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How the Czech Republic became a colony

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List of abbreviations

ANO	Action of Unsatisfied Citizens (political movement founded by Andrej Babiš)
ASO	Association of Individual Independent Unions
ČMKOS	Czech-Moravian Confederation of Trade Unions (Českomoravská konfederace odborových svazů)
ČNB	Czech National Bank (Česká národní banka)
ČSSD	Czech Social Democratic Party (Česká strana sociálně-demokratická)
ČSÚ	Czech Statistical Office (Český statistický úřad)
EBRD	European Bank for Recovery and Development
EEC	European Economic Community
EET	Electronic Records of Sales
EFTA	European Free Trade Association
EGAP	Export Guarantee and Insurance Corporation (Exportní garantní a pojišťovací společnost)
ERDI	exchange rate deviation index
FDI	foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNI	gross national income
GVC	global value chains
ILO	International Labour Organisation
IMF	International Monetary Fund
KSČM	Communist Party of Bohemia and Moravia (Komunistická strana Čech a Moravy)
ODS	Civic Democratic Party (Občanská demokratická strana)
OECD	The Organisation for Economic Co-operation and Development
PPP	purchasing power parity
PZO	Enterprises for Foreign Trade (Podniky zahraničního obchodu)
SAP	Structural Adjustment Programmes
SPAS	Alliance of Labour and Solidarity (Spojenectví práce a solidarity)
SPD	Party of Direct Democracy (Strana přímé demokracie)
UNCTAD	United Nations Conference on Trade and Development
V4	Visegrad countries consist of the Czech Republic, the Slovak Republic, Poland and Hungary
WHO	World Health Organization
WTO	World Trade Organization

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Introduction

Jak jsme se stali kolonií ('How we became a colony') was published in 2015 (Švihlíková 2015) and became a bestseller because it grasped a topic that was taboo. It successfully undermined the myth of the 'transformation success', and showed that the position of the Czech Republic in the world economy is unsustainable and disadvantageous for its citizens. Furthermore, it highlights the interests of certain actors behind the transformation policy and the tendency to retain cheap labour policies, which benefited certain groups. I have travelled throughout the whole of the Czech Republic with this book because of the seemingly endless enthusiasm for debates among its readers. The widespread interest in the book reflects the deep dissatisfaction hidden within Czech society. The word 'colony' has since been included in the vocabulary of some politicians, and topics such as the outflow of dividends, the wage gap, and the role of transnational companies are now included in 'mainstream' discussions and are no longer viewed solely as 'communist critique'.

This book is not just a translation of the original version into English. It respects the viewpoint of a foreign reader, for whom the context may be very new, and it includes current developments up until April and May 2022.

In this book, a span of more than thirty years is covered. After a brief introduction of the centrally planned economy, its specifics, and the position of Czechoslovakia in the Eastern Bloc¹, the focus shifts towards the transformation process. The transformation process was strongly influenced by neoliberal ideology and the Washington Consensus². The failures of the transformation process rapidly became obvious, but leaving the 'path of dependency' has proven to be very difficult.

In the following chapters, the development of the Czech economy is described regarding its position and category within the international division of labour, structural changes in the economy, cheap labour, and all the features of a dependent economy. The Czech Republic is suggested to be – politically and economically – a colony, giving this book its name. Within the book, the interconnectedness of individual features is emphasised. These features include the outflow of dividends, the wage ceiling, high engagement of foreign direct investment, transnational corporations, and the influence of foreign

interests. Together they paint a clear picture, and represent a socio-economic model which is long overdue.

Furthermore, the political context of the Czech Republic has been taken into consideration, especially the fall of left-wing parties, which had been losing ground, and dropped out of Parliament after 2021 Parliamentary election. The political situation is presented using the main trends and tendencies so as not to bore the reader with many, to them, unknown politicians.

The book also contains numerous tables and figures which illustrate the development of certain economic indicators over time, for example the development of the minimum wage. They also offer a comparison with other countries, for example in the category of the outflow of dividends.

The socio-economic development of the Czech Republic is set in the framework of the development of the world economy and the main ideologies of the time. Thus, the globalisation era and its background are analysed. Further, the impacts of the Great Recession and the COVID-19 pandemic on the international division of labour are discussed. The Czech Republic has been strongly influenced by external factors and suffers from a long-term inability to present and implement economic strategies acting in its own interest. Such strategies would aim towards gaining a more dignified position in the world economy, wage convergence, and more strategic goals such as self-sufficiency in food production. All such steps would, of course, require not only a grasp of current changes in the world economy, but also the implementation of modern industrial policy.

A brief introduction to the centrally planned economy

Before analysing the case of the centrally planned economy in Czechoslovakia, it may be worth describing what a centrally planned economy is. It is, however, always necessary to perceive the differences among countries regarding structural issues, growth problems, internal imbalances, etc.

The centrally planned economy was developed as a tool to control the capacities of a given economy without using the market, which was seen as a destabilising factor. Thereby, the economic and political spheres become intertwined; the ruling party is closely involved in the management of the economic system using state ownership and evaluates performance according to quantitative indicators.

In a centrally planned economy, it is not only the planning and balancing of supply and demand which are directed from the centre, but also structural changes and innovations. Since the 1970s, centrally planned economies began to significantly lag behind the economies of Western countries. The prices of goods were determined centrally, and while basic goods were subsidised, others, for example the tape recorder, were considered a luxury.

The structure of centrally planned economies enabled many distortions, both macroeconomically and on the level of individual enterprises. State enterprises were permitted to set their own goals, which they often set very low in order to appear to successfully exceed them and obtain bonuses without much work. This decreased efficiency. State-owned enterprises were also able to negotiate with the state, and some were able to obtain more favourable conditions, depending on the extent to which they were controlled by the state. The system of evaluation using quantitative indicators was able to measure development based on quantities in certain economic sectors, such as heavy industry, but remained an obstacle for the modernisation and development of services.

The consequences of these conditions in Czechoslovakia included permanent shortages and long queues; the provision of specific goods, such as meat, only being possible for those with influential contacts; and the establishment of the informal black market.

One of the weakest features of centrally planned economies was integration into the world economy. Reintegration was one of the main features of the transformation process, however there were huge variations in the way it occurred in different countries. Foreign trade was a complication for centrally planned economies as it presented a de facto obstacle to a domestic balance between supply and demand. The Council for Mutual Economic Assistance (created in 1949, abbreviated Comecon) was very important.

Centrally planned economies were built strategically, and thus with emphasis on self-sufficiency. This cannot only be viewed negatively. The production base was very broad, which led to lower specialisation and in some cases lower productivity. On the other hand, this kind of economy was less dependent on its surroundings and on the world economy. Some sectors lagged behind those in Western countries, which was partly because of the 'artificial' exchange rate. The price system of centrally planned economies was decoupled from the real/market price and existed independently. Prices did not fulfil their roles in domestic, foreign, or economic relations. The Comecon was often motivated by the effort to utilise surpluses from domestic markets. This cooperation was based on complementarity, not competition, but foreign trade was not limited only to countries within the Comecon framework; there was commerce with Western countries as well, and also with developing countries.

Structurally, the core of the centrally planned economies was in heavy industry. This inclination towards heavy industry was understandable following the Second World War, but it later became a problem because the structure within a centrally planned economy is difficult to change and modernise. Quantitative economic analysis focused on quantities and was not able to measure quality, be it design or technological advancement.

It may sound paradoxical, but research and development were supported within these centrally planned economies. The problems which arose for various institutions did not lie in insufficient expertise but rather in political blockages, absence of price signals, complicated implementation of innovation, and lack of international contacts.

To give a short summary, these centrally planned economies were able to achieve rapid post-war recovery (mobilisation of resources) through extensive development. However, they were later unable to 'switch' to qualitative growth, which is reflected in higher living standards and a higher quality of consumer goods. These problems started to be visible in the 1970s, when centrally planned economies started to stagnate.

Table 1 summarises these tendencies. The first period (ending in 1973, the first oil shock) shows positive growth rates for both Western European countries and countries with centrally planned economies. The differences in growth ratios are not very significant, thus indicating that resource mobilisation within a centrally planned economy can be efficient in crisis situations. The post-war recovery of these countries is an example of this. The 1970s were a turning point for all the countries in Table 1. The seventies represented a troubled decade for Western countries, which led to the establishment of neoliberal policies and neoliberal globalisation.

In the following decades, an increasing divergence is evident between the Eastern and Western European countries. The fall in Polish economic growth rates was especially dramatic due to the strong influence of the revolution in 1990, which resulted in a negative growth rate.

Table 1 Average growth rates in various socialist countries and in Western Europe, 1950–1990.

	1950– 1973	1973– 1989	1973– 1990
Czechoslovakia	3.09%	1.38%	1.12%
Hungary	3.6%	1.32%	0.85%
Poland	3.45%	0.39%	-0.25%
Soviet Union	3.35%	0.99%	0.75%
Western Europe	4.05%	2.07%	1.99%

Source: Myant, M., 2013b, p. 52

The development of the centrally planned economies in these socialist countries can be divided into three stages. In the first stage, the growth rates were the highest, due to a high rate of investment and extensive growth with an industrialisation focus. The second stage was associated with growth intensification, which led to an increase in labour,

but a low level of innovation. The final stage was dominated by fear of any change, and stagnation. The perestroika³ process, a political movement, attempted to end stagnation in the second half of the 1980s, but failed.

Table 2 offers more information about the living standards of Eastern European countries with centrally planned economies, compared to Western European countries.

Table 2 GDP per capita, in %, compared to Western European countries (= 100%).

	1950	1973	1989
Czechoslovakia	76.5	61.7	55.3
Hungary	54.2	49.0	43.5
Poland	53.4	46.8	35.8
Soviet Union	62.1	53.1	44.8

Source: Myant, M., 2013b, p. 53

Table 2 shows that Czechoslovakia occupied rather a privileged position within the Eastern Bloc, as the most developed country. Thus, Czechoslovakia entered the transformation process in the best position, relative to the other Eastern Bloc countries. The slump in Poland was shocking, and the country was having difficulties with a huge amount of external debt. The dramatic fall in living standards offers at least a partial explanation for the establishment of Poland's Solidarity movement, and the Round Table talks with the opposition.

It would be a misinterpretation to view centrally planned economies only through the disposability of consumer goods. The system focused on low levels of inequality and social security. Healthcare and education were free, and food and housing were subsidised. Families were supported with generous maternity leave and a vast infrastructure of kindergartens and nurseries. The inequality rate was very low in Czechoslovakia. In the final phase of its centrally planned economy, several ways of earning extra, moonlighting jobs, and bribes were very common, which reflected efforts to increase the standard of living.

There were several attempts to reform the economic system. Among the most important were the reform efforts in Prague, in the spring of 1968⁴. One of the proposed steps

involved the reintroduction of market prices, but without private property.

