IV. MICROECONOMY

IV.1 Revived Privatization

While privatization of small firms was completed successfully in the early 1990's, the privatization of large companies, including banks, was much slower – despite the fact that a significant share of these companies was distributed to the public in voucher privatization. In fact, when the current minority government came into power in 1998, most large strategic companies were under state control – either directly or indirectly through state-owned banks. This led to incestuous ownership relations. There is now micro evidence available on the poor economic performance and increasing indebtedness of joint stock companies controlled by investment funds which were owned by semi-state banks that provided soft loans to these firms, closing a full circle.

Privatization activities were resumed at the beginning of 2000, after the minority social-democratic government and the largest opposition party ODS agreed to complete the remaining privatization of large enterprises within the next two years. They clearly will not be able to complete this goal. However, the government has several achievements it can boast. The state sold its 30 % share in Škoda Auto to Volkswagen AG in June 2000 and the government approved the sale of České radiokomunikace to a consortium of Tele-Danmark and Deutsche Bank.

Most importantly, all large banks were sold to foreign investors. In February 2000, the Česká spořitelna was acquired by the Austrian Erste Bank Sparkassen, after the carve-out of low quality credits of 33 bln. CZK in nominal value. The privatization of Komerční banka has been postponed by the government due to enormous illegal activities uncovered at the end of 1999 and at the beginning of 2000. Bad assets worth more than 80 bln. CZK were carved out from Komerční banka's balance sheet. Finally, in mid 2001 the government announced that Société Générale won the tender and took over the bank.

IPB, the bank privatized "as is" in 1998 to the Japanese Nomura, was facing serious problems with maintaining its capital adequacy ratio and with deposit outflow in the first half of 2000. Given that IPB was then dealing with the second largest amount of payments in the economy, the Czech National Bank imposed administration on the bank. This was shortly followed by a quick sale of the IPB business to ČSOB owned by Kredietbank of Belgium. To complete the deal, the government agreed to provide protection against the credit risk of a large part of IPB's loan portfolio.

The total cost of the post-1997 bank restructuring may well turn out to be close to 15 % of GDP. This figure is on top of the significant bailouts of many small banks collapsing throughout the mid 1990s. Not surprisingly, the state is seeking to maximize privatization revenues. In particular, the privatization of the electricity generator ČEZ, electricity distributors and the whole gas distribution sector is finishing, but is unlikely to generate the maximal revenue because

CZTop100 in Profit

Rank 2000	CT100	Firm	Industry	Profit 2000	Profit 1999
1	3	ČEZ, a.s.	Electricity	8,266,266	2,862,046
2	2	Unipetrol, a.s.	Chemicals/Oil	5,797,257	3,145,252
3	5	Český Telecom, a.s.	Telecommunications	5,448,413	5,983,292
4	1	Škoda Auto, a.s.	Car	4,175,389	3,814,203
5	4	Česká rafinérská, a.s.	Chemicals/Oil	4,045,851	2,003,410
6	40	Frantschach Pulp & Paper a.s.	Wood and Pulp	2,630,227	152,843
7	8	Agrofert, a.s.	Agriculture Wholesale	2,418,668	1,003,164
8	6	Transgas, s.p.	Transport/Gas	1,822,416	8,801,792
9	30	Glaverbel Czech, a.s.	Glass	1,249,269	475,809
10	84	SPP Bohemia, a.s.	Transport/Gas	1,158,847	332,595
11	47	Sazka, a.s.	Public	1,101,170	1,082,375

CZTop100 in Number of Employees

Rank 2000	CT100	Firm	Industry	Labor 2000	Labor 1999	Change in %
1	1	Škoda Auto, a.s.	Car	22,588	20,322	11.15
2	11	OKD, a.s.	Mining	20,282	22,876	-11.34
3	5	Český Telecom, a.s.	Telecommunications	18,693	20,824	-10.23
4	10	Nová huť, a.s.	Steel	12,793	13,583	-5.82
5	104	Dopravní podnik hl. m. Prahy, akciová společnost	Public Transport	12,425	12,434	-0.07
6	14	AHOLD Czech Republic, a.s.	Wholesale	10,000		
7	3	ČEZ, a.s.	Electricity	9,069	9,889	-8.29
8	15	IPS a.s.	Construction	7,716	8,651	-10.81
9	16	Třinecké železárny, a.s.	Steel	7,290	8,124	-10.27
10	35	ALIACHEM a.s.	Chemicals	7,160	8,286	-13.59

of the privatization authors and the design of the call. The sale of Český Telecom, the long-protected monopolistic provider of fixed-line telecommunication services, has been under preparation for years as there are no serious investors at the moment. Other companies are in need of significant restructuring (unbundling) before they can elicit any interest from foreign investors. This includes the steel companies (Nová huť and Vítkovice), the coal mines (OKD, Mostecká uhelná), and the already sold oil and chemical companies (Unipetrol, who owns Chemopetrol and Benzina).

Privatization in the Energy Sector: Electricity and Gas

Year 2000 was an important landmark in the recent history of the Czech energy sector. The decision about privatization of ČEZ and Transgas – the gigantic state-owned energy monopolies – was finally taken, and a new Energy Act was approved that should create conditions for the opening up of the electricity and gas sector to competition. Not even in this year, however, were the prices of electricity and gas fully liberalized and hence the cross-subsidization between different categories of consumers removed. Moreover, although the independent electricity regulator originally announced regional differences in prices, at the final stage, after consultation with the government, the government itself announced that the price changes would not be regionally adjusted.

The birth of the new act was painful: more than a thousand amendments were suggested. Still, the final version of the act can hardly be considered perfect as it suffers from an overly general voice and occasional ambiguity. The flaws should be remedied by a number of supplementary decrees, most issued by a new regulator that started to work on 1 January 2001. As no deadlines were set for these decrees, however, an impression arises that the parliament managed to postpone current problems for the indefinite future, as the previous example suggests.

The major novelty of the new act is that it allows consumers to choose their supplier, according to EU requirements. The process of opening up the market is gradual, from large to medium to small consumers. In the electricity sector this process should take place from 2002 – 2006; in the gas sector it should start in 2005.

Both ČEZ and Transgas are in the privatization process. Their privatization, though, has been the subject of a protracted and heated debate between the Ministry of Finance and Ministry of Industry and Trade. While the Ministry of Finance was strongly in favor of "per-partes" privatization in which producers would be privatized independently of regional distribution companies, the Industry and Trade Ministry advocated "pooled" privatization – the sale of majority shares of both the producer and the distributor companies to the same owner. Eventually, the government opted in the case of ČEZ and Transgas for the pooled variant. The arguments of the Ministry of Finance about the benefits of increased competition yielded to the opinion of the Minister of Industry and Trade, Mr. Grégr, who claimed that "per-partes" sales would generate considerably lower revenue for the government. Additional requirements were put forth, including that the new owner should not only be familiar with nuclear power generation (because of Temelín) but has to agree to buy a certain amount of brown coal during the next 15 years. Such privatization is at best dubious since separate sales would surely attract more potential buyers and so drive the prices up. The parliament took unusual procedural steps during the approval of a new amendment of the business code and constitutional court challenges are expected. Unfortunately, part of the amendment contained a new section that would require

the new majority owners to make an offer to buy out shares from the minority stakeholders after privatization. This uncertainty will definitely lead to a reduction in their price bids. Originally, the government expected 500 bln. CZK revenue in total. The best solution, at this stage, is to postpone the privatization until the court decides the issue. While the true reasons for the parliament's decision can only be speculated, we cannot escape the conclusion that short-sightedness and hunger for immediate revenues triumphed over prudential foresight. Nevertheless, Unipetrol was sold for the second highest bid of 11.75 bln. CZK to domestic Agrofert. The government refused the highest bid of 14.5 bln. CZK submitted by British Roche. German RWE offered 133 bln. CZK for gas utilities and won the call. The highest bid for ČEZ, 135 bln. CZK, by Italian Enel was not satisfactory. The government decided to allow Électricité de France and Enel into the second round of the call in spite of the fact that EdF missed the deadline and demanded changes in the contract, which should lead to the automatic refusal of the bid in the call.

Investment and Banks

(Based on Lízal L., and Svejnar J., Financial Conditions and Investment during the Transition: Evidence from Czech Firms, CERGE-EI Working Paper 153 and WDI Discussion Paper 235, 2000)

As the transition from central planning to a market system started to unfold in the 1990s, it became clear that the transition economies needed to invest heavily in order to modernize their obsolete capital stock and become competitive on world markets.

