double in 1993 as privatized firms come under new management.

GDP slumped 16% in 1991 and 8% in 1992, with much of the drop due to the 50% fall in exports to the ex-USSR. Industrial output began to recover in October 1992, with GDP growing 3.8% in the fourth quarter. Czech foreign trade showed a deficit of $300mn in 1992, after a surplus in 1991. 30% of trade is with Germany and 15% with the ex-USSR, and it is the oil and gas imports from the latter which account for the deficit.

In 1990 the Czechoslovak crown was made partially convertible, and has held its value against other currencies. The crown was undervalued to discourage imports, boost exports and attract foreign investors: Czech wages are half those of Hungary or Poland, and one tenth those of Germany. It took several years for foreign investors to enter the Czechoslovak market, from which they had been almost totally barred prior to 1989. However, by the end of 1992 some $1.5 billion funds had flowed in (93% to the Czech Republic). Volkswagen bought the auto concern Skoda Mlada Boleslav, and promised to double production and invest DM 9 billion over the next decade. (This would make the VW-Skoda deal the largest cross-border acquisition in history.)

Klaus’s privatization programme has four main components. First, some 100,000 properties confiscated after 1948 are being returned to their former owners. Farmers are also eligible to reclaim their land from the cooperative farms. Second, a ‘small privatization’ programme was launched in February 1991, under which 22,000 stores and workshops have been auctioned to private bidders. Third, restrictions on private enterprise were lifted, and an astonishing 1.1 million people (9% of the adult population) have registered as individual entrepreneurs. By the end of 1992 the private sector accounted for 21.5% of GDP.

The crucial element, however, is the programme to divest large state-owned enterprises. Each firm was required to prepare its own privatization project, proposing direct sale
to a foreign or domestic buyer, public auction, or sale through the ‘coupon method’. The latter was the most innovatory aspect of Czech privatization. Recognizing that not all 3,500 Czech firms would find cash buyers, Klaus issued coupons to the general public (for a nominal sum) which were then used to bid for shares in state firms. 80% of the public bought coupons, although 70% lodged their coupons with private investment funds.

The first wave of mass privatization, involving around 25% of Czech industry, began in May 1992 - just in time for the parliamentary elections. The timing was not coincidental: Klaus saw the coupon method as a way of forging a political constituency for change. By the end of the first wave in January 1993, $12 billion of assets had been privatized, 65% of which were sold for coupons. A second wave is planned for late 1993. The major concern now is the impact of the Bankruptcy Law, which comes into effect in April 1993. Most Czech firms are heavily in debt, and the new law may trigger a wave of closures.

The separation from Slovakia has added another element of uncertainty to Czech economic prospects. Both sides agreed to maintain a customs and currency union, but due to an outflow of hard currency from Slovakia the two currencies were separated on February 2nd. The Czech crown should hold its value, but the Slovak crown will probably be sharply devalued. Confusion over tax and customs paperwork at the border caused a worrying drop in trade between the two republics in January. (25% of Czech exports go to Slovakia.) Also, Slovak firms stopped making payments on their debts to Czech firms, which total $800mn. In retaliation, Klaus suspended the issue of shares to Slovak citizens under the privatization programme. Further disruption of economic links between the two countries may occur, although this will harm the Slovaks more than the Czechs.

**Conclusion**

Vaclav Klaus’ government has overcome its major political challenge: overseeing the break-up of the federal state. Given the successful completion of the first wave of large-scale privatization, and assuming that the economic upturn which began in October 1992 continues to strengthen, one can expect further consolidation of Klaus’s political position. This paper provides a short review of the political and economic situation as of March 1993.