The failed attempt of 1968 might have seemed like a victory for the orthodox Brezhnev regime, but in my opinion, it was just the opposite. The Gorbachev proposals (which were chaotic) came too late, at a time when the economies had neither the necessary base of competent, decision-making personnel, nor the financial resources to implement them.

The specific situation of the Czechoslovakian centrally planned economy can be briefly summarised by a tendency present throughout its history – to be more Catholic than the Pope. This tendency, to be more religiously adherent to laws than the predominant authority, was already evident at the establishment of the centrally planned economy. Czechoslovakia thoroughly and dogmatically implemented both nationalisation and collectivisation. The cooperative sector, which was very strong in the First Czechoslovak Republic (1918–1938), was especially severely hit. The memory of this disaster is still present, and the cooperative sector remains associated with the previous socialist regime, although its roots lie in the Bohemian countries of 1847.

The thorough nationalisation was not motivated by a search for productivity, but, rather, a desire for maximum control. The complete centralisation of economic activity resulted in the overburdening of the decision-making centre. This could explain why there was more and more focus on solving immediate problems and far less on real economic management. This system also contributed to the unwillingness to make decisions at ‘lower levels’, shifting responsibility to ‘the political top’. Centralisation was also very inflexible, causing the Czech Republic to lag behind Western countries. New technologies represented a threat to the established status quo, and potential chaos.

A specific feature was the structure of Czechoslovakian exports. Regarding developing countries (African and Latin American countries) and Comecon countries, Czechoslovakia was in the position of a developed partner, being able to realise deliveries of investment complexes, such as brewery factories, electric plants, etc. The exports of such investment complexes represented the highest value added possible. On the other hand, the Czechoslovakian position with regards to developed countries was very dif-

ferent. In this case, exports were motivated by gaining foreign exchange, and the export structure was more similar to that of a less developed country. However, the specific state enterprises, *podniky zahraničního obchodu* (‘Enterprises for Foreign Trade’ or PZO), were centres comprised of experts and professionals. Their destruction following 1989 was later viewed as a mistake.

Another specific feature of the Czechoslovakian centrally planned economy was high energy intensity and raw material consumption. The focus on heavy industry (coal mining, steel, and iron production) led to an inevitable intensive use of energy, which was supported by the importance given to quantitative indicators. The high proportion of stocks in comparison to the shortage of consumer goods (sometimes basic goods) was another feature of the economy.

However, as has already been mentioned, the centrally planned economy did offer its citizens free education and healthcare, a system of national insurance, state pensions, and a social security net, including pensions for the handicapped. The social infrastructure was vast. There were expansions in the energy and transport infrastructure, and rural areas were electrified and modernised. Agriculture was able to satisfy domestic demand.

The year 1968, and the failed attempt to politically liberalise the system and increase the efficiency of the centrally planned economy, opened the door to so-called ‘normalisation’. This process was connected with renewed centralisation, a return to dogmatism, and the end of reforms (economic and political).

It is paradoxical that despite this development, the initial stage of the transformation process was far more successful in Czechoslovakia than in the cases of Poland and Hungary, both of which were experimenting with reforms. For example, foreign debt represented a huge issue for both Poland and Hungary but was not an issue for Czechoslovakia. The Polish regime actively negotiated with the political opposition, and Hungary experimented with price liberalisation and foreign direct investment. The Czechoslovakian regime concentrated on ‘stabilising’ its position and the normalisation status quo. The elite showed resistance and disdain towards the reform efforts of Gorbachev and opposed them openly.

To summarise, in 1990 the Czechoslovakian GDP per capita made up 52% of the European Economic Community average. This was a far better position than that of Hungary or Poland. Concentrating only on the Czech part of Czechoslovakia reveals an even better economic situation, in which GDP per capita made up about 57% of the average of the European Economic Community (EEC)⁵ countries. The Czech industrial tradition, dating back to the nineteenth century, and its geopolitical position represented major advantages. Macroeconomic imbalances were low, as was foreign debt.

Ideological anchoring was very different from that within Poland and Hungary. Czechoslovakia was in the hands of outdated dogmatism, and its politicians were neither willing, nor able, to implement any reforms. Alternative proposals were suggested by the Prognostic Institute led at the time by the reform economist Valtr Komárek.

This socio-political landscape had consequences for the path of the transformation process. It provided a fertile ground for naïve optimism and faith in the simplicity of the transformation process, together with the expectation of a relatively short time span for 'catching up' with developed countries. As Czechoslovakia was still viewed by its own citizens as a country with an exceptional industrial tradition, the consequences of re-integration into the world economy were largely underestimated. This also created conditions for systemic undervaluation of modern structural and industrial policy. It is no wonder that these naïve notions were destined to be disappointed.

Changes in the world economy since the 1970s: the crucial role of the Washington Consensus

To assess the adequacy and success of the transformation process, it is necessary to analyse the economic, social, and political state of the economy that is to be transformed. Furthermore, the state of the world economy, its situation, and its power structure need to be taken into account. Unfortunately, looking back at the transformation process in the Eastern Bloc countries, one could judge that the primary assumptions were that these countries would be integrated into a macroeconomic textbook. The reality of the world economy was very different from how it was presented. Neglecting to consider the true state of the world economy, including the enormous influence of transnational companies, is one of the key factors that led to disappointment in the transformation process.

As mentioned in the previous chapter, the 1970s were not only an important turning point for the Eastern Bloc countries. This decade was also crucial for capitalist, Western countries. The 1970s are marked by a concentration of serious crises, beginning with two oil shocks and the collapse of the Bretton Woods system. The phenomenon of stagflation (the combination of stagnation and inflation) was accompanied by structural unemployment. The post-war recovery phase was over, and the economic structure in developed countries had shifted towards services. Services thus became the largest sector, in both the ratio of GDP and employment. The labour market changed significantly. The most important policy shift was represented by the decline of Keynesian policies and the rise of monetarism and supply-side economics. The new approaches put focus on free market solutions and a smaller role played by the government, and later were described by the term 'neoliberalism', which was to become the dominant economic ideology for the countries of the Eastern Bloc.

The most significant development of this decade, the start of economic globalisation, was thus enabled by the dominance of neoliberal approaches that advocated for the liberalisation of capital, privatisation of public goods (including experiments with pensions schemes), and deregulation. These neoliberal approaches were adopted by the New Right and gained popularity and political success in the US and UK. Technological advancements (such as the

microchip, the development of the PC, etc.) and container shipping created a favourable environment for transnational corporations and their new *modus operandi*.

Whereas the former position of transnational corporations had been strong in the field of resource seeking (typically, on natural resources such as oil) during the 1970s their influence began to grow. These companies became the major drivers of globalisation and also its most influential actors. New motives for international expansion developed: market seeking and efficiency seeking. Market seeking involved the search for attractive new markets with lucrative purchasing power, to compensate for the economic problems in developed countries. However, it is efficiency seeking that is most strongly connected with globalisation. Efficiency seeking refers to the ability of transnational companies to shift their production (and other processes) to countries with a lower minimum wage, lower (or no) social standards, no trade unions, lower taxes or generous incentives, lower or absent environmental standards, etc. These substantial changes to the international division of labour prompted the so-called 'race to the bottom', in which countries competed to earn the preference of transnational companies by providing the cheapest labour. Thus, globalisation resulted in profound changes to the power structure between companies and the state. The state partly loses its economic sovereignty (and in some cases is not willing to use this sovereignty under the dominance of the neoliberal paradigm). The consequences of this include growing interdependence among countries, splintered production processes, and a rise in the importance of international shipping and intermediate products. This process is largely controlled by a private actor – the transnational company. These companies are originally established in developed Western countries and carry out high value-added activities, such as research and development, financial management, and marketing, within their mother country. Regarding this new division of labour, the term 'neo-imperialism' is not an exaggeration.

The dominance of the neoliberal paradigm was helped by institutions like the International Monetary Fund (IMF) and the World Bank. After the collapse of the Bretton-Woods

system, the IMF changed its role and became a lender of last resort for countries in financial difficulties. However, this financial aid was given on the condition of policy adjustment. The Structural Adjustment Programmes (SAP) are notorious for this. The IMF and the World Bank together with the US Treasury became the authors of the Washington Consensus, the recipe book that had enormous influence, both practically and ideologically, on the transformation process and economic policy formation within Eastern Bloc countries.

The neoliberal policies of the Washington Consensus, combined with the power of transnational corporations resulted in a strong concentration of economic power, involving interlinked networks of production and services. The ability to move, shift, or run away from consequences is a huge advantage for transnational corporations, but represents an obstacle and limiting factor for the host country, which cannot 'run' anywhere. However, this hierarchical structure was absolutely ignored by the transformation process, which resulted in serious negative consequences for the re-integration of centrally planned economies into the world economy – or, more precisely, into neoliberal globalisation.

The globalisation process was accompanied by financialisation, which was marked by an increasingly important role of loans (and debt) for keeping economies afloat. The 1990s were marked by a substantial concentration of financial distortions. Beginning with the burst of the Japanese bubble at the end of the 1980s, followed by the Mexican Crisis, and then the major series of crises, originating in south-east Asia, in Thailand. This wave spread to other emerging countries, until it reached Argentina at the beginning of the new millennium. In the US, the dot-com bubble also occurred during the late 1990s, followed by the dot-com crash in the early 2000s.

This highly unstable world, with its underlying power hierarchy, was presented as a new paradise of opportunities for the transformation countries, and this naïve outlook contributed to major failures in the transformation process. It is important to state that the transformation process in itself represented a unique breaking point in the development of the Czechoslovakian economy, and directed it along a new course. It is possible, but extremely difficult, to change this course once it has been set; to change the economic

model once it has been established. Some indicators are very 'stubborn' and leave deep marks in the economy, be it the economic structure, or economic thinking. The three deep devaluations of the Czechoslovakian crown in 1990⁶ could serve as an example.

However, the collapse of the Eastern Bloc also had serious consequences for Western countries. Triumphalism is a term that could be used to describe the overwhelming feeling in Western countries when their main rival (the Soviet Union) collapsed together with the whole of the Eastern Bloc⁷. For Western countries this represented ideological and economic salvation. It seemed that leftist policies lost their *raison d'être*, their legitimacy. Neoliberal globalisation was presented as the only possible way to continue, and the 'there is no alternative' ideology was accepted. Only with the growth of problems and serious distortions (such as the crisis in south-east Asia) did critical voices begin to emerge, including that of US economist Joseph Stiglitz. At the time, China was not considered to be a serious threat, and its development was rather underestimated. The triumph of neoliberalism hit social democratic parties badly. They lost their anchor, which was later reflected in their desperate and unsuccessful embracing of the 'Third Way'.