Both the supply and demand side of investment should be examined. On the supply side, a principal goal is to assess if the investment behavior of firms is linked to the availability of internal finance and if this effect varies across the principal ownership-legal form categories of firms. The switch from central planning to a transition period forced firms that traditionally received centrally allocated investment funds to face the emerging commercial banks and other financial institutions. In this context, it appears that many of the existing (larger) firms continued receiving credit even for non-performing projects, while new firms tended to face expensive external finance for investment or were denied such finance. The data from transition economies hence lend themselves to testing the credit rationing hypotheses advanced about the supply side of investment in the western literature and also put forth as an explanation of the sharp decline of investment in the early transition period. On the demand side, the investment process can be modeled as belonging to the neoclassical, accelerator or structural dynamic specifications.

The data contain relatively detailed information about the ownership and legal form of firms. In examining the annual evolution of investment/capital, investment/labour and investment/production ratios, we see that foreign owned companies generally tend to invest the most and (domestically owned) cooperatives the least. The behavioral

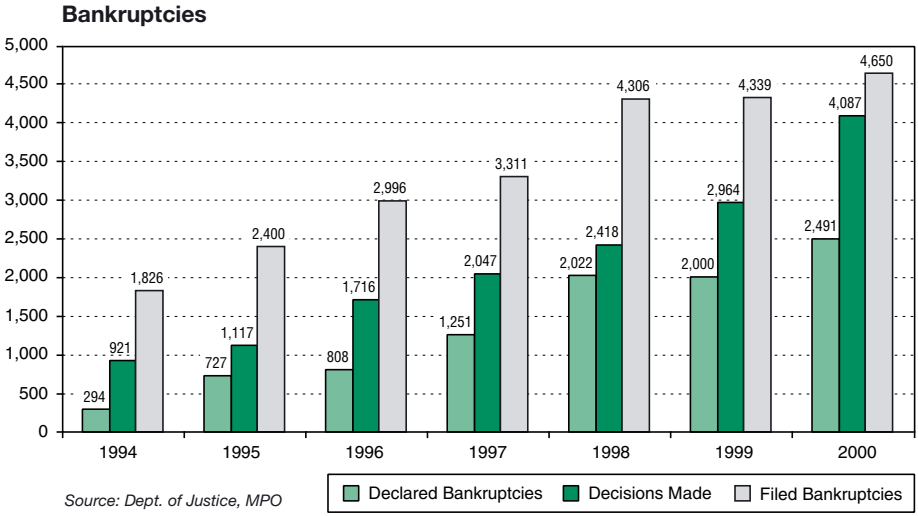
difference that is perhaps the most interesting from a policy standpoint, namely that between the private and state owned firms, is more complex. Private firms clearly invest more than the state owned ones in relation to their recorded capital stock. Private joint stock companies also tend to invest a bit more than the state owned joint stock companies on all three criteria. However, in the last two years state owned-limited liability companies have dominated all domestic private firms in terms of the investment/production ratio. Moreover, the privately owned-limited liability firms (the category with the greatest number of firms) and individual/family firms rank high in investment/capital but low in the other two indicators, suggesting that these smaller private firms operate with a small (recorded) capital stock and do not invest heavily in output and employment. The widely accepted notion, based on a Polish survey, that during transition investment is high in the new private firms and low in the state owned enterprises is hence not supported by the larger Czech data set.

Econometric tests indicate that investment behavior of firms during transition reflects both the demand side features captured by the neoclassical, accelerator and dynamic structural models, as well as the supply side (cash flow or financing constraints) hypotheses. When the basic neoclassical/accelerator specification is used on the demand side (stressing the link of investment to lagged production), the overall findings suggest that the general behavior of firms in the transition period may be better approximated by this model than that based on cash-flow or financing constraint theories.

In our overall 1992-98 estimates of a dynamic structural model, we find support for the hypothesis that the transition economies have an imperfectly functioning legal system that permits firms not to honor commitments to their partners (i.e., a form of soft budget constraints) and that this phenomenon affects investment. In particular, we find that receivables overdue are associated with lower investment and payables overdue with higher investment, suggesting that firms do not expect these commitments to be honored.

Credit rationing can partly explain aggregate economic performance and the behavior of firms in the transition economies. Yet, a massive rollover of bank loans has allowed firms in these economies to continue operating under a soft budget constraint. An analysis of investment during the transition, focusing on the issues of whether firms are credit rationed or subject to a soft budget constraint, and whether their behavior resembles that of a profit-maximizing firm, is a key issue in evaluating the pursued economic policies in transition countries. The econometric findings on Czech industrial firms suggest that cooperatives and small to medium sized private firms are credit rationed, but that other firms are not. Given the large volume of non-performing bank loans to firms and the high rate of investment of large state owned and private firms, this finding strongly suggests that larger domestic firms tend to operate under a soft budget constraint.

IV.2 Enterprise Restructuring: Bankruptcy



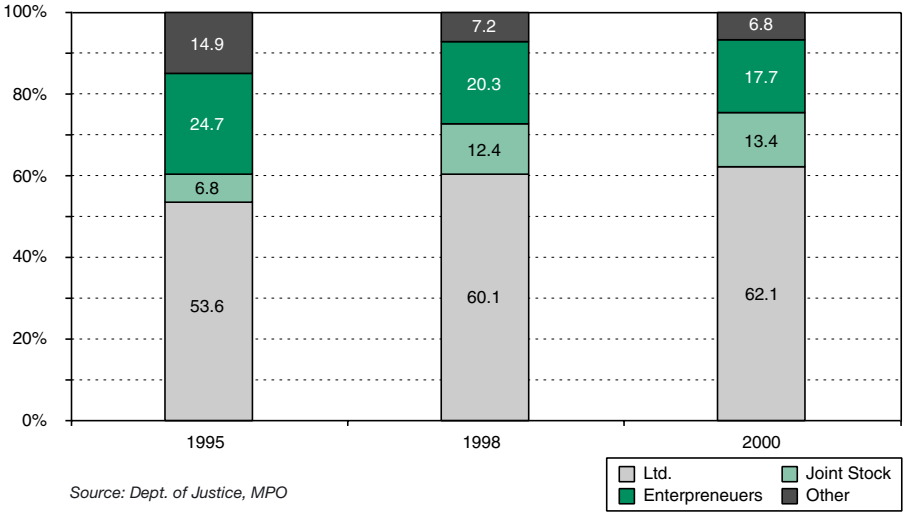
Source: Dept. of Justice, MPO

In the neoclassical view bankruptcy should volley unproductively allocated resources back to productive sectors. This may also be the case for transition economies. Bankruptcies are sometimes referred to as a restructuring device. How much the bankruptcy procedure is used is a different question. Over the last seven years the number of bankruptcies were nearly halved in Finland, France, Holland and Sweden, while Belgium, Italy and Switzerland have kept approximately the same number of bankruptcies during those same years. The Central European countries under transition give a completely different picture.

In the Czech Republic there was substantial growth until recent years when the number of declared bankruptcies stagnated. This rapid growth basically copies the evolution of the legal framework of bankruptcy procedures in the Czech Republic. Initially, bankruptcy was almost impossible since the government feared massive layoffs and economic collapse. As these fears faded and the law converged towards a standard law for the market economy, bankruptcies were more likely to happen. Likewise, increasing bankruptcies have been be observed in Slovakia and Hungary, although Hungary took a courageous approach and made bankruptcies easier with an automatic trigger in the early transition stage. Taking into account country sizes, we observe the same pattern in all these countries. A completely different situation is Poland, where the peak occurred in the first year of available data. Moreover, the total number of bankruptcies is remarkably lower since the Polish economy is larger than the other three economies put together, and larger than all the so-called EU First Wave Candidates.

The Polish economy was the first to recover from the initial drop. After rapid growth in the mid-nineties, the pace of filed

Bakruptcy Composition



Source: Dept. of Justice, MPO

and declared bankruptcies stagnated during the last year, and the actual growth from 1998 to 1999 was 0.8 %. In 1999 there were 4339 filings in total, while from 1997 to 1998 there was approximately 30 % growth. Moreover, the declared number of bankruptcies decreased by 1.1 % to exactly 2000 in total in 1999. In 2000, there was a 7.2 % increase in the number of filings. The success rate was 46.1 % in 1999 compared to 47 % in 1998 and grew to 53.4 % in 2000. A major change can be observed in the rate of rulings made by the courts. While in the mid-nineties the rate was

Declared Bankruptcies

	1992	1993	1994	1995	1996	1997	1998	1999
France	57,795	60,481	56,573	54,800	58,576	47,751	36,800	34,980
Italy	11,703	14,094	16,506	13,347	15,500	13,774	12,000	13,000
Switzerland	9,578	10,513	10,350	9,761	10,192	9,182	8,980	8,474
Sweden	n.a.	18,731	15,666	12,184	12,200	13,493	8,959	7,319
Belgium	5,115	6,154	6,354	7,088	7,539	7,751	6,860	6,550
Holland	n.a.	6,428	6,644	6,199	5,573	5,547	5,300	3,770
Finland	7,348	6,769	5,502	5,234	4,800	2,743	2,650	2,325
Czech Rep.	1	66	294	727	808	1,251	2,022	2,000
Slovakia	0	7	33	70	126	329	755	n.a.
Hungary	n.a.	n.a.	n.a.	1,616	2,000	4,569	7,297	n.a.
Poland	n.a.	n.a.	n.a.	1,008	683	550	818	n.a.

