



Zdeněk Tůma

CZECH REPUBLIC

Zdeněk Tůma graduated from the University of Economics, Prague and finished his postgraduate studies at the Czechoslovak Academy of Sciences. In the early 1990s, he participated in the reintroduction of economics education at the Charles University where he was an associate professor. He continues lecturing at Charles University until today; in his academic career, he focuses on central banking and financial regulation. He worked as the chief economist in Patria Finance and was a member of the Executive Board of the European Bank for Reconstruction and Development. In 1999, Zdenek was appointed the vice-governor of the Czech National Bank, after which he was the governor from 2000 to 2010. He has been a partner in KPMG Czech Republic since then, focusing on consulting in the financial sector. He is a member on several university scientific and statutory boards and was president of the Czech Economic Society.



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It is now almost 30 years since the fall of the Communist regime. Slightly more than a blink of an eye in our lives from one perspective, almost an eternity from another. For instance, it is impossible to explain to our children how the system worked before the year 1990 with its centrally planned economy, distorted prices, closed borders, fake elections, and controlled access to education. I visited the western part of Europe, namely the Netherlands, for the first time when I was almost thirty years old. Needless to say, it was quite a complicated process to get there: visa, hard currency, various permissions.

My children had visited most European countries by the time they were twelve. They can choose their university freely – at home as well as abroad – and the choice is conditioned primarily by their interest, talent and willingness to work/study. We have a fully fledged democracy despite the fact that we are not always happy with the outcome of elections, or some of our political representatives. We have a market economy and we returned to our traditional markets where we were present before the second world war. We should keep this enormous change in mind.

My feeling is that we often forget this fantastic change and our perception is influenced too much by daily issues and problems around us. Perhaps our expectations were higher in 1990 but –



with the advantage of hindsight – it is obvious that we were naïve at that time. We started from scratch in many areas and the achievements were a huge success in the given time span. There were a number of important milestones on the road from communism to democracy, from the centrally planned economy to the market one. Let me mention some of them that I consider the most important ones. I distinguish two groups, institutional and economic changeovers.

Institutional metamorphosis

1. Political control was supported by the police and military forces. It was also represented by the Russian army that somehow “forgot” to leave the country after “friendly help” in 1968. The peaceful withdrawal of Russian troops from the former Czechoslovakia was a safeguard that changes would not be undone.

2. People could participate in free elections after decades and they did it with enthusiasm and because they wanted to. Unfortunately, the initial high spirits have receded but this does not differ from more developed countries. We may individually sometimes dislike the choices of other voters but the will of the electorate and the system of democracy are two different things. In other words, there is the standard set up of democratic

institutions.

3. We became members of the OECD in 1995 and of NATO in 1999. I perceived our membership in OECD as a confirmation of our return to the club of democratic and developed countries where we traditionally and mentally belong. NATO membership was a crucial step from the point of view of our security. Today, nobody questions that decision, but I can imagine it was not an easy judgement for western countries at that time. For us, it was the final evidence that we were out of the Russian sphere of influence.

4. We became members of the European Union in 2004 and of the Schengen area in 2007. I see these memberships as confirmation that we are perceived as a part of the European family of democratic countries and as trusted partners. This was the final institutional milestone on the long way to democracy and a market economy.

Economic restart

It is difficult to explain to contemporary students of economics how the centrally planned economy worked. There was no market with prices reflecting demand and supply, the allocation was managed centrally, including the determination of prices.



There was no banking system as we know it today; we had the so called “monobank” – financial flows just reflected the decisions of the planned allocation of resources.

There were attempts to develop specific economic theories to describe this system. Probably the best known was the description of the system by Janos Kornai, the Hungarian economist, who labeled his book “Economics of Shortage”. He introduced a number of new concepts, such as the “soft budget constraint”. He explained in his works that problems of centrally planned economies are of a systemic nature and that the system was inefficient in its basic design. The system began changing quickly after 1990.

1. One of the first measures introduced by Czech policymakers was the liberalisation of prices. The price level jumped by tens of percentage points but stabilized later on. A certain part of the consumer basket continued to be controlled at the beginning, primarily energy prices, rent and some others. Gradually, these prices were deregulated, too. This step was the precondition for matching demand and supply.

2. One of the preconditions for our membership in the OECD was liberalisation of the capital account. It was another risky step as it was difficult to predict how the Czech koruna would

respond and whether people would prefer foreign currency or remain loyal to the local one. There was even a more dangerous phenomenon, which became known as the “Tosovsky dilemma” (referring to the former Governor of the Czech National Bank). Real convergence led to real appreciation of domestic currency and attracted massive foreign capital inflow. Consequently, appreciation of the Czech koruna required low interest rates, but such level of interest would not have been appropriate with respect to the desired level of savings/investment. These processes resulted in imbalances of the external current account.

3. The aforementioned development in terms of pressure on the domestic currency and related external imbalances brought about a change in the monetary policy regime. The central bank abandoned the “fixed exchange rate” and introduced “inflation targeting” at the end of 1998. It was quite revolutionary at that time as inflation targeting was used primarily in developed countries and experts believed that this was an appropriate framework for maintaining low and stable inflation. The Czech Republic was among the first emerging market economies (with Chile and Israel) that applied this regime of monetary policy also for the disinflation process. And it has succeeded: within a couple of years it had become a member of the family of low inflation countries.



4. Building the banking system was a painful process. The country did not have relevant legislation for the banking sector, there were no private banking institutions, banking supervision did not exist and had to start from scratch. At the beginning of the 1990s, a number of new licences were granted. Many of these new banks got into trouble later on and the central bank began the process of cleaning up the banking sector. Consequently, we saw takeovers of failing banks, and also financial assistance from the central bank as well as the government. At the end of that decade, the government decided to privatize the biggest banks.

The banking sector was restructured and this was considered as one of the critical reasons why Czech banks went smoothly through the global financial crisis a couple of years later. I consider the privatization of the Czech banking sector and its restructuring as the essential ingredient in the excellent performance of the Czech economy in the period 2001-2008. The market economy needs rational allocation of resources which is unimaginable without the sound functioning of financial markets and the banking sector.

5. The Czech Republic became not only a member of the European Union, but it automatically gained membership in the European System of Central Banks, ESCB. It also changed the way the

ESCB/ECB worked. The number of members almost doubled in 2004. Moreover, the majority were non-euro members then, an obvious reversal of the situation before EU/ESCB enlargement. One can imagine that the agenda of the General Council (the meeting of ESCB governors) changed significantly. The Czech National Bank has been much more interconnected in terms of cooperation and exchange of information with its European counterparts since then.

Challenges ahead

The Czech Republic is institutionally, economically and politically a completely different country today as compared to 1990 and the achievements have been tremendous. Our membership in the EU has played a vital role in this process. It contributed both to institutional and economic changes in the Czech Republic as well as in other CEE countries.

Nevertheless, many challenges lie ahead. To mention just one, I would point to the issue of the future economic growth potential. People believed in a quick economic convergence with more developed countries, especially within the EU area. This has materialized to a certain degree but the catching up has been slowing down. The buffer in labour productivity was largely exploited and we need to switch to a type of economic



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growth that would be based more on innovations. But it is much easier to speak about “research and development” rather than to implement appropriate policies.

The EU played a crucial role in the institutional and economic metamorphosis of its new members but there are new challenges ahead. The process of convergence has slowed down or even stopped and gaps in the standard of living and quality of life have remained substantial, leading to serious tensions across Europe. Regardless of future development within the EU, there is no doubt that the enlargement contributed to setting up fully fledged democracies and market economies.