Economically, the fall of the Eastern Bloc and the spread of neoliberal capitalism (in the form of neoliberal globalisation) offered Western companies many benefits. Suddenly, there was a large new market, hungry for Western goods. More importantly, there were cheap workers within easy reach of international companies of Western origin. This meant that, firstly, there were opportunities for production facilities to employ workers extremely cheaply, due to the difference in minimum wage and the weak currency. Secondly, the proximity of a vast supply of cheap labour meant that pressure could be put on workers in Western countries with such threats as: 'We will shift our production to Poland if you do not accept lower wages/a longer work week, etc'.

At the same time, it is obvious that Western countries never had the intention of making these transition countries their new competitors, but rather of integrating them in a way that would benefit the Western countries themselves, and stabilise the new neoliberal order.

A major influence which helped to expand the neoliberal approach was the Washington Consensus. The role of the IMF as the lender of last resort helped to anchor neoliberal policy recommendations as 'the only possible way', which resulted in the exclusion of any discussion concerning possible alternatives or more tailored measures. Indeed, the neoliberal approach is based on extreme economic simplifications leading to a 'one-size-fits-all' approach, ignoring local specifics, local policy, and the local socio-political context. This arrogant set of dogmatism, first laid out in 1989, became the symbol of the transformation process of the Eastern Bloc, and much later on came to symbolise disillusionment and failed policy recommendations.

The Washington Consensus and its implications

The Washington Consensus represents the neoliberal bible applied universally to the transformation countries of the Eastern Bloc. It is true that the extent to which the neoliberal policies were applied did vary, however, the overall macroeconomic context corresponded to the most important premises of the Washington Consensus.

The following section presents a critical analysis concerning the main issues which arose during the transformation process.

The first policy recommended by the Washington Consensus was fiscal discipline. This recommendation did not make sense considering the reality of most developed countries which, at the time, were becoming increasingly indebted (due to the strength of tax havens, opportunities for tax avoidance by transnational corporations, and the race to the bottom competition among countries which involved the lowering of corporation taxes). As the systemic weakening of governmental revenue was ignored (and this is still the case in the Czech Republic today), pressure was put on fiscal expenditure. This recommendation thus led to a serious inhibition of state capacities and of its active economic policy, including investment and social policy.

Another recommendation was tax reform, concentrated on broadening the tax base and introducing mild marginal tax rates. Mild marginal tax rates were in strong contrast to post-war Keynesian policies, which were based on progressive taxation. No wonder the neoliberal paradigm pleaded for low taxation, in some cases even for a flat tax system. The 1990s mark a trend of lowering taxation across European countries (both for natural persons and corporations) and the increasing importance of VAT which, of course, is regressive tax mostly impacting the poor. The Czech Republic still has a highly distorted tax system today, with very weak progression, non-existent property taxes, and high importance placed on indirect tax such as VAT.

The adoption of competitive exchange rates was another recommendation from the Washington Consensus. This issue is of crucial importance to the Czech Republic (previously Czechoslovakia). Instead of instrumenting pro-export-oriented policy, or economic diplomacy (together with industrial policy), the neoliberal dogma knows only

one direction – the anchoring of cheapness. ‘Competitive’ exchange rates (in reality strongly undervalued exchange rates in comparison to the purchasing power parity concept i.e., with a high exchange rate deviation index (ERDI) meant that national labour was exported below its price. Competitive exchange rates have serious consequences for an open economy like the Czech economy. They set up a system of perverse incentives which damage the economic structure and development of a developing country, and actively hinder the catching-up process. Competitive exchange rates are a danger, not only for the development of a single economy, but globally, as they can initiate monetary wars and conflict.

A further recommendation was trade liberalisation. Trade liberalisation in the form of the abolishment of restrictions, such as quotas, is a tool favouring the so-called globalisation winners. Liberalised trade was proposed by countries with a significant head start. On the other hand, countries throughout history have applied some forms of industrial policy together with targeted protectionism to help their economies to catch up. This is reflected in the initial development of the US and the policy suggestions of Alexander Hamilton. The theory of infant industry formed by German economist, Friedrich List, has been influential for centuries and it would be hard to find a country that did not rely on a mix of protectionism and industrial policy while trying to catch up with the rest of the world. We can use a series of examples from the twentieth century, including Japan, South Korea, and, of course, China.

The focus on trade liberalisation also neglected the aforementioned fact that neoliberal globalisation created a new power hierarchy, with transnational corporations at the top. Trade liberalisation meant the absence of sophisticated economic policy, leading to the need to the necessity to integrate into the pre-existing global value chains, which are controlled by transnational corporations, originating from Western countries. Trade liberalisation results in integration into the global market on the basis of prioritising cheapness, similarly to establishing a ‘competitive’ exchange rate.

The liberalisation of foreign direct investment (FDI), which was another recommendation, added to these effects. For

transnational companies, the fall of the Eastern Bloc was a gift from heaven – the possibility to gain access to lucrative assets (via the undervalued exchange rate) almost for free. This is truly a colonial approach. No interest was shown in the creation of domestic structures, or to their modernisation; the main goal of these ‘respectable’ reforms was to prepare the ground for the modern conquistador – the transnational corporation. Such approaches petrify the asymmetries in the world economy. Transnational corporations have the power to manage the international division of labour, while the governments of transformation states remain in a position of subservience. Instead of concentrating on creating domestic, competitive structures, governments were encouraged to focus on creating favourable conditions for international companies, which, of course, follow their own interests rather than those of the country in question and its citizens.

A further policy prescription of the Washington Consensus was the privatisation of state enterprises. This recommendation was directly connected with the belief that the state itself is a poor economic actor. Privatisation enabled a rapid distribution of vast amounts of property among foreign owners, this sometimes included the distribution of strategic assets, such as water, infrastructure, telecommunication, and mining. Needless to say, China proceeded in its own transformation in a very different way, actively making state-owned (or controlled) enterprises into competitors with private transnational corporations from the West.

Another recommendation was deregulation. Deregulation is, in itself, a problematic concept, postulating that market forces are self-regulating. There is hardly a single piece of evidence to support this. Prominent examples of deregulation include the abolishment of the Glass-Steagall Act, which had disastrous consequences in contributing to the outbreak of the Great Recession. Together with liberalisation, deregulation favours the globalisation winners, while the protection of weaker subjects (or citizens) is viewed as an inefficient obstacle. Deregulation can also boost systemic risk, as in the case of financial deregulation.

The protection of property rights and intellectual property is another tool, recommended by the Washington Consensus, which developed countries can use to retain their head start in the global market and avoid practically all competition.

To summarise, the Washington Consensus is a set of policy recommendations which mostly benefit corporations from Western developed countries. It leaves no space for active industrial policy. The Washington Consensus also strongly limits opportunities for independent economic policy, which is viewed as detrimental. The transformation countries therefore quickly became (asymmetrically) dependent and vulnerable.

Under the neoliberal dogma, the reforms and reform steps were considered to be easily manageable, with rapid implementation. The phrase ‘leap into the market economy’ was coined at the time by the economist Jeffrey Sachs. The one-size-fits-all attitude completely ignored the economic structure, micro-foundation, tradition, and history of different countries. The countries were viewed as blank sheets of paper, still to write the first page of their economic history, as if starting from ‘point zero’.

Supporting the interests of transnational corporations and their mother countries was presented as being in the best interests of the transformation countries and their citizens. It is striking that Western countries gave the transformation countries an economic model, via institutions such as the IMF, which they themselves had not followed during the development and modernisation of their own economies.

There is one example of a country that never accepted the Washington Consensus and focussed on its own priorities – China.

The transformation process – common features

There were variations between the transformation processes in different countries. However, there were two major common factors that influenced the economic performance and the socio-economic stability of all the transformation countries. The first was a dramatic fall in GDP, and the second was the economic consequence of the Comecon collapse. However, there were variations between the countries according to the length of the economic crisis, its severity, and the time needed for economic recovery.

The Comecon collapse began in 1991 and led to the necessity to trade in 'hard' currencies. Energetically intensive countries, like Czechoslovakia, were severely hit by oil prices.

Myant and Drahokoupil discuss two basic approaches taken during the transformation process: shock therapy, and the gradualism approach, which they regarded as opposites.

Shock therapy was closely linked with the Washington Consensus. This approach was also connected with the denial of any 'alternatives', which reflected efforts to bury the legacy of socialism once and for all. This approach was marked by a sharp discontinuity: a 'cut' in the economy and in society.

The main theory behind shock therapy is the belief that the capitalist⁸ market economy can easily be established. The main guidance for this approach was given by the Washington Consensus, and the rest was more or less a question of letting the market forces act on the economy. Speed was important, as there were worries that the process could somehow be reversed. Thus, it was also necessary to create the new elite as soon as possible. Shock therapy counted on rapid positive results, and led to excessively high expectations. One of them was the transformation promise that if the Czech Republic followed the path of neoliberal reforms, it would catch up with Germany in five years' time. The legitimacy of the reforms was boosted by the engagement of IMF and the World Bank, whose recommendations were sometimes contrasting with those of the European Economic Community.

A change in the geopolitical situation when the Soviet Union dissolved, also meant that any early thoughts of applying the Marshall Plan⁹ were quickly abandoned. Integrating the Eastern Bloc countries into the sphere of economic influence of Western countries was much more lucrative and promised the Western corporations the consolidation of their position in the market.

The gradualism approach was more concerned with the specific socio-economic features of individual countries and with knowledge of the institutional economy. It cannot be claimed, however, that EEC countries were proponents of this approach over the IMF's. Rather, the EEC, and later the EU, saw the transformation process in a broader sense and with important political dimensions.

Despite the fact that EU membership was the ultimate goal for countries in Central Europe, it cannot be said that a welfare state would have been recommended by the EU institutions. On the contrary, the European countries themselves came under pressure for their 'socialist' ways, and the fall of the Soviet Union economic system meant that they became defensive of all their leftist ideas and preferences.

The EU viewed the political and economic transformation as an interconnected process. Successful transformation would bolster democratic political reforms. It seems that nobody really considered what would happen if the transformation process failed.

The transformation process in the Czech Republic

All transformation countries had to solve several issues in a relatively short time, such as how to re-integrate into the world economy, and the creation of a new price and property structure. The main aim of this extensive chapter is not to describe each step in detail, but rather to concentrate on the long-term consequences of the most important measures.

The first changes were mostly political, articulated by the, at time, 'civic', and later political movement, *Občanské fórum* ('the Forum of Citizens'). The first catchphrases associated with the movement were 'free election' and 'return to Europe'.

The aforementioned economist, Valtr Komárek, presented his views, but was not able to gain wide support. He was a proponent of the gradualism approach, and of carefully managed structural changes. Instead, it was Václav Klaus¹⁰ who gained the dominant voice concerning economic affairs. He was deeply involved in shaping the economic landscape in the Czech Republic. His unshakable confidence (hardly distinguishable from arrogance), political skills, and charisma helped him gain vast public support.