Source: Dept. of Justice, MPO

approximately 50 % and slowly increased to 60 % by 1997 and then to 70 % by 1999, in 2000 it reached 88 %. This is clear evidence that the bankruptcy code was slowing down the decision process and the last amendment made in 2000 achieved its goal, since the economy started to grow and the recession was over. Over the whole period 1993 – 2000 there were 25,286 filed bankruptcy petitions. In the period 1994 – 2000 there were 23,828 petitions filed with an overall success ratio of 40 %, with the courts deciding on 64 % of cases.

As far as the regional distribution is concerned, the majority of bankruptcies were declared in Prague, where a substantial portion of all firms is also registered. This data is based on the registry, not the actual establishment location. The graph depicts the distribution of bankruptcies (filings) across the major legal categories. The major group consists of limited liability companies, which typically represent SMEs. The other category comprises cooperatives of various kinds (the most frequent are agricultural ones) and special types of companies (e.g., societé comandité). Over time there is a clear pattern of a growing share of companies with limited liability and joint stock companies, while the remaining types are becoming less visible.

What Drives Bankruptcies in the Czech Republic

(Based on Lízal L.,: Determinants of Financial Distress: What Drives Bankruptcy in a Transition Economy? The Czech Republic Case, CERGE-EI Discussion Paper No.68, 2001)

Enterprises in financial distress are the most endangered ones. Data from the Czech Republic from the period 1993 – 1999 is used to assess the main factors influencing the probability of bankruptcy. Three competing models of principal cause of the distress are compared:

*1. **Neoclassical model.** In this case bankruptcy is a good thing since it frees badly allocated resources. This is the "restructuring" case when the bankrupt company has the wrong mixture of assets;*

*2. **Financial model.** The bankrupt company has the right mixture of assets but the wrong financial structure; and*

*3. **Corporate governance model.** Here, the bankrupt company has the right mixture of assets and financial structure but is badly managed. In this case bankruptcy is an inefficient way of solving the problem. More efficient is to fire the management. While corporate governance does not receive much support in ownership structure, it is well supported by the indicator of voucher privatization, which can be interpreted in certain setups as a different measure of the corporate governance structure.*

When fully controlling for the composition of debt and liabilities, the firms from voucher privatization are less likely to go bankrupt. This can be interpreted as an indication of a soft budget constraint. There is quite a substantial role of bank debt/assets that increases the probability of bankruptcy. Moreover, the voucher-firms are

on average three times more sensitive to this factor. The profitability measured by profit/assets is never significant for the non-voucher firms. The effect on voucher firms is negative (i.e., lowers the probability of bankruptcy) but not always significantly.

On the other hand, when the specification does not fully control for the composition of the financial state, the voucher privatization firms are more likely to face financial distress leading to bankruptcy. In this setup it should be interpreted as a result of poorer performance due to the initial stage or less capable management (i.e., corporate governance). Since we found no difference between voucher privatization firms and other firms in the mid-nineties, we can rule out the effect of initial conditions. We have found no significant ownership effect (as another measure of corporate governance) while controlling for voucher privatization and basic or full financial state.

There is no evidence that the initial conditions from the first half of the 90s were the driving force of the financial distress in conjunction with the selection of voucher privatization scheme. This leads us to the policy conclusion that the voucher scheme leads to poorer corporate governance (while the ownership structure does not necessarily have this effect) and therefore these firms are more likely to go bankrupt, ceteris paribus. On the other hand, since these former large SOEs selected for the voucher privatization scheme are safer from bankruptcy than other firms with a similar debt structure, there is other limited evidence for soft budget constraints on these firms.

The voucher scheme as conducted in the Czech Republic could not be recommended as a means of privatization since it was identified as a risk factor or a signal of future soft budgeting.

History of Bankruptcy Law

(Based on Lízal L., and Jánošík D.,: Notes on History and Development of Bankruptcy Procedures in the Czech Republic, CERGE-EI Discussion Paper No.67, 2001)

Comparative history

Czech, Austrian and Hungarian bankruptcy laws have the same roots. The codification of bankruptcy law as separate and serried laws started in the 1730s and peaked with the addition of a general bankruptcy code by Joseph II in 1781. If the creditor was the initiator of the process, the formal means of starting the procedure was to file a petition (note: at that time it had the form of a prosecution) and all claims were filed as actions. The procedure was lengthy and costly. Because of its costs and length the bankruptcy procedure was replaced with a new bankruptcy law in the 19th century. The new bankruptcy act No. 1/1869 was accepted after several

unsuccessful attempts, and bankruptcy was adjudicated in a more modern code. Emperor's decree No. 337/1914 introduced, among other things, separate settlement rules for out-of-bankruptcy (voluntary) settlements and new punitive provisions with respect to bankruptcy procedure. This bankruptcy law was introduced into Czechoslovak law by act No. 11/1918 together with Hungarian bankruptcy law XVII/1881 and with both Austrian and Hungarian settlement rules.

Bankruptcy and Composition Act (BCA, "Zákon o konkursu a vyrovnání") No. 328/1991 Sb., in effect from Oct. 1, 1991, stemmed from Act 64/1931 Sb. as well as from the legal norms of other countries. Austrian, German, Italian and French influences are notable, but we can also find British and American elements. The new law was intended to facilitate the transition of the Czechoslovak economy. Unlike the pre-war legislation, this Act did not cover appeal rights separately, nor did it introduce a so-called bankruptcy commissioner (trustee). The whole bankruptcy procedure was in the hands of the court.

The first amendment was in favor of the bankrupt company but this change seems to have been motivated by the split of Czechoslovakia, so the firms were left in an uncertain stage. Their legal status was not in line with the fact that certain firms were split similarly under the former federation into two independent firms, while others continued operation in both countries as separate divisions of a firm that were located in either state.

The second major amendment also favored the bankrupt company and introduced a protection period (Act 122/1993) in which the debtor had a chance to consolidate itself. Because of the voucher privatization scheme, firms with more than 50 % of shares dedicated to the scheme did receive a reprieve until the shares were transferred to the new owners. The amendment also introduced a creditors' committee, which led to better procedural arrangements and allowed better coordination among creditors. The management of the bankrupt was restricted and could not buy assets of the bankrupt even at auction (to prevent speculative bankruptcies).

The third major amendment (Act 94/1996) prohibited transfers of assets, voided such acts and allowed them to be appealed, did not allow bankruptcy to cause a cease in production or ordinary activities, set time limits and reasonable means of delivery, and required the debtor to ask for bankruptcy. The amendment aimed at speeding up the bankruptcy process, to make it more transparent and to protect creditors from debtors' asset stripping. Under amendment (12/1998) it was the obligation of the debtor and management of the debtor to file a petition for bankruptcy. The amendment modifies the possibility of selling assets of the bankrupt company, so auction is not always required. It allows the hiring of third persons to levy receivables of the bankrupt company and it obliges the trustee to present a final report within 18 months of the declaration of bankruptcy.

Major amendment 105/2000 Sb. made the BCA unusable. It eliminated procedural parts of the act and completely blocked BCA usage. A new amendment 214/2000 resulted in a usable law and yet another correction was made (370/2000). These amendments transfer a part of the competence from the court to the trustee, and introduce a public interest, a preliminary trustee, and punitive clauses. They permit the use of third-party assets, make the distribution among creditors fairer, simplify the formal necessities, and restrict the debtor in his actions affecting the assets. The rights of the trustee are widened and the creditors' committee role is strengthened.

The decree's major amendment was 277/1996, which increased the trustees' reward as well as did amendment 229/2000.

Note that the State is always better than the secured creditor (so the change is relative to this category) and could be better than the owner as well. If the owners are also managers, they should be treated as managers.

Overall, as the table shows, Czech development is in favor of ordinary creditors and procedural improvement.