His paper on the strategy of economic reform was pushed through despite opposition from, for example, the University of Economics. The four main pillars laid out by him in this paper were restriction, privatisation, price liberalisation, and currency convertibility.

Klaus's personal enthusiasm for monetaristic approaches and Margaret Thatcher policies led to inflation being considered the main threat for future economic development. Strong macroeconomic restrictions were therefore needed, to hinder the spiral of inflation. Such policies were accompanied by high interest rates, which again represented a hurdle for enterprises seeking loans. During the whole of the 1990s there was an obsession with the idea that demand needed to be 'cut' (one of the favourite mottos of the time was 'we will tighten our belts and then catch up with Germany'). The problem, in my view, was never on the demand side, but on the supply side – an insufficient supply of quality goods, and of goods that could compete in the international market. The problems underlying this were low investment and technological backwardness.

Before we continue with further analysis, let us repeat that the initial conditions of Czechoslovakia, later the Czech Republic, were exceptionally favourable (unlike in Poland or Hungary), with low foreign debt and no major macroeconomic imbalances.

Privatisation was the next fundamental pillar in the transformation process. Importance was placed on the speed of the process. Price liberalisation was viewed as risky, as the monopoly structure of the economy could quickly result in excess prices. Trade liberalisation was to counter this effect, for example regarding competition from abroad. Thus, the rapid implementation of inner convertibility was necessary. The Czechoslovakia crown was deeply devalued (this is thoroughly discussed in further chapters), which was supposed to limit problems in the balance of payments.

It was not surprising that the combination of these measures led to a transformation shock. The main focus was on macro aggregates (rather than structural issues), and the widespread view that the market economy is easy to implement, shared by the Washington Consensus.

The speed of the process became a crucial factor, and was seen as a value in itself. The speed was presented as a 'guarantee' of no return to before the November of 1989 (the month beginning the Velvet revolution¹¹). Those who proposed different paths were coined as 'communists', and 'dangerous' for future development. The Czech tendency to go to extremes was very visible at the time, and ardent communists turned into market fundamentalists, overnight.

The 'purity' of the market approach was accentuated, and there was a strong refusal to consider any third way (which included alternatives such as the welfare state), the term 'market without adjectives' was like a drug for most citizens. This intoxication with the free market was directed, just as sheep are led by their shepherd. Václav Klaus was able to charm citizens enormously, which helped him to realise his transformation views, which were firmly based in monetaristic theory.

When assessing the extent of change due to integration into the world economy, it makes sense to first consider the initial phase of transformation.

Table 3 *Openness of economy, exports of goods and services, in% of GDP, 1990.*

Czech Republic	45.2
Slovak Republic	26.5
Hungary	31.1
Poland	28.6

Source: Myant, M., 2013b, p. 93

Table 3 shows that the Czech part of Czechoslovakia had the most open economy at the beginning of the transformation process. Since then, the extent of openness has almost doubled. It is also worth taking a more detailed look into the market structure.

Table 4 *Ratio of exports to key markets, in %, 1989.*

	Soviet Union	Other countries of Eastern Europe	EEC and EFTA countries
Czechoslovakia	32.9	23.1	23.5
Hungary	25.1	15.9	35.6
Poland	20.8	14.0	43.6

EEC – the European Economic Community (consisting of twelve countries; Germany, France, Italy, Belgium, the Netherlands, Luxembourg, Denmark, UK, Ireland, Spain, Portugal, and Greece).

EFTA – the European Free Trade Association, at that time including Austria, Norway, Sweden, Switzerland, Finland, and Iceland.

Source: Myant, M., 2013b, p. 93

Interestingly, Table 3 shows that in 1989 Czechoslovakia was strongly connected with the Soviet Union, while Poland and Hungary already had more intensive trade relations with the West than with the Soviet Union. This reflects the economic and political changes mentioned in previous chapters.

The collapse of Comecon was thus a very painful experience for Czechoslovakia and the need to reorientate and increase trade with Western markets was urgent. This territorial reorientation was characterised by a decreased ratio of exports to developing countries and to countries of the Eastern Bloc, and a higher importance placed on exports to

Western markets. Needless to say, such a profound change was accompanied by a change in the commodity structure.

Czechoslovakian exports before 1989, were characterised by their dual structure. Statistics for the year 1989 (Kubišta 2009, 218) show that the structure of exports to developed countries was dominated by intermediate goods, chemical products, and food, while machinery accounted for about 12%.

On the other hand, the export structure in relation to centrally planned economy countries reflected the strong position of Czechoslovakia within this group, in which machinery accounted for nearly 60% of exports.

The import structure reflected the high energy intensity of the Czechoslovakian economy. Fuel represented one fourth of imports from centrally planned economy countries. Machinery and chemical products were mostly imported from developed countries. The import of consumer goods was relatively small, which explains the appetite for Western goods which arose later, in the first years of the transformation process.

Despite the dramatic devaluation of the Czechoslovakian crown, the first years of transformation were marked by a sharp fall in machinery exports, balanced by a rise in the export of intermediate goods. Imports of consumer goods increased. Semi-finished goods made up the majority of goods produced in the Czech Republic, very few finished products were produced. One of the main features of the Czechoslovakian economy at this time was the dominance of so-called 'wage labour'. Czechoslovakian labour was used in assembling imported parts, or intermediate goods, which were then exported again. This type of integration into the world economy (which is still present in the Czech economy) is typical for developing countries, and is connected with substantial wage differences, routine operations with low value added, and transport proximity to major markets. The devalued currency offered competitive prices, but not competition based on differentiated or sophisticated products.

As the country's current account began to run steep deficits, and considerable external imbalances arose, the issues regarding imports and their structure became controversial. Imports of machinery could have been interpreted as an impulse for innovation, and thus as something desirable. However, a closer look at the years preceding the mon-

etary crisis in 1997 revealed that more than 50% of goods imported under the 'machinery category', were goods for final consumption such as luxury cars for the newly established wealthy class of entrepreneurs. The issue of fixed exchange rates will be discussed later in this chapter.

The form of integration into the global market is closely connected with microeconomic aspects which were not considered an important issue in the transformation process. Within the neoliberal framework of transformation, issues such as the structure of economic sectors, access to loans, and enterprise motivations – which would have been considered of crucial importance for institutional economists – were largely ignored. The main focus was put on aggregate macroeconomic indicators.

Integration into the world economy can be roughly divided into two periods. In the first, the Czech (by property) companies struggled to compete in the world market, using the 'exchange rate cushion', and competing mostly by providing cheap prices. As the 'Czech capitalism' effort failed, importance was given to attracting transnational corporations which directly, or indirectly, took over the surviving Czech companies, resulting in consequences such as the wage ceiling and production dependency.

The destruction of PZOs was considered 'modern' but resulted in worsening the situation. It is true that state enterprises could not directly communicate with foreign markets and had to use PZOs, which had monopoly over foreign trade operations. On the other hand, the destruction of the PZOs occurred during a period of world market expansion via transnational corporations and their operations. The replacement of PZOs with modern trading houses would have been a great help for Czech companies trying to establish themselves within the foreign market. However, economic diplomacy did not fit into the neoliberal framework (free market without adjectives), and was highly unpopular. This, may be a minor example, but it reveals how the right-wing governments of the time adopted 'ideological purity', without taking the reality of the economic situation into account. This practice of ignoring reality led to the paradox of Czech politicians, especially Václav Klaus, lecturing their foreign counterparts about the market economy and how it should function.

Regarding trade agreements, Czechoslovakia regained accession to the General Agreement on Tariffs and Trade (GATT¹²), and soon retained the most-favoured-nation clause. Association agreements with the European Economic Community were concluded in 1991 (along with those of Poland and Hungary), but the ratification process took some time. In the meantime, there were special agreements made concerning trade and trade liberalisation. It was a shock when the new neoliberals in the government found out that there were ways to protect the market, for example in the case of Czech steel, which was facing antidumping tariffs.

As for institutions, the *Exportní garanní a pojišťovací společnost* ('Export Guarantee and Insurance Corporation') or EGAP was founded in 1992, and the Czech Export Bank in 1995. The agency CzechTrade was not founded until 1997, its mission was to help Czech companies in their re-orientation with Western markets by providing consultation and information services.

The destruction of the PZOs left insufficient substitutes to give assistance to the new Czech export system, which needed new industrial and modernisation policies. Thus, the export structure reflected the economic structure of the whole of the Czechoslovakian, later Czech, economy. It required two crutches; low wages, and strongly depreciated exchange rates. This prioritisation of providing cheapness represented the main economic orientation of Czechoslovakia, and due to the inflow of FDI into the economy, remains so today. It has now been proven that it is very hard to change the set course of an economy, which is also due to the disillusionment of its citizens.

The exchange rate played a crucial role in the transformation process; therefore, it is necessary to discuss it in more depth. It actually signalled the failure of the transformation process, the clearest feature of this being the monetary crisis in 1997.

In the centrally planned economy, the exchange rate was set artificially, and could not fulfil its role. The Czechoslovakian economy was thus detached from world prices and their signals. There were attempts to improve the exchange rate through various reforms (the best known of these was the reform movement of the Prague Spring), but the real change came about in 1990, following the Velvet Revolution.

In 1990, three deep devaluations were made. These devaluations belonged to the most important steps taken during the transformation process. Altogether, the exchange rate was devaluated by more than 86% in convertible currency. One of the biggest mistakes was the establishment of a special tourist exchange rate at twenty-six Czechoslovakian crown to Deutsche Mark. The consequence was that millions of tourists poured into the country to buy food, which at the time was subsidised by the state.

The strongly devaluated exchange rate reflected the logic of the Washington Consensus, and penetrated the whole economic system. It must be stressed that for any dynamic economic process of change, including transformation, analysing the initial conditions is of crucial importance. Because of these devaluations, the Czechoslovakian crown deeply diverged from purchasing power parity. Miloš Pick, one of the few economists who was critical of the transformation process from the beginning, stressed that this inequality in trade conditions is usually associated with developing countries. He stated that a weak currency could be compared to a tax for lagging behind Western countries. The exchange rate cannot be a tool for convergence per se, as it reflects convergence. There are, however, various tools of economic policy which could contribute to the convergence process, these would ensure that the exchange rate develops in accordance with the purchasing power parity. The negative effects of these deep devaluations can be summarised as follows:

- The underselling of national labour, at between a third to a seventh of their actual worth, according to the indicator ERDI.
- The replacement of one distortion by another. The conditions for exportation were not strict enough, which meant that there was support for ineffective exports, which relied on price competitiveness. There was insufficient pressure to modernise the economy's structure.
- The establishment of inefficient and obsolete economic structures due to production with low value-added, low levels of technological skills and qualifications, and intensive energy use.
- The initial setting of the exchange rate can distort the whole economic environment.