Institutional Effects of Bankrupcy Act Amendments

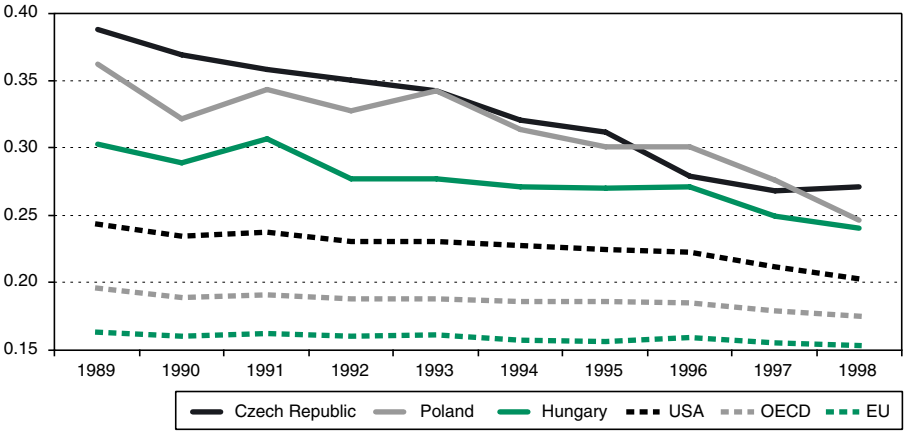
A/D Year	A92	A93	A96	D96	A98	A00/1	A00/2	D00
Bankrupt (Management)		B	A		PA	b	P	
Creditors (Secured)			B				B	
Creditors (Ordinary)			b				BB	
State	b	B	b			b		
Trustees				B	h		b	b
Court/Procedural/Legal	b	b	B	b		H	B	
Bankrupt (Owners)		B				b		

Notes:
Axx = Act amendment in year xx, Dxx = Decree amendment in year xx
B = high benefit, b = low benefit,
P = punitive actions, A = worsening of ability to strip asset,
H = major harmful change, h = minor harmful change

Source: Author

IV.3 Energy Intensity

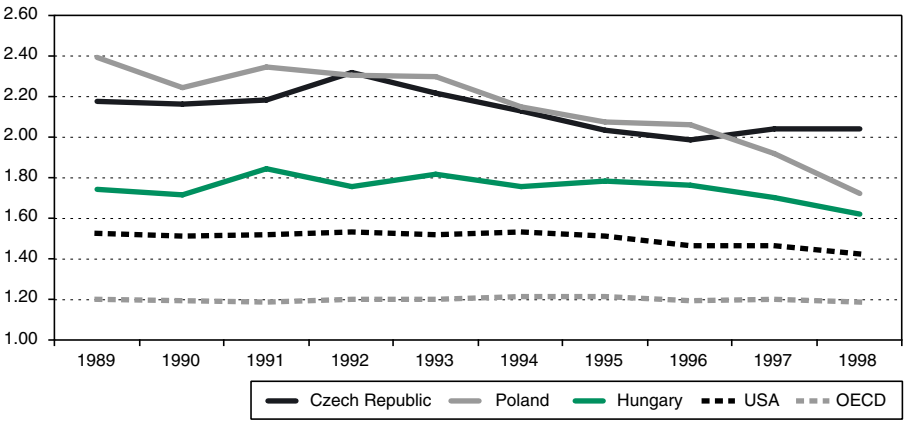
Total Final Energy Consumption per GDP



Source: International Energy Agency, Energy Balances of OECD Countries (Paris: OECD)

How efficiently economies manage energy resources can be expressed on an aggregate level by the total final energy consumption or supply of primary energy resources per unit of GDP – energy intensity. In the first graph energy intensity is measured as the total final consumption in toe per USD 1,000 of GDP at 1990 prices and using exchange rates expressed in purchasing power parity (1 toe = 41,868 MJ). From the table and the graph we see that the Czech Republic managed to decrease

Total Primary Energy Supply per GDP (Relative Lag to the EU Values, EU = 1.00)



Source: International Energy Agency, Energy Balances of OECD Countries (Paris: OECD)

energy consumption rapidly over the 1990s, but still the Czech economy consumed 1.8 times more energy to produce USD 1 of GDP than the EU countries in 1998.

Next, we compare the total primary energy supply in toe per USD 1,000 of GDP at 1990 prices and exchange rates expressed again in PPP. In the second graph we plot the lag of the Czech Republic and some other CEE countries behind the EU. Relative lag is computed as the ratio of total primary energy supply for a given country and the same value for the EU. The development of the time series reflects the combined effects of structural changes in industry, efficiency improvements, imports/exports of primary energy resources, and fuel substitution.

From the graph we see that the Czech economy uses two times more primary energy resources to produce USD 1 of GDP than

Energy Intensity of GDP

	Czech Republic			Hungary			Poland		
	TFEC	TPES	LAG	TFEC	TPES	LAG	TFEC	TPES	LAG
1989	0.39	0.51	2.18	0.30	0.41	1.75	0.36	0.56	2.39
1990	0.37	0.50	2.16	0.29	0.39	1.72	0.32	0.52	2.25
1991	0.36	0.51	2.18	0.31	0.43	1.85	0.34	0.55	2.35
1992	0.35	0.53	2.32	0.28	0.40	1.76	0.33	0.53	2.31
1993	0.34	0.51	2.22	0.28	0.42	1.82	0.34	0.53	2.30
1994	0.32	0.47	2.13	0.27	0.39	1.76	0.31	0.48	2.15
1995	0.31	0.45	2.04	0.27	0.40	1.79	0.30	0.46	2.08
1996	0.28	0.45	1.99	0.27	0.40	1.76	0.30	0.47	2.07
1997	0.27	0.45	2.04	0.25	0.37	1.70	0.28	0.42	1.92
1998	0.27	0.44	2.05	0.24	0.35	1.63	0.25	0.37	1.72

	EU			OECD			USA		
	TFEC	TPES	LAG	TFEC	TPES	LAG	TFEC	TPES	LAG
1989	0.16	0.23	1.00	0.20	0.28	1.21	0.24	0.36	1.53
1990	0.16	0.23	1.00	0.19	0.27	1.20	0.24	0.35	1.51
1991	0.16	0.23	1.00	0.19	0.28	1.19	0.24	0.35	1.52
1992	0.16	0.23	1.00	0.19	0.27	1.20	0.23	0.35	1.54
1993	0.16	0.23	1.00	0.19	0.28	1.20	0.23	0.35	1.52
1994	0.16	0.22	1.00	0.19	0.27	1.22	0.23	0.34	1.54
1995	0.16	0.22	1.00	0.19	0.27	1.22	0.23	0.34	1.52
1996	0.16	0.23	1.00	0.19	0.27	1.19	0.22	0.33	1.47
1997	0.16	0.22	1.00	0.18	0.26	1.20	0.21	0.32	1.47
1998	0.15	0.22	1.00	0.18	0.26	1.19	0.20	0.31	1.43

TFEC (Total Final Energy Consumption) in toe per USD 1,000 of GDP using 1990 prices and purchasing power parity
TPES (Total Primary Energy Supply) in toe per USD 1,000 of GDP using 1990 prices and purchasing power parity
LAG – Ratio of TPES for a given country and the same value for the EU

Source: International Energy Agency, Energy Balances of OECD Countries (Paris: OECD)

the EU. The values for the Czech Republic are quite close to that of Poland, but considerably higher than for Hungary. The relative position of Hungary and developed countries remained the same over the 1990s: Hungary operates on 1.7 times, USA 1.5 times, and the OECD 1.2 times the EU level. During the 1990s Poland managed to decrease the lag from 2.4 to 1.7 whereas the Czech Republic only from 2.2 to 2.0.

What can explain the picture presented here? The big difference between total final consumption and total primary energy supply in the Czech Republic is caused by oil imports and considerable electricity exports. From the data it follows that the Czech economy is still biased towards more energy intensive industries, particularly to those that consume primary energy resources. Currently, big state-owned monopolies operate the whole energy sector and the prices are not fully liberalized, but we expect big changes in the near future. The new modern Energy Act was approved in 2000 and the privatization of state-owned monopolies began and should be finished in 2002.

IV.4 Law and Economics

Reforms in post-socialist countries is quite a different experience from those of all previous reforms in other countries. It is an attempt to invert the communist experiment using democratic means. The transition should lead to the replacement of nearly everything, starting with the allocation of resources and ending with institutions. Only two factors cannot be immediately replaced: people and old capital stock. These areas of reform are difficult to isolate, which makes the task of dealing with them even more complex, yet maybe here is the key to the success of the reforms.

New or reformed institutions primarily affect the microeconomic sphere of the economy, while the effectiveness of the microsphere hinges on the quality of these institutions. On the other hand, macroeconomic results usually drive the preliminary judgement of the success of a reform, although the main reason (correlation between growth and well being) is of a long term, not a short term, nature. And here we probably face some time inconsistency in the evaluation of various effects. The microeconomic effects are of a long-term nature as they include both institution building and behavioral changes. They are also much harder to measure and evaluate since only case evidence exists and no good or widely accepted indicator of the state, like macro inflation, developed. Moreover, it takes a much longer time for the microeconomic foundations to fully reveal themselves in the macro figures. Therefore, problems that occur in the microeconomic foundations are detected only after a long time delay and, presumably, the longer the delay the more those powerful groups with vested interests oppose the correction.

In order to achieve efficiency we need two conditions in addition to the existence of private ownership. The first is competition. The second is the existence of an economic and legal environment that allows safe, fast and costless exchange, an environment where property rights are not affected by negative externalities of the exchange. All these conditions are referred to as the

proper institutional environment. Inadequate institutional infrastructure leads to economic inefficiencies and possible decline as it restricts competition, causes additional costs to emerge (which lead to the waste of resources), and leads to a slowdown in economic progress.

In practice, analyzing how the environment influences economic efficiency is modeled using various types of costs. These costs could be classified into three nonexclusive major categories:

1) **Uncertainty.** This is not a risk but alludes to possible changes in the economy which cannot be insured against. The difference between risk and uncertainty can be illustrated as follows: A change of exchange rate is a risk since we can use options to hedge our position against loss. On the other hand, problems associated with property rights caused by imperfect laws or unexpected changes in the law cause uncertainty. Since we need more managers and lawyers to decrease the uncertainty, we have costlier, more complex and less efficient corporate governance structures.

2) **Institutional costs.** These include rent seeking behavior, lobbying, and existing differences between the formal and informal (black) market.

3) **Transaction costs.** These are necessary direct costs of the exchange, like bank fees or transport costs.

The first two types of costs are possible to model as transaction costs, but if these first two categories become neglected an erroneous impression of their unimportance may arise. The difference between the true transaction costs and institutional costs is that the institutional ones could be fully eliminated by a proper institutional infrastructure.

Business disputes in the Czech Republic are a typical example. If the rule of law is weak and court orders are not enforceable, all firms have to behave such that they should minimize their costs and losses in case the other party violates the contract – especially by the use of the condemned cash method of payment at the time of delivery. The cash payment itself is a transaction cost since it requires additional expenses on the armored escort, personal meeting, and free cash. But the necessity of its usage due to the inadequate function of the legal, state, and financial institutions ranks it among institutional costs.

Ownership and Performance in Voucher-privatized Firms

(Based on Kočenda, E.: Development of Ownership Structure and its Effect on Performance: Czech Firms from Mass Privatization. CERGE-EI Working Paper No. 188., 2001)

This feature article summarizes the findings of the analysis of the development of ownership structure and its effect on performance during 1996-1999 among voucher-privatized firms.

The Czech voucher privatization scheme, as a part of the transition process, can be considered a unique natural experiment rarely seen on such a scale in the real economy. Voucher-privatized firms swiftly became legally private subjects of the emerging market economy. The critical assumption behind privatization in many parts of the world is that private ownership together with concentration improves corporate performance.

The years 1991-1995 were marked by an ongoing process of voucher privatization. The resulting ownership structure after both waves was more or less an outcome of the logistics of the voucher scheme's administration. In 1995 changes in ownership also reflected legal requirements to prevent excessive stakes being held by privatization funds. More economically meaningful patterns of ownership structure began to emerge in Czech companies in 1996.

The changes in ownership structure from 1996 to 1999 in voucher-privatized firms was analyzed with respect to different concentration levels. The single largest owner was found to be a decisive shareholder. The changes in ownership structure were then analyzed based on six types of owners: industrial company, bank, investment fund, individual owner, portfolio company, and the state. In general the highest average concentration increase between 1996 and 1999 was recorded in the case of investment funds (from 27.9 to 45.9, a 64 % increase) and portfolio companies (from 38.8 to 55.2, a 42 % increase) as the single largest owners. A decrease in mean holding can be observed in the case of banks (from 38.5 to 34.8, a 10 % decrease).

Between 1996 and 1999, industrial companies were found to be the most stable type of single largest owner, followed by individual owners. The most unstable type of owner was the portfolio company. In 1999 only 5 % of firms had a single largest owner like in 1996. Industrial companies recorded by far the largest ownership gains over time.

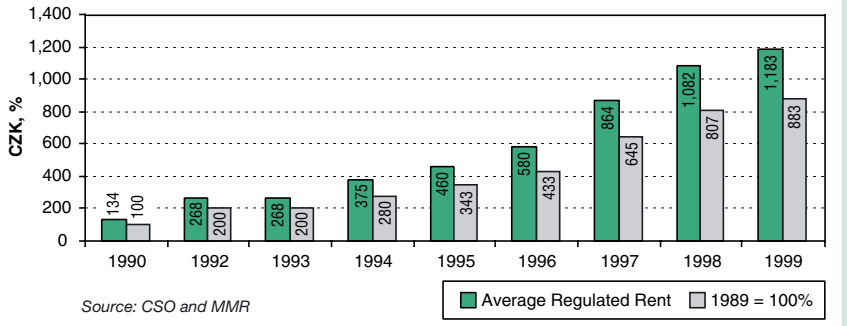
For an econometric analysis a broad set of financial variables was selected in order to capture the different aspects of firms' performance: the profitability of a company, the strength and size of a firm, its financial position, and its scope of business activity. Moreover, in order to seize the effect of owner type on a firm's performance, models incorporated two types of dummy variables for five different categories of owners, and a share of ownership per each category in total ownership of a given firm. Based on pre-testing procedures a random effect model was adopted.

Based on the results we conclude that ownership concentration does not explain a change in a firm's performance. Further, no industry sector was found to have a specific effect with respect to a firm's performance. Using a random effect model there exists evidence about the effect of a certain type of owner or its cumulative share on specific performance measures. Investment funds, either as single holders or cumulatively as an owner's category, tend to negatively affect the growth of both total and fixed assets. Individual owners as the single largest holders tend to negatively affect the growth of total assets, while individual owners and industrial companies as cumulative shareholders have a negative impact on the growth of fixed assets. The presence of the state positively affects the cash flow/equity ratio, while the portfolio company as a cumulative shareholder has a negative impact. Industrial companies, either as single holders or cumulatively as an owner's category, tend to decrease the growth of long-term bank loans. The same is true for investment funds as single largest owners and banks as cumulative owners. However, support does not exist that the type of owner has an effect on a firm's performance in general.

Rent Control and Housing

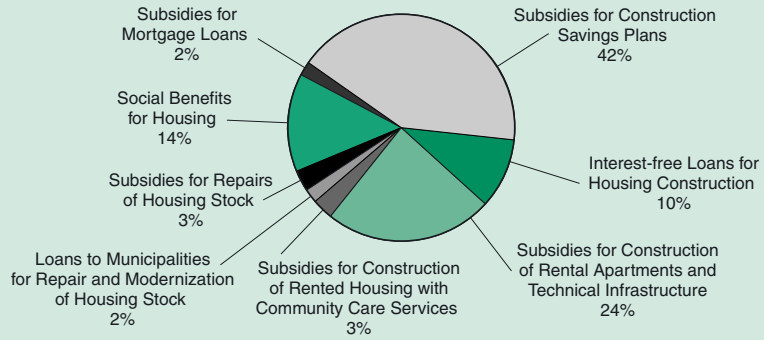
Since the liberalization of prices in the early nineties, rental housing has been one of the few sectors (like utilities) where direct price control was not abolished. But unlike the case of utilities, rent deregulation was perceived as political hara-kiri. Unfortunately, politicians did not take timely advantage of widespread public support for economic changes to advocate a move from regulated to market prices. The major problem with the adopted scheme of rent deregulation was the idea of uniform percentage increases, since the original rents were set arbitrarily over several decades and reflected nothing but the time they were set. The average rent in 1990 was just

Regulated Rents



Source: CSO and MMR

Form of Housing Support, 1999, 14.7 bln. CZK



Source: CSO and MMR

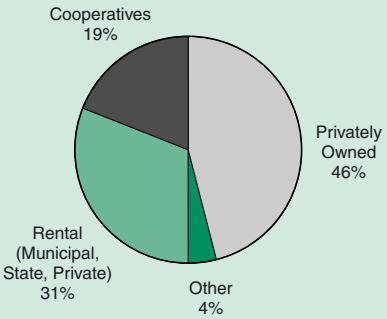
slightly above 134 CZK (USD 5). It is no wonder that there existed (and still exists) enormous excess demand. Although the rents have risen nearly tenfold since 1989, the average household spends only about 16 % of its income on housing, including all utilities.