The devaluation of the exchange rate distorted prices and wage levels for years to come. Miloš Pick (Pick 2009, 22-23) accurately stated that exchange rate distortions should

not be regarded as a sacrifice leading to future prosperity, but rather a sacrifice for foreign interests, he described the Czech transformation process as a 'neocolonialist model of market adaptation'.

Technically, the fixed exchange rate was first pegged on five currencies, and later, on the American Dollar and the Deutsche Mark. The oscillation band was very narrow, at only +/- 0.5%, which put pressure on the Czech Central Bank. The exchange rate was considered to be a nominal anchor of the transformation, the mythical 'stable point' in an environment full of changes. There are disputes about whether a fixed exchange rate can work against inflation. However, in the Czech Republic there was a positive inflation differential, meaning that inflation and interest rates were higher than in Western countries.

This leads us to the major problem of inflation, which peaked during the monetary crisis of 1997. Inflation, which was consistently higher than in the Western European countries, contributed to real appreciation, the de facto 'devouring' of the exchange rate. The highly devaluated exchange rate created a generous environment for all companies – efficient and inefficient – and set the course towards price competition. The high inflation differential attracted speculative capital, which contributed to the collapse of the fixed exchange rate regime.

The exchange rate cushion and the wage cushion were thus the main instruments used during the transformation process (precisely in accordance with the Washington Consensus). At the beginning of 1991, the internal convertibility of the Czech crown was established. Following this, the growing internal and external imbalances led to disputes among major political actors, namely between the prime minister of the time, Václav Klaus, and the central bank. In the second half of the 1990s, the pressure to revalue the Czech crown (CZK) was interpreted very differently by the government and the central bank. The situation became unbearable as the Czech Republic experienced a capital flow bonanza – in 1995 the balance of the capital account reached 18% of GDP!

In 1995, external convertibility of the CZK was established not only in the current account, but in the capital account as well, which perfectly corresponded to Václav Klaus' ideology, and to the Washington Consensus. The combination

of extreme economical openness and the fixed exchange rate, was a major attraction for foreign speculative capital. The Czech National Bank (CNB) was under pressure and increased interest rates, which further strengthened the inflow of foreign capital. Czech companies were forced to search for financing abroad, as loans became too expensive. Evaluations of the situation, as mentioned above, were very different. The government boasted of the inflow of capital, presenting it as a sign of success in the development of the Czech economy, and the positive impact of transformation. On the other hand, CNB was concerned about the speculative nature of the capital.

As a defensive strategy, the Czech National Bank attempted to broaden the currency band to +/- 7.5%, which should have led to higher speculative risk. The domestic imbalance was reflected in the high current account deficit, which made up 7.6% of GDP. It was becoming obvious that the fixed exchange rate did not equate to successful economic development. However, the devaluation of the CZK was not considered a failure because, at the time – as contradictory as it may seem – transformation was considered accomplished. The collapse of this economically and politically unsustainable situation came in 1997, when the wave of crises originating in south-east Asia, reached the Czech Republic. Speculators lost interest in the Czech crown and fled the country. The Czech National Bank tried to defend the exchange rate, and lost a considerable portion of its foreign exchange reserves. In the end, the Czech central bank had to give up the fixed exchange rate and adopt the floating exchange rate regime.

This situation led to further political controversy about the course of economic policy, and it contributed to the fall of the government, and the premature election. Economically, a repetition of the first phase of the transformation oc-

curred. The issues were thought to be on the demand side of the economy, thus another wave of restrictive policy appeared to be the appropriate reaction. In reality, the main problem was not demand but supply: the supply structure, and insufficient modernisation of the domestic economy.

The Czech national bank later decided to adopt the disinflation process, enabled by the floating exchange rate regime. Table 5 summarises the main macroeconomic tendencies and imbalances.

To sum up, the fixed exchange rate policy (as a nominal anchor) can be viewed as a failure for various reasons. The distortions created by the deep devaluations still affect Czech price and wage levels today. A fixed exchange rate cannot be regarded as a sufficient tool for changing an obsolete economic structure. It made imports more expensive and, together with the high interest rate of the Czech central bank, made modernisation more difficult and expensive for Czech companies. Devaluation inevitably contributed to inflation. In an inflationary environment, the impacts of devaluation are very short-lived, as inflation 'devours' the exporters' exchange rate cushion. The failure of the fixed exchange rate nominal anchor was a symbol of failure for the entire transformation process.

Privatisation was another key feature of the transformation process. To begin with, the question of what exactly should be privatised, was not clearly defined. Regarding 'the family silver'; strategically or traditionally important enterprises for the Czech Republic, no systematic definition was made. The neoliberal tragedy was that privatisation became a 'golden calf'; a goal in itself. A more practical goal would have been to create modernised competitive economic structures.

Table 5 *Indicators of external imbalance, 1990 – first half of 1996.*

	1990	1991	1992	1993	1994	1995	First half of 1996
Net exports, stable prices in % GDP	-0.4	7.0	0.1	-1.7	-6.9	-15.1	-19.8
Current account, % GDP	-	-	-1.5	2.5	-0.04	-2.9	-6.9
ERDI (DEM based)	4.1	4.5	4.1	3.5	3.3	3.1	-
GDP deflator in %	9.5	47.2	17.9	16.2	11.0	11.4	8.5

ERDI – exchange rate deviation index based on Deutsche Mark (DEM)

Source: Pick, 2009, p. 47

The privatisation process was strongly influenced by an insufficient juridical framework. Slogans from this period, include 'it is necessary to switch the lights out', and, from Václav Klaus¹³, 'I do not know what dirty money is'. These show that the main focus was on the speed of the transformation process, and suggest short-term gratification, and opportunistic behaviour, which in some cases bordered on crime.

What are the key elements of a privatisation process? How, and based on which criteria, should the enterprises for privatisation be chosen? Furthermore, what contribution can be expected from privatisation? Here, as stated, the tool did not help in proceeding towards the goal of modernisation. Further questions include: Why should enterprises be privatised? If, during the privatisation process, companies could be paid for in cash, then the process would favour those who had been successful within the centrally planned economy due to their understanding of economics and experience in activities on the fringe of the law. Loans seemed to be another possibility, albeit a strange one, as the banks still belonged to the state. Despite the lack of clarity, privatisation was adopted.

Voucher privatisation appeared to answer all these questions. The method of privatisation by employee ownership, which was used in Slovenia, was not deeply considered by the Czech Republic.

To explain the situation, let's start with small privatisation. This type of privatisation actually refers to the possibility of running a certain facility for a limited amount of time. From the macroeconomic point of view, it did not play an important role. However, it did lead to high engagement of foreign retail chains, with disastrous impacts for local producers and farmers.

At the beginning of the 1990s, there was already criticism concerning voucher privatisation. One critique claimed that it would fragment ownership, as transnational corporations monopolise such a high concentration of ownership within the world economy. The speed of privatisation resulted in insiders, and those with economic understanding, gaining a considerable advantage and amassing vast fortunes. Privatisation led more to the establishment of the nouveau riche, than to modernisation of the economy.

Voucher privatisation meant that citizens could buy a book of vouchers, and invest in, or buy shares in, the domestic companies that were chosen for privatisation. A major game changer was the marketing campaign by Viktor Kožený (now hiding in the Bahamas, and held up as an example of crime and corruption during the transformation process). Part of his marketing campaign was to promise citizens a tenfold return on their investments. However, citizens unfamiliar with economics did not understand that the tenfold gain actually meant that the enterprises were undersold – at only a tenth of their real value. Another confusing factor was the constant praise of the role played by the market, as it was the state and not the market which chose the privatisation method and also the list of companies to be privatised.

All citizens were given the opportunity to become holders of privatisation vouchers. In the first wave of privatisation, 77% of citizens participated, in the second wave, 74% participated. The Harvard Funds, established by Kožený, became one of the largest Investment Privatisation Funds.

The original idea behind voucher privatisation seems to have been the creation of 'people's capitalism'. Citizens were supposed to become small shareholders and contribute to the development of enterprises and the economy, resulting in a capitalist society. However, there are indications that the holders of investment vouchers were not really interested in investing, and would instead sell their vouchers, to gain a quick profit.

In a brutal statement by Miloš Pick, the situation was thus described: Five of the biggest banks, an insurance company, and fourteen Investment Privatisation Funds, which are mostly owned by the banks, have gained more than 40% of shares from the first wave of privatisation, and 80% of shares in bank loans. This has resulted in a pyramid of economic power ... About 500 families now control the majority of the economy, without owning it directly. It is truly an 'economic Politburo', newly built. This was not voted for by the owners of the fragmented businesses, and there is almost no possibility of ever reversing it. An extreme concentration of economic power, extremely separated from extremely fragmented owners. That is the current result of voucher privatisation (Pick 2009, 42). With a bit of irony, it could be said that the motto of socialism 'all enterprises belong to all of us' was finally fulfilled.

Voucher privatisation did however also create a cash cushion for households, as income was boosted by the sale of national wealth at dumping prices.

The Czech method of privatisation received the support of the World Bank and, unbelievably, was presented as a paragon. This was not, however, the view of the famous American economist, Joseph Stiglitz (Stiglitz 2003). He was in favour of low interest rates in order to allow enterprises to invest in and modernise their production. In his view, banks should be the first to be privatised. As Stiglitz later cited, the proponents of voucher privatisation claimed that they 'had no other choice', but this simply was not true. Slovenia, for example, focussed on employee participation.

To summarise, voucher privatisation led to the following problems:

Fragmented ownership (the opposite of the increase in Western ownership through transnational corporations) created manoeuvring space for the sale of national wealth at very low prices. This, of course, attracted many resellers, but none who really wanted to see modernisation of the enterprises. It attracted those who saw an opportunity for quick profit – to buy shares, export stocks and machinery, and then close down and destroy the enterprise, or speculate with real estate. The process was fast (welcomed by the government) and highly profitable.

Miloš Pick's estimate was that, through voucher privatisation, the national wealth at the value of 250 billion CZK, was sold for about 70 billion CZK.

Citizens who bought vouchers did not, in most cases, have any idea of how to run a business, nor did they have any experience with capitalism¹⁴. The legislative framework around privatisation was very weak, and banks were still under state control. In such circumstances, expecting to bring about 'people's capitalism' was naïve, to say the least. Citizens were given the position of minor shareholders, but in most cases, they had no interest in running or improving companies, they simply wanted to gain from the privatisation process. Almost a quarter of the participants in voucher privatisation sold their vouchers to an Investment Privatisation Fund.