Regulated and unregulated (a significant portion also belongs to the shadow economy) rental housing causes hoarding, but also causes paradoxical situations. In the 2001 census 12.4 % of the total housing units were reported as vacant. Many units are used for recreational purposes, although this is truer for the rural areas. Yet even in Prague the census discovered that 9.4 % of housing units are empty.

The government focuses on the increase of housing supply in general. It wants to double the existing annual flow of resources to housing to 1.5 % of GDP, although no one really knows what the target situation is on the housing market, nor what kind of aid is sufficient. The heavily subsidized construction savings plans, for example, are used as ordinary long-term savings contracts with higher returns, since there is no requirement to ensure that the resources are allocated to housing construction.

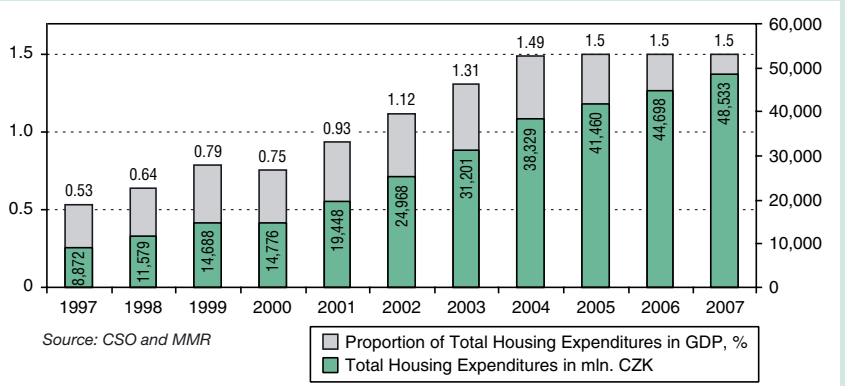
Last year the constitutional court declared that the existing rent control is a violation of proprietors' rights and ordered rent regulation to be void as of January 1st, 2002. The court also claimed regulation immoral since it transfers state responsibility in the

Housing Units



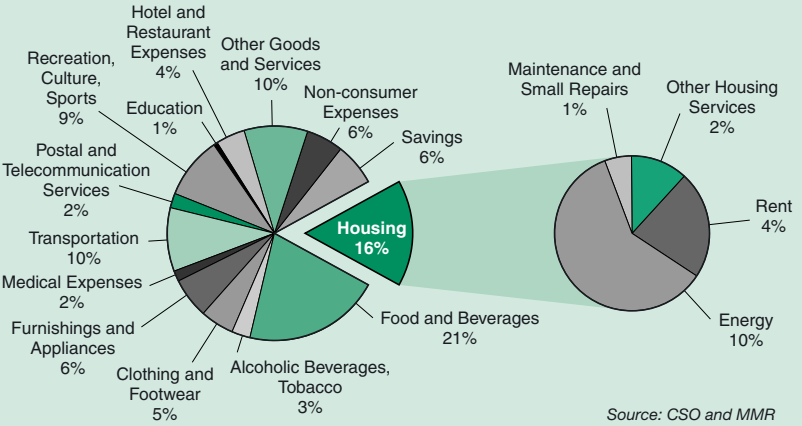
Source: CSO and MMR

State Housing Aid Programme



social arena to private entities without compensating them for their services. Although the court has allowed the unconstitutional laws to remain in effect for more than one year in order to allow the government and political parties to prepare a new social aid scheme, nothing has happened. The government wants to utilize a law on prices in monopoly segments to continue the practice of housing price regulation by means of governmental decrees. The current law governing rent procedures is from the communist past and helps neither tenants nor landlords to solve any disputes on contract matters.

Estimate of Expenditures in an Average Household



IV.5 Health Economics

The health sector in the Czech Republic has undergone major changes in the last decade. The General Health Insurance Act (Act 550) of 1991 shifted financing from the government budget to the population in the form of a payroll tax of 13.5 %. Employers pay 4.5 % of gross wages, and employees 9 %. The government contributes only for the unemployed, the elderly, and children under 18. The money is transferred to health insurance companies which are not allowed to make any profit. Any surplus they make goes to a special account called the Reserve Fund. The government contributions are paid to the government-owned General Health Insurance Fund.

The rules of the functioning of the insurance market were specified in Act 280/1992. The idea behind this arrangement was to make health insurance coverage compulsory and promote competition among health insurance funds. By 1993 there were 27 competing non-profit insurance companies. After several bankruptcies of the funds, competition was partially reduced in the amendment of 1997 (Act 48). Now there are 10 insurance companies.

Some medical service providers have also been privatized. Most of the general practitioners, specialists, and dentists are now private. About 95 % of pharmacies have been privatized. The situation in the hospital sector has not changed that much. Around 75 % of hospitals are still public. The percentage of public beds is even higher. However, most of the doctors in the hospitals are employed on a contractual basis, which enables better control of the quality of medical service.

The Ministry of Health also manages specialized institutions for research and postgraduate education. It partially covers the costs of training medical personnel and specialized health programs such as AIDS prevention, drug control, etc.

Medical service providers contract with insurance companies. Doctors and hospitals are paid on a point basis depending on the amount and the level of difficulty of the services they provide. The value of a point is partially set by the insurance company, so those which are more efficient are able to offer higher payments per point, and attract more health care providers. There is a maximum amount of total point payments, so if overall activity levels increase, the value of a point decreases. Insurance companies are obliged to cover the costs of a predetermined set of medical services. They may also decide about additional services to be covered. This way they can compete to attract more consumers.

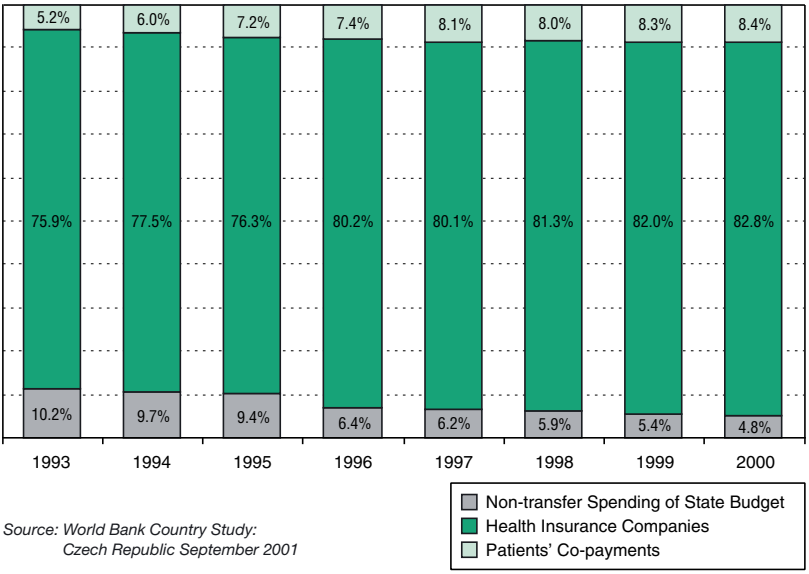
These changes in the health care system, together with improvements in the economy as a whole, resulted in an improvement in health indicators. Since 1990 life expectancy rose from 71.6 years in 1990 to 74.8 years in 1999. Infant mortality dropped from 10.8 per 1000 live births in 1990 to 4.6 per 1000 live births in 2000.

Administering Costs of the System

Health care expenditures as a percentage of GDP remained relatively stable during the last decade. Gradually, the budget's role in financing health care provision is being reduced, while health insurance companies and patients themselves pay a bigger percentage of the health care bill. Such a combination usually leads to a more effective use of health care and a possible reduction in health care spending. However, the effectiveness of the health care system in the Czech Republic still remains low, and the spending is high compared to countries with relatively similar income levels.

One of the main problems of financing the health care system is the overuse of health care by the population. Since the amount the patient pays in most cases does not depend on the amount and complexity of the service, there is no tendency to limit the use of the services. The actual co-payments of the patients, even though increased during the last decade, still constitute less than 10 % of the total expenditure. Moreover, these co-payments are mainly limited to pharmaceuticals and dental services. Similarly, health care providers have little incentive to reduce the costs of health care.

Composition of Health Care Financing, 1993–2000
(% of Total Health Care Spending)



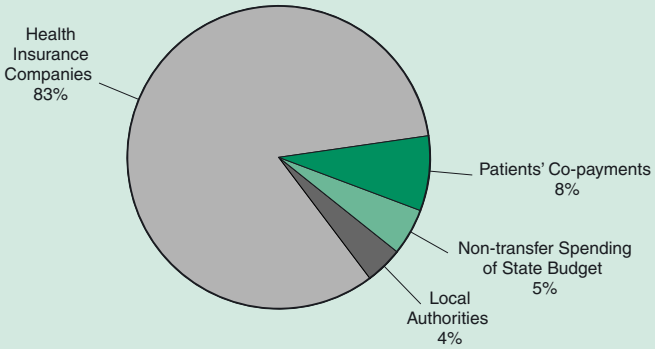
Source: World Bank Country Study: Czech Republic September 2001

Being paid according to the point system, they have an incentive to exaggerate the complexity of the care.

In order to reduce inefficient incentives, a more effective cost-sharing system should be introduced. Direct payments of a proportion of the actual costs of the services would reduce the moral hazards (and eventually the costs) for both care providers and care receivers. However, the introduction of a direct co-payment mechanism is likely to meet serious political difficulties. The low-paid or unemployed part of the population would not be willing to increase their expenditures for health care. Thus, the government would have to design a system of refunds and co-payment waivers for poorer people and change the tax system for the employed in order to maintain overall expenditures on a similar level. This is not an easy task.

The other way to increase the effectiveness of health care spending lies in the increased role insurance companies can play in diminishing costs. Until now insurance firms have little interaction with health care providers or their customers besides financial operations. Closer co-operation, which would lead to the management of health care arrangements, can increase the effectiveness of the health care system. One example of such an arrangement may be the increasing role of general practitioners as a screening device before the patient is referred to a more specialized and more expensive doctor.

Composition of Health Expenditures, 1999



Source: World Bank Country Study: Czech Republic September 2001

IV.6 Bank Privatization Issues: Czech Banks Are Private

With the sale of a 60 % stake of Komerční banka to Société Générale (France) in July 2001, the privatization of the banking sector in the Czech Republic has been completed. As a result, about 95 % of total banking assets are controlled by foreign owners, significantly more that in any other neighboring transition economy.

Back in 1989, there were five major banks controlled by the state – Komerční banka, Česká spořitelna, Investiční a poštovní banka, Živnostenská banka, and ČSOB. All five have been part of the voucher privatization program. The state, however, retained a significant controlling stake in all of them. The first bank to be privatized was Živnostenská banka in 1993, when 40 % of its assets were sold to Germany BHP-bank, 12 % to IFC, and the remaining 48 % were owned by investment funds and private individuals. The current majority owner of ŽB, Bankgesellschaft Berlin (85.16 %) is experiencing financial problems and the sale of its controlling stake to a new owner might be possible.

The second large privatization episode happened in 1998 with Japanese Nomura acquiring 36 % of IPB. In the summer of 2000, the bank experienced a significant liquidity crisis and after a short period of forced administration the assets and liabilities were transferred to ČSOB. IPB is currently undergoing an independent audit that will determine the value of its assets and as a result the settlement price to be paid by ČSOB.

ČSOB itself was privatized in early 1999, when the government sold its 65 % stake to Belgian KBC bank and IFC acquired 4.3 %. KBC has consequently increased its stake to over 74 %. Despite the significant problems related to the restructuring of IPB's bad assets, ČSOB is currently the largest bank in the country in terms of the volume of consumer deposits.

In early 2000, the government selected Austrian Erste bank to be the new owner of Česká spořitelna. The majority stake, 52 % of the shares of the bank, were transferred to EB in exchange for cash payment and a complicated set of additional obligations from capital increase to support for small business and housing programs. It is estimated that the state spent about 33 bln. CZK on ČS rescue programs before its privatization.

The last bank to be privatized was Komerční banka. The agreement with French Société Générale for the sale of a 60 % stake was reached in June and the transaction completed in October 2001. In preparation for the sale, the government has assumed billions of CZK of Komerční banka bad loans.

ČS	%
Erste Bank (Austria)	52.10
Česká pojišťovna	8.10
Municipalities	7.40
EBRD	5.90
Other	26.50

ČSOB	%
KBC (Belgium)	71.24
EBRD	7.47
KB AB CERA	5.55
KBC Verzekeringen	5.55
IFC	4.39
Other Czech Shareholders	4.45
Other Slovak Shareholders	1.35

KB	%
Société Générale (France)	60.00
Bank of New York	6.68
Others	33.32

Source: Public Sources

Costs of Privatization

Banks and bank financing played a crucial role in the funding of enterprise sector formation at the beginning of the transition process in the countries of Central and Eastern Europe. Transition countries had ex-ante basically two choices in the reform of their financial sector. First, they could start privatizing the state owned banks relatively fast and impose hard competitive conditions on them. The advantages of this approach would be that banks would be quickly cut off from the implicit guarantees and soft budget constraints given by state ownership and thus would avoid the abuse of these conditions by the bank management. Stronger competition would be beneficial for customers. On the other hand, it could also cause a great shock cost to the sector because of the immediate imposing of hard budget constraints and also could bring instability to the financial sector. Second, privatization could be postponed in order to cushion the industries and also maintain the state influence on the economy. This gradualist way would assure an easier and smoother transition from a centralized regime to a decentralized one and avoid the large one-shot cost. On the other hand, significant efficiency losses could be expected.

A retrospective view of the development of the Czech banking sector reveals that choosing the latter alternative brought about a significant unexpected cost. The state appeared incapable of monitoring and pursuing the efficiency of the banks under its control. A significant moral hazard problem prevailed in the Czech state banks, which only enhanced soft budgeting (large established firms with large debts easily obtained loans and in the case of default there was a large chance of the loan being refinanced) on the one side and led to insufficient credit supply (small and new firms with smaller projects faced difficulties in negotiating with banks and obtaining financing) on the other. The moral hazard of bank management led to great problems with capital adequacy as a consequence of the subsequently-revealed bad loans. It has been established in the literature that recapitalization without privatization only enhances the moral hazard and the expectation of a soft budget constraint, as further bailouts are expected. The fast privatization after recapitalization was then the only way to avoid further losses.

The Cost and Revenues of Bank Privatization in the Czech Republic (CZK bln.) in the Second Half of the 1990s

Bank	Revenues	Cost
Komerční banka	40	97.7
ČSOB	40	56.5
Česká spořitelna	19	46.7
IPB	3	16.1*
Total	102	217.0

* Not included: an expected loss of CZK 40–100 bln. that the state guaranteed to pay to ČSOB after taking over the IPB business in mid-2000

Source: CERGE-EI Calculations

The Czech government obtained an acceptable price for the banks sold at the expense of large bailouts and portfolio guarantees given to the investors. As can be seen in the table, the explicit costs exceeded the pecuniary revenues by more than two times. However, it must be taken into account that the real cost of this postponed privatization is much higher. The (re-)financing of non-viable projects instead of the financing of the development of small and medium enterprises is the most pronounced cost.

One more issue is connected with the accumulated amount of bad loans and the depth of the Czech banking sector. As a consequence of the existence of bad loans, the share of credit in GDP is over-estimated in conventional statistics-under normal circumstances, prudent banks would have granted a lower amount of credit. This can be observed in the wide differences in the amounts of bad loans among transition countries. Therefore, for a correct comparison of the depth of the banking sectors in the European transitional countries, the stock of domestic credit should be adjusted for the amount of bad loans. As a higher share of bad loans is likely to arise in transition, the share of bad loans in Hungary (the lowest among European transition countries) is taken as a "normal" value. Hypothetical shares of domestic credit in GDP after cutting off the bad loans above the "normal" level are presented in the table below.

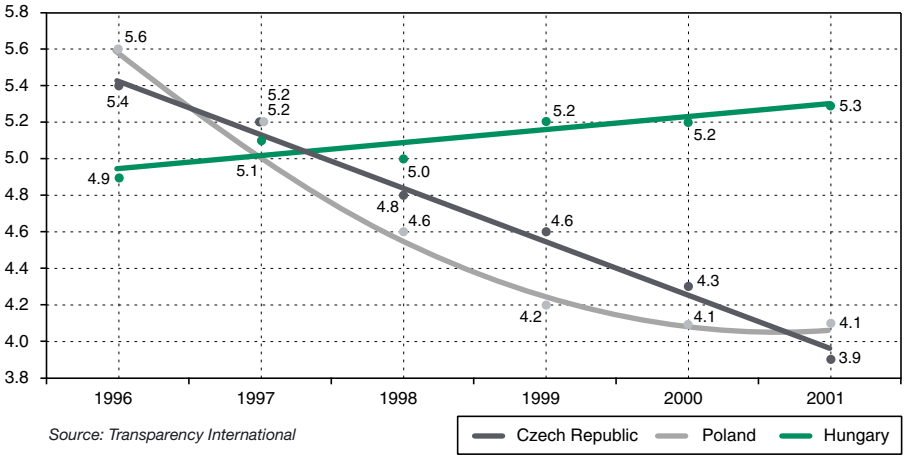
	Domestic Credit/GDP in 2000	Bad Loans in 2000 (%)	Hypothetical Share of Credit
Hungary	54%	7.0	54%
Czech Republic	57%	19.7	50%
Poland	38%	15.3	35%
Slovakia	60%	15.3	55%

Source: CERGE-EI Calculations

Note: The data for the Czech Republic exclude the category of "watched" credits.