Investment funds played a very controversial role. In some cases, they were able to prevent the collapse of a company by asset stripping, but often they did not have the tools to restructure the company. The weak legal framework and inexperienced shareholders created a perfect environment for hardened criminals and scumbags without any scruples. Buying a new Mercedes every half year became a status symbol, and was seen as the sign of a 'successful entrepreneur'. In this context, Václav Klaus stated that he was unable to define 'dirty money', and that he did not know what it was.

The speed of this process created a new right-wing elite, which overwhelmingly dominated the media and still does today. Leftist views were either ignored, ridiculed, or seen as a threat to successful transformation. This mindset still remains, thirty years after the beginning of the transformation process!

Table 6 Performance indicators of Czech industrial companies by privatisation method, 1997.

	Turnover, % from total	Profit, % from equity	Productivity, % from average	Overdue debts, % from turnover
Public sector	19.3	4.33	109	6.4
Voucher privatisation	25.3	-0.16	84	5.8
Standard methods	8.2	9.12	92	9.1
Foreign owner	14.6	18.58	205	3.9
Other	32.6	5.08	95	8.9
All enterprises	100	4.84	100	6.9

Source: Myant, M., 2013b, p. 380

There is plenty of evidence showing that the privatisation process was a total failure. The performance of the privatised companies was weakened, and they lagged behind all other categories of companies, including public enterprises. The highest performance was seen in companies with a foreign owner. Later, this fact prompted the policy shift towards investment incentives for transnational companies. The failure of voucher privatisation led to the monopoly of the economy by transnational companies, and ended the dream of a Czech 'people's capitalism'.

The consequences of the privatisation method chosen by the Czech Republic went beyond economic indicators. Citizens were divided into two categories: successful (those who became very rich very quickly), and unsuccessful. Growing dissatisfaction with the economic and political state of affairs led to increasing popularity of the Czech Social Democratic Party (ČSSD). Miloš Zeman, who became the leader of the party, and later the prime minister, famously stated that voucher privatisation represented the 'fraud of the century'.

It took many years for the actors in the privatisation process to speak openly about what really happened. Jan Stráský (Šídlo 2019), one of Václav Klaus's closest allies, admitted that there was a silent agreement to 'turn the lights out', so that those citizens who were shrewd enough could grab the wealth. He also admitted that the banks were deliberately included (they were still state property at the time). He further acknowledged that 'some people paid, some people didn't'. Hundreds of billions had to be written off. Stráský stated that in a wave of debt elimination in 1993, about 50 billion CZK was required to pay back loans originating from the centrally planned economy. Just five years later however, the Czech Republic had amounted debts ten times as high.

During an interview for the magazine *Ekonom* (Ekonom 2013), Tomáš Ježek¹⁵ acknowledged that there was a deliberate change in the law concerning investment funds: Funds could handle the property of the shareholder, as though it belonged to them. In the interview, Ježek explained: 'Some people made a fortune, like Petr Kellner¹⁶. It is a fact that one group of citizens robbed another ... Well, you can also be a good manager of stolen property'. He also tried to put all the blame on Václav Klaus, and mentioned that at the end of Klaus's presidential term, he granted a broad amnesty¹⁷ on New Year's Day, so, clearly, he had always been involved in corruption.

The monetary crisis in 1997 and growing disillusion concerning the transformation process, led to the establishment of the minority government of Social Democratic Party, led by Miloš Zeman. The government put excessive focus on attracting foreign capital, which has led to the current extremely high influence of foreign companies over the Czech economy. However, it should be mentioned that this government was elected during a highly difficult economic period, with increasing unemployment rates.

Although the outlook regarding foreign capital varied among central European transforming countries at the beginning of the transformation process, in the second half of the nineties, competition arose between them regarding the attraction of foreign investment. The consequences included the establishment of special agencies for export promotion, investment incentives, and tax dumping. The Central and Eastern European countries thus joined the race to the bottom.

Foreign direct investment is one of the most stable forms of foreign investment. However, its positive attributes often disabled discussions concerning potential negative consequences, and the framework of the international division of labour was largely ignored. Regarding the issue from the perspective of political economy, one cannot ignore how strongly FDI has shaped Czech economic decision making and the wage level.

The distribution of FDI across the globe is a crucial factor shaping the international division of labour, and practically determines the value added of the economy. The efficiency seeking motive, combined with proximity to core Western markets such as Germany, led to investment in Central and Eastern European countries.

FDI is often associated with positive contributions, such as upgraded technology, management, and marketing skills. The inflow of capital used (according to the mother company) for modernisation was also considered to be very important. One major incentive was the opportunity of rapid inclusion within the global division of labour, and access to foreign markets. The desire to become part of this global network was understandable, yet in the long run it resulted in many disadvantages. An increase in export capacity, especially for countries like the Czech Republic, may seem a fair argument. However, export is often accompanied by

import, the extent depending on the value-added of the host economy.

There is no evidence connecting an inflow of FDI with modernisation. In many cases, transnational corporations do not want to modernise their host countries. Instead, it is in their interests to retain the advantages which exist in outdated systems, such as cheap labour and an undervalued exchange rate.

In the case of the Czech Republic, it is clear that the inflow of FDI was motivated by its geopolitical position and industrial tradition. Regarding economic history, it is clear that a real structural shift up the economic development ladder, was always initiated by government policy. China, South Korea, Japan, and Singapore being prominent examples of the twentieth century.

After the failure of voucher privatisation, the engagement of foreign companies was viewed as an easy 'salvation'. However, future perspectives and the need to reduce reliance on FDI in the future, were simply ignored.

The influence of FDI is usually not evenly spread across an economy; transnational corporations invest in sectors which are interesting for them. The sections of the economy which are not directly connected with transnational corporations may either develop independently, or with partial dependency on transnational corporations. This sometimes results in a dual economy. Duality can be reflected in ownership (domestic vs foreign), value added, level of qualifications, wage level, etc. As it is an important topic, it will be addressed in the following chapters.

Transnational corporations may even decide to deliberately destroy some companies, if they represent a serious competitor.

The risks and disadvantages of FDI have been already mentioned, one of the crucial issues is the position of the dependent economy, whose key 'advantage' becomes the supply of cheap labour and undervalued exchange rate. With the absence of modern industrial and structural policies, whole segments of the economy develop a wage ceiling. A wage ceiling results from the fact that the companies operating in the Czech Republic (daughter or subcontractor) are price-takers, and do not represent the final

production stage. The privatisation of basic infrastructure, such as the water industry, was hugely controversial. Foreign companies (for example Veolia) were able to engage in rent-seeking, and the costs connected with the infrastructure in question was usually borne by the municipality. A further blow for Czech ownership was the de facto takeover of the entire retail network by foreign companies, which focussed on the production of foreign goods, and mistreated domestic producers. The banking sector's role will be discussed in a further section.

The 'maturing' of investment was also a huge issue; the term 'maturing' referring to the point in time at which the outflow of dividends exceeds the inflow of FDI. Although this point was reached very fast in the Czech Republic, the problem has long been ignored, and has only recently entered into economic and political debate. This crucial topic will also be discussed further in the following chapters.

The banking sector held a special position during the transformation process. A belief held by some is that the main problem with the transformation process was that the banking sector remained in the hands of the state. It is worth mentioning that in the Washington Consensus the banking sector is neither specifically mentioned, nor analysed.

One of the first steps in the transformation process was the creation of a double-stage banking system, separating the central bank from commercial banking. The central bank was represented by the State Czechoslovakian Bank which became the Czech National Bank, after the breakup of Czechoslovakia. Separating the roles of the central bank from the commercial banking sector led to serious issues such as:

The question of how the transformation process was to be financed.

The rapid creation of many small banks in an environment where larger banks were either state owned or under state surveillance.

The necessity to consolidate the banking sector, which emerged repeatedly, and heavily influenced state debt.

During the 1990s, the situation in the banking sector began to escalate. The share of classified loans began to rise quickly. Larger banks, which were in many cases under the

influence of the state, granted loans to companies, but their repayment was dubious to say the least. In some cases, the reasons behind this were social circumstances; it was considered important to hold some companies above the water and not to allow too much of an increase in unemployment.

The legal framework was very weak, for example in the case of bankruptcy law. Both larger and smaller banks¹⁸ were held back by a lack of experience and economic instability. In some cases, household savings were used to finance companies which belonged to stockholders. There were intense interrelations between the larger banks and investment funds.

To summarise, the main reasons for these issues included: Granting loans to companies not able to succeed in the new economic environment, inexperienced staff, difficult assessment of new projects by newly established companies, and deliberate asset stripping.

Concentration in the banking sector began to occur. Between 1993–2002, the situation became more stable. During this period, the Czech National Bank granted nineteen banking licenses, enforced sequestration in nine cases, and in eighteen cases decided to withdraw a banking license. The surveillance of banks was difficult as, ideologically, any regulation was viewed as a ‘return to communism’, and the market economy was assumed to be self-regulating.

One of the first dramatic cases was when Agrobanka Praha was placed into receivership and part of the bank was sold to a strategic partner, the Czech National Bank carried the losses of about 35 billion CZK. It was the Social Democratic government which was given the responsibility of solving the problems in the banking sector. Between 1999–2001 it was necessary to clean up the books of three huge banks (*Československá obchodní banka*, *Česká spořitelna*, *Komerční banka*). It was a financial disaster when the Japanese investment group, Nomura, became a shareholder in the IPB or *Investiční a poštovní banka* (‘Investment and Post Bank’). The European bank for Reconstruction and Development (EBRD) (Myant 2013b, 397) stated that in 1999, the share of unpaid loans was almost 38%!

Four large banks co-financed the transformation process. These banks represented the medium through which the transformation process was channelled, although the fail-

ures of the process impacted the entire Czech population. It may not have been such a bad idea for the state to retain its influence on banks, as demonstrated by China. The Czech banks did not prompt the emergence of ‘national champions’, partly because they themselves were only the tip of the iceberg of failed privatisation and incorrect economic policy. The chain involved ran from banks, to investment funds, to companies.

Another notorious example is the *Česká spořitelna* (‘Czech Savings Bank’), traditionally associated with small savers. Due to dominant state ownership, the bank was forced to grant loans to companies and smaller banks. In the end it had to be nationalised and then sold to Erste Bank Sparkasse (an Austria bank). Not surprisingly, the money gained from privatisation was much less than the debt amassed during the 1990s.

The banking sector’s activity often bordered on criminal. One example of this was a short legal involvement with the Japanese group, Nomura, in which the Czech state was sued by Nomura for failing to protect its investment. This led to the sale of *Plzeňský Prazdroj* (‘Pilsner Urquell’), one of the most famous brands in the Czech Republic and definitely part of the national wealth.

Further instability was brought about by the sector of credit unions. Normally, this sector is regarded as very stable and serves the needs of the local economy. However, due to the reluctance to use surveillance, this sector became an attraction for asset stripping and swindlers. The disastrous chain of credit union bankruptcy severely damaged the image of cooperative banking, which has not yet recovered.