IV.7 Business Environment in the CEE

Corruption Perception Index



Source: Transparency International

The country corruption perception index (CPI) measures the degree of corruption perceived by business people, risk analysts and the general public; it ranges between 10 (highly clean) and 0 (highly corrupt). The state of corruption in the Czech Republic, as measured by the CPI, poses a serious problem since no improvement has been observed during the course of transition.

Since the ranking may vary year to year due to different compositions of the sample, the main indicator is the index. The table below juxtaposes the Czech Republic's index to those of Hungary and Poland, neighboring transition countries. For all years the index for the Czech Republic is declining, similar to that of Poland. On the other hand, Hungary's index is increasing. Indeed, the relatively large gap between Hungary's index and those of the other two countries widens over time. Given the same starting position of all the countries in the mid-nineties, such a development should be alarming.

Looking at the Czech Republic alone, the pattern of development of the CPI is even more disturbing. Over the last years the index fell from 5.4 to 3.9. The downward trend is statistically significant and the constantly declining pattern for the Czech Republic is distressing. Although the starting point 5.6 and endpoint 4.1 of Poland gives the same absolute index decline as in the case of the Czech Republic, the Polish trend contains a significant component of the reverse trend. Indeed, during the last three years the corruption perception in Poland has remained at a constant level. While the CPI time series is rather short, it gives a statistically decisive answer to the observed pattern for the Czech Republic, which is the worst of all three countries. As a political conclusion we may state that despite the promised fight against corruption that the current government made during its election campaign, the real effects are not even nil; they have been constantly negative.

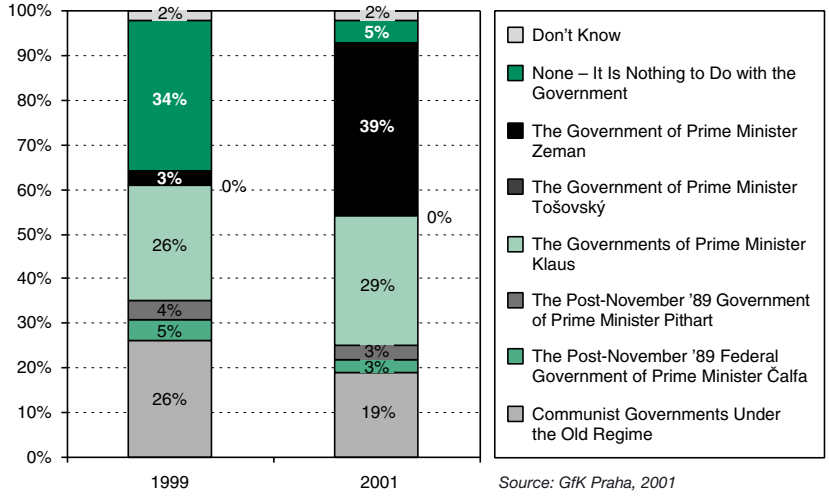
Corruption during Transition

(Based on Lízal L., and Kočenda E.,: The Paradox of Czech Crusaders: Will They Ever Learn the Corruption Lesson? (Corruption and Anticorruption in the Czech Republic), CERGE-EI Working Paper No.171, 2001)

Corruption has a negative impact on society and the economy. The transition process in Central and Eastern Europe (CEE) uncovered dormant possibilities for corruption and the necessity for appropriate steps to be taken. The state of corruption in the country as measured by the Corruption Perception Index (CPI) presents a serious problem since the index deteriorates as the transition process advances.

As the CPI is based on surveys and opinions, it is of general interest to see how opinions are changing. First of all, the most important issue is what people believe. In a recent opinion poll by GfK, 52 % of citizens responded that they live in a corrupt state. So, a simple majority of inhabitants do not have basic trust in society. But who are to blame except the people themselves if 55 % of the respondents also state that they would not be willing to support the fight against corruption in the Czech Republic, for example, by taking part in public demonstrations? On the other hand, 48 % state that corruption could be eliminated; that is, they do not believe the fight against corruption is useless.

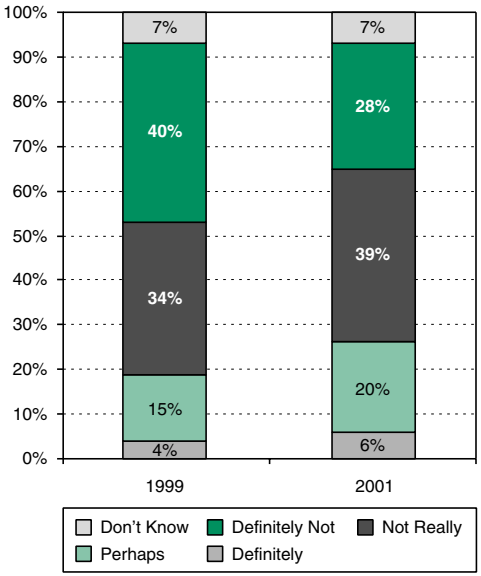
Which Government or Governments Do You Think Have Played the Greatest Role in Spreading Corruption and Bribery in the Czech Republic?



Source: GfK Praha, 2001

One source upon which people form their beliefs is the role of government. Originally, 34 % believed that the government has nothing to do with corruption. This figure has recently dropped to 5 %. In this light we should also interpret the changes in the assessments of past governments. Paradoxically, the government believed to be the least corrupt seems to be the clerical government of former CNB governor Mr. Tošovský. The government perceived to be most contributing to corruption is the current one. Two years ago only 3 % of respondents believed the government was corrupt. After two years, on the eve of new elections, the situation is just the opposite. The current figure is 39 %, the highest in both polls and for all governments. Most of the respondents, 58 %, also suspect that the current government of Prime Minister Zeman has no interest in fighting corruption.

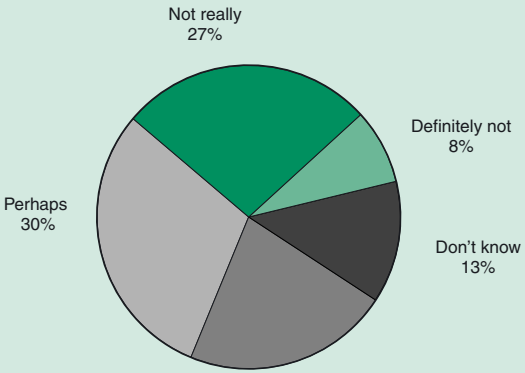
To What Extent Do You Agree With the Opinion That Giving Bribes Is Not as Immoral as It Is Sometimes Made Out to Be?



Source: GfK Praha, 2001

The state of corruption in the Czech Republic has evolved rapidly and measures to fight it should be introduced. Sectors of society and economy differ according to their susceptibility to a corruption hazard. The more complex the system is, the more likely different loopholes, backdoors and contradictions are. Once the state becomes unable to enforce every part of the law for whatever reason, its reputation suffers. As in an unending spiral, to improve its reputation it has the tendency to use more and more complex regulations – which again it is not able to fully enforce. In this environment of rapid and unsystematic solutions, the quality of the legal framework deteriorates and, in addition, the lobby groups are better able to pursue special provisions (of whatever quality and reason) in the existing legal order. Rent-seeking behavior becomes encouraged just to meet the "exception" rule. Proper means of lobbying are replaced by its shadow counterparts, if not corruption.

Do You Agree That the Czech Republic Is a Corrupt State?



Source: GfK Praha, 2001

The best prevention of corruption is not only to make all procedures completely transparent, simple and lucid, but also, more importantly, to establish such an environment that minimizes the incentives to go around the rules, even in the absence of punishment. The changes in the procedure for issuing passports is an example: In the early nineties it was impossible to obtain a passport within several days, even in the case of an emergency, and informal and illegal ways to speed up the process had to be used. Currently, people who need a passport to be issued earlier than within the regular period have a legal option of paying additional fees for express service. There are no incentives to go around the rules. In addition, the state is able to collect additional fees.

A substantial change in the approach to the institutional framework is necessary in order to prevent and fight corruption successfully on all levels.