The cost of consolidation of the Czech banking sector has been calculated at 300 billion CZK. The lack of institutional framework backfired, and as a solution the same method was used as by enterprises – attracting foreign capital.

This last section describing the Czech transformation process is devoted to macroeconomic policy. The dispute concerning the direction of macroeconomic policy is sometimes described using the example of the clash between the prime minister, Václav Klaus, and Czech National Bank governor, Josef Tošovský. However, using this single clash to represent all the issues regarding macroeconomic policy, would be an excessive oversimplification.

In 1994, there were already signs of overheating in the Czech economy. The exchange rate cushion was getting weaker due to rising inflation, and current account deficit was increasing. The resultant policy-making decisions were, in my opinion, inappropriate as they only concentrated on making restrictions on demand, while the main problem was in fact in supply – insufficient outputs, both in quality and quantity. To acknowledge the root of the problem as inadequate supply would, at the time, have been seen as unacceptable, as it would mean accepting the failure of transformation. As a reminder for the reader, the ideological anchoring of the time was such that any private owner was considered a success; there was no room for the consideration of subtle aspects of structural policy.

The repetition of restrictions on demand was actually a sign of helplessness. The restriction of demand created a false equilibrium, further decreasing the wage level and long-term development of purchasing power. It would be rash to state that restrictions do not leave scars on the economy. Miloš Pick correctly pointed out that current account deficit needs to be interpreted accurately with respect to weak supply connected with unused capacities and productivity. The imbalance between aggregate demand and supply was reflected in the main indicator of external balance – the current account deficit.

This deficit became one of the main triggers for financial instability at the end of the 1990s. The lag behind in research and development endured and worsened. Enterprises privatised by voucher privatisation showed the worst results in performance.

The orientation towards restriction policies, backed by the Washington Consensus, helped to 'arrange' a financial crisis which finally led to the abandonment of the fixed exchange rate.

The attractive interest rate differential, in combination with the fixed exchange rate caused an inflow of speculative capital. In 1995, the balance of the capital account amounted to 18% of GDP. To maintain the exchange rate, this inflow had to be sterilised using the Czech National Bank vouchers.

The personal and political dispute between the prime minister and central bank governor reached a head in 1996,

when the Czech National Bank raised interest rates¹⁹. The Czech National Bank stated that the problems which followed were caused by unsustainable economic imbalances, while Václav Klaus accused the central bank as being responsible for the economic slowdown.

The inflow of speculative capital was viewed by the Czech central bank as dangerous, even though it resulted in short-term pressure for the revaluation of the CZK. Václav Klaus viewed the revaluation pressure as positive, and a sign that the transformation process had been successful. The rapid outflow of speculative capital resulting from the crises in emerging markets, particularly Thailand, caused the central bank to attempt to defend the exchange rate. However, after about ten days, in May 1997, the bank gave up the fight and had to devalue the crown and shift to the floating exchange rate regime. Its main policy direction changed to targeting inflation. The disinflation process was to become a new 'anchor'.

This minor monetary crisis led to several reflections concerning economic policy. Some transformation mistakes even started to become topics of discussion in mainstream media. These included the insufficient legal framework and low efficiency of the banking sector. However, the current macroeconomic direction of restriction was still considered to be the right path. The problems with supply were mentioned, but not solved.

The external imbalances did not disappear. Current account deficit was covered by speculative short-term capital until 1997, afterwards the main type of investment was foreign direct investment.

Although we cannot regard the restructuring of the Czech economy as successful, this does not mean that there was no structural shift. The biggest hit was taken by the agriculture sector (Myant 2013a, 54), which lost a third of its workforce between 1990–1992. The position of the food sector strengthened at the expense of the agriculture sector. This was not surprising as the import of agricultural products had started to increase right at the beginning of the transformation process. Table 8 offers some insight into this structural shift. The general increase in importance of the services sector corresponds to the structure of developed countries.

Table 7 Current account (CA) and its development, 1993–2000.

	1993	1994	1995	1996	1997	1998	1999	2000
CA to GDP in %	1.1	-1.6	-2.3	-6.1	-5.7	-1.9	-2.2	-4.4
CA in bil. CZK	13.3	-22.6	-36.3	-111.9	-113.1	-40.5	-50.6	-104.9

Source: Czech Statistical office, *Macroeconomic overview*

Table 8 Employment (in thousands) and productivity per employed person (in thousands CZK), by economic sector, in 1990 and 1993.

Sector	Employment 1990	Employment 1993	Productivity 1990	Productivity 1993
Agriculture	631	331	73	232
Industry	2025	1710	268	215
Construction	402	452	373	228
Trade and repairs	613	720	259	230
Transport	371	385	209	271
Financial services	28	65	1838	797
Trade related services	382	303	333	521
Other	896	878	167	194
Total	5351	4848	244	247

Source: Myant 2013a, p. 92

The work by Myant also states that there was an overall decrease in loan granting between 1990–1993, with the deepest declines being in the agriculture and industry sectors, and the only increase in the trade sector.

Industrial policy, which is concerned with structure, did not correspond to the logic of the Washington Consensus. This is despite, or perhaps due to, the fact that developed countries pursue this policy in order to catch up with other developed countries ahead of them.

I consider the total underestimation of the globalisation process a failure. Enterprises were able to adjust temporarily by laying off employees, or orientating towards low value added activities (wage labour). In most cases, restructuring, which would have directed focus towards producing novel innovative products and services, was not carried out. The prevalence of short-term thinking in the first years of the transformation process led many companies to engage in simple production processes in order to gain income fast.

The failure of voucher privatisation tore apart the structure that had existed in the centrally planned economy. Although not always functional, it provided a hub for development and research, which was linked to production capacities and export. The lack of this structure, and the ideological resistance towards it, extended into the banking sector. In sectors such as steel manufacture, it was unclear what role the government was supposed to play.

The efforts of the Social Democrats regarding comprehensive industrial policy probably came too late, and suffered from bad timing. The government had to attempt to reduce the increasing unemployment rate, and solve vast problems in the banking sector, caused by the economic crisis. Thus, the idea of a 'revitalisation agency' was attractive as, by the end of 1998, debts had amounted to 207 billion CZK.

This cumulation of problems for the minority Social Democratic government resulted in the decision to adopt policies supporting the inflow of foreign direct investment, and economic diplomacy.

Table 9 *Unemployment rate, in %, 1993–2000.*

	1993	1994	1995	1996	1997	1998	1999	2000
Unemployment (ILO) in %	4.3	4.3	4.0	3.9	4.8	6.5	8.7	8.8

ILO – International Labour Organisation

Source: Czech Statistical Office, Macroeconomic overview

The issue of social stability cannot be omitted. In comparison with other transition countries, the social stability of the Czech Republic remained fairly strong. One explanation for this could be the low level of protest within the Czech political landscape. Another could be the existence of several ‘cushions’; one of the most important was probably the cushion resulting from voucher privatisation. The selling of national wealth paradoxically retained purchasing power parity, and also the social peace. A further important cushion was comprised of restitutions, which involved about 15% of the population. Another factor that contributed to social stability was the low rate of unemployment, which remained low until 1997.

However, inequality was rising. The agriculture sector suffered a steep decline, while the banking sector became highly lucrative. This inequality also had a geopolitical dimension, Prague became very rich and influential due to a concentration of banks and other financial institutions. Because of its importance, Prague’s right-wing extremism became reflected in the rest of the country’s political preferences.

To summarise; regarding macroeconomics, the excessive focus on restriction and inflation had serious consequences. In finding solutions for the Czech economy, inflation was with all probability the wrong target, a more effective strategy might have been to focus on the value added in the economy. However, the Washington Consensus mostly concentrated on price dumping and tax dumping, and did not address issues regarding value added. A crucial mistake was voucher privatisation. Company ownership changed at the cost of the sale of national wealth, but this did not provide the solutions needed by the Czech economy. Solutions would have included modernisation, the creation of innovation potential, financial resources for projects, institutional framework, state support in forming international export networks, etc. The revitalisation plan came too late. Timing, it needs to be stressed, is crucial when discussing

a system as dynamic as the economy. It is not possible to ‘start all over again’.

Further mistakes included the lack of information concerning the globalised economy and its innate hierarchy. The focus on speed was another mistake. Speed was mostly politically motivated (an example is Sachs’ catchphrase: ‘leap into the market economy’), as it was considered important to quickly establish the new elite, and to prevent a ‘regression’ to communism.

Even if the Czech Republic had made different decisions, mistakes would still have emerged due to a lack of experience. Nowadays, the Czech Republic is in the position of a ‘colony’ with many serious problems (to be discussed further).

The debate about whether the transformation process was a series of failures leading to the position of a dependent economy, or if it was so arranged, is never-ending.

It was Miloš Pick (Pick 2009, 91-92), who so brutally but truthfully summarised the results of the transformation process: ‘The Czech Republic entered the transformation as a middle-income developing country. Its productivity reached only two fifths of the productivity of the old states of Germany. The lagging behind was worse, the more complicated the product. The Czech Republic had a higher economic level than the poorest EU countries, such as Greece and Portugal. In comparison with other central European countries, it had a considerable head-start in performance; it had low foreign debt, a low domestic market imbalance, and very low inflation. Its main comparative advantage was the high education and qualification level of its citizens, including a high rate of adjustment capability. These favourable conditions present at the start of the transformation, were not sufficiently used within the chosen transformation strategy, to a large extent they were wasted.’

The Czech Republic in the international division of labour

The position of the Czech Republic in the international division of labour has been influenced by the following factors: deep devaluations at the beginning of the transformation, the policy of the Washington Consensus focused on price competition, and failed voucher privatisation with the subsequent engagement of transnational corporations.

Today, we can describe the Czech Republic as a dependent economy. This dependence is obvious in its economic ownership structure and the accompanying features of outflow of dividends, the wage ceiling, a low level of employee compensation (and high level of gross operational surplus), etc.

First, let's have a look at the export structure, both territorial and commodity. The Czech Republic is closely linked to EU markets; about 80% of Czech exports are delivered to EU countries. The Czech Republic has a favourable trade balance with the EU countries, and has a particularly high trade surplus with Germany. On the other hand, with regard to imports the EU does not occupy such an important position; only about two thirds of Czech imports come from EU countries. The Czech Republic has a negative trade balance with non-EU countries, mainly Russia (natural gas and oil) and China.

Despite various efforts to support Czech companies in markets outside the EU, this strong dependence continues. One explanation is connections with the EU due to the ownership structure.

The overall discourse on this topic has become more critical in recent years. It is often claimed that the Czech Republic is used as 'an assembly line' with low value added. The commodity structure of exports proves that there is a strong dependence on the Czech Republic for machinery, especially motor vehicles. On the other hand, oil, natural gas, and food products are all commodities with a negative trade balance.

The economic openness of the Czech Republic (the average of OECD²⁰ countries is, according to World Bank data, around 26%) led to many 'misunderstandings', or efforts to politically exploit this topic. After the Great Recession, policies demanding brutal cuts and restrictions were defended by the fact that 'exports make up 80% of GDP' and therefore that domestic demand was unimportant. This

economic nonsense has been repeated many times, by mainstream journalists and even ministers. In reality, GDP is calculated using net exports (exports minus imports). It is important to distinguish between share and ratio, as otherwise one might end up concluding that countries such as Ireland have a domestic demand of minus 40%.

The Czech economy is highly import intensive. The Czech statistical office has used the term 'transformation economy' to describe this feature. We import machinery parts, assemble them, and export them again. This import intensity can be described in different ways. The analysis carried out by the Unicredit (Pour 2018) Bank reveals both direct and indirect import effects. The vehicle sector has a direct import intensity of 40%. However, regarding indirect effects, such as those within the production chain, there is an increase in the import intensity up to 58%.

It also makes sense to gain a deeper understanding of high-tech exports. The analysis carried out by the Ministry of Industry and Trade (latest data from 2018) shows a trade deficit in high-tech goods, which is due to the high import intensity of the communications sector (MPO 2019). High-tech goods are mostly exported to Germany, and imported from China. There is a trade deficit, despite the fact that the Czech Republic is one of the most important EU countries in the trade of high-tech goods.

To quote the Ministry of Industry and Trade: 'It is clear that the Czech Republic places itself at the disposal of many technologically developed companies within global value chains (GVC), which place their profitable pre-production phase (research, development) in their mother country. Production and export, reliant on high quantities of high-tech semi products, is placed in the Czech Republic. This results to a large extent in the consequence of the modern practice of using cheap labour instead of investment in digitalisation and progressive technologies.'

A recent comprehensive analysis by Deloitte (Deloitte 2019) confirmed the inferior position of the Czech Republic in the international division of labour. It is worth discussing several findings of this extensive study.

The study offers a different view of trade flows, via value added. In this regard, the position of the Czech Republic is weak, and the share of domestic value added in exports is about 61%, one of the lowest when compared globally. Regarding the export of the value added, it is the motor vehicles that take the biggest share, but once more, in a global comparison the share of value added is only 41 %, which is very low. The study further states that the most intensive trade partner (and channel for transmission shocks or changes) is Germany.

A further section of the analysis confirms the position of the Czech Republic as a colony by describing the country as a textbook example of a small and open economy, highly involved in GVCs. The relatively low share of domestic value added is explained by the extensive usage of foreign semi-products for manufacture. The study also states that the Czech Republic's involvement in GVCs is increasing, making the country highly vulnerable to external economic shocks, and resulting in very low economic resilience.

The dependence on foreign markets is also reflected in employment. Deloitte states that 52% of Czech employees are connected to foreign demand. Analysis of the ten most important sectors regarding export volumes shows that nine of them are connected with low value added (at the bottom of the value-added U-curve). The Czech Republic is also one of the countries which is far away from the final consumer of its products. This is extremely important as it means that the goods manufactured/assembled in the Czech Republic travel much further than to the next export station, leaving the final price in different hands.

The investment position (ČNB 2022) can give us a further extensive view of the position of the country. The investment position of the Czech Republic is negative, revealing its position as international debtor. It is true that, compared to how high it was in the past, the negative balance has somewhat decreased. However, this decrease was mainly due to the huge foreign exchange reserves of the Czech National Bank. Foreign exchange reserves account for more than 44% of overall assets, but they are effectively passive assets because they (exceeding 60% GDP) were created by a more than four-year intervention aimed at crown depreciation against the euro (EUR).

Regarding liabilities, the biggest item is, unsurprisingly, foreign direct investment, which makes up more than 50% of all liabilities.

This comparison of gross assets and liabilities shows that the most important assets in an investment position are the foreign exchange reserves connected with the Czech central bank, which cannot effectively be used to modernise the Czech economy if we exclude the use of foreign exchange to support the Czech currency. On the other hand, the high involvement of transnational corporations in the Czech Republic is also a liability.

The Czech National Bank provides a more detailed look into the issue of FDI (ČNB 2019), using data collected at the end of 2019.

The amount of FDI amounted to 3.9 trillion CZK at the end of 2019. This represents 67% (or two thirds) of the Czech GDP in the same year. Surprisingly, the most important FDI source countries did not include Germany, but the Netherlands and Luxembourg. As these two countries represent specific tax or bank havens, it is possible that FDI may partly be connected with companies that were originally Czech, but changed headquarters to avoid taxation. The next most important source countries are Germany, Austria, and France. Switzerland is the most important FDI source country outside the EU. The total dominance of European countries explains the Czech exports network.

Considering distribution of FDI across the economy, the largest sector is finance and insurance with almost 32% (it would be difficult to find a bank in entirely Czech hands). In the second place is the manufacturing industry, with more than 28%. Following this come wholesale and retail (see the chapters above mentioning the sell-off of the Czech distribution network), real estate, and research activities. FDI is present throughout the economy, including the monopoly sectors: Electricity, gas, and heating production and distribution.

Consequences of a dependent economy

In the previous chapter the path leading towards the development of a dependent economy has been outlined. One important thing needs to be repeated: It is possible to change a country's position within the international labour distribution, however, in order to achieve this, well thought-out strategic economic policies must be implemented. This process requires not only a thorough analysis of the domestic economy and its economic surroundings, but also the choice and usage of suitable economic instruments. The implementation of economic strategy can take decades and thus needs a consistent policy approach. Not surprisingly, the Czech Republic and its decision-makers lack all of these necessary preconditions.

There are various symptoms, or consequences, of the position of a dependent economy (or colony). The political factors are intertwined with the socio-economic, however in this chapter we pay more attention to macroeconomic factors. The following chapters will be devoted to economic management and decision making.

The consequences for 'modern colonies', which are so hard to overcome, can be divided into several categories:

- Low labour productivity, resulting in low wages which further penetrates the model of cheap labour. In this category the wage ceiling should also be mentioned, and crucial categories regarding the political economy – the division of product between employee compensation and gross operational surplus. Further issues regard long working hours and wage convergence.
- Outflow of dividends. Significant outflows of dividends from the Czech Republic signal the rapid maturing of foreign direct investment. These outflows also highlight the significant difference between GDP and GNI²¹. Widespread usage of transfer pricing means that hundreds of billions of CZK are not available for wages or investment.
- A tax system which resembles tax systems of developing countries. Low levels of taxation, an absence of property taxation, a disproportionately high burden placed on regressive taxes, such as VAT, etc.
- The strong resistance of decision makers and various 'stakeholders' against changes in the model. The longer the model 'works' (for certain groups), the more difficult it is to change it. In this context, it is also necessary to

analyse the phenomena of state capture and rent-seeking.

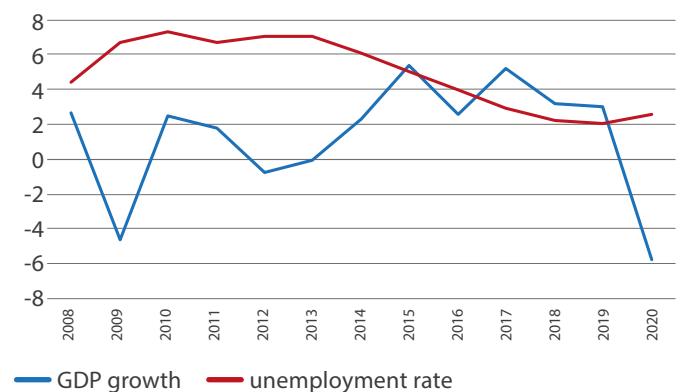
Let us first analyse the linkage between the value added in the economy and the labour market.

It is significant that for many years, in fact decades, the debate concerning the success of transformation was considered to be an almost 'unacceptable' topic. The transformation was a success, and that was all there was to it. Doubts or differences of opinion were a sign of 'communist' thinking and thus dangerous.

The issues regarding the wage gap between the Czech Republic and its more developed neighbours, such as Germany²² or Austria, were simply ignored. The right-wing governments which initiated dramatic fiscal consolidation, brought about a double recession. Luckily, this also prompted a strong resistance movement among citizens, which led to many demonstrations and debates about socioeconomic issues²³.

A strongly right-wing government was in power at the time when the economy was hit by the Great Recession. This government aimed at privatising the pension scheme, fighting against trade unions, and destroying the welfare system²⁴.

Figure 1 Development of GDP growth and unemployment rate, in %, 2008–2020.



Source: Czech statistical office

The government focused on fiscal consolidation, and during the election campaign it misused the topic of Greek debt, claiming that socialist governments 'would lead us to Greece'. The second recession of 2012–2013 was 'home-made' due to excessive cuts resulting in high unemployment and a rapidly worsening social situation.

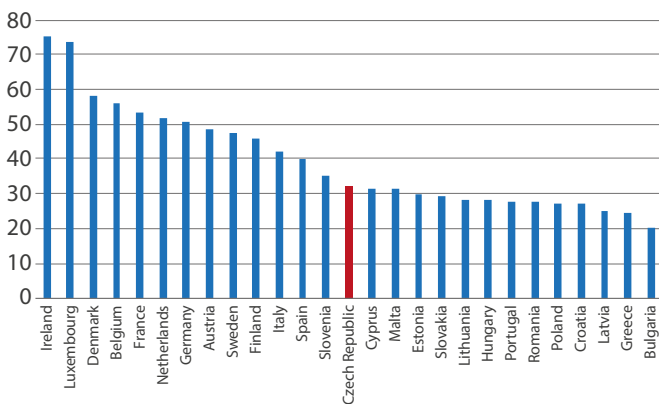
The positive results brought about by this situation included, not only the debates and increasingly open discussions about previously 'unacceptable' topics, but also the strengthened position of trade unions, which were the main actor in organising huge demonstrations against the government²⁵. Trade unions, especially the ČMKOS (Czech-Moravian Confederation of Trade Unions) deeply analysed the progression of economic development, and they were able to predict macroeconomic development much better than the government itself. This gave the ČMKOS credibility, and its position in society started to improve; it was not so often viewed as 'the enemy'.

Labour market and productivity

Debates concerning low Czech wages are usually monopolised by mainstream economists (ČMKOS 2021b), who claim that the low wages are due to low labour productivity. Productivity is a category that is often misinterpreted and, from the mainstream point of view, it has always been presented as a problem connected with low labour performance, but in reality, nothing could be further from the truth. This misinterpretation gives the impression that it is the workers who are to be blamed for the low wages – if they worked more, they would earn more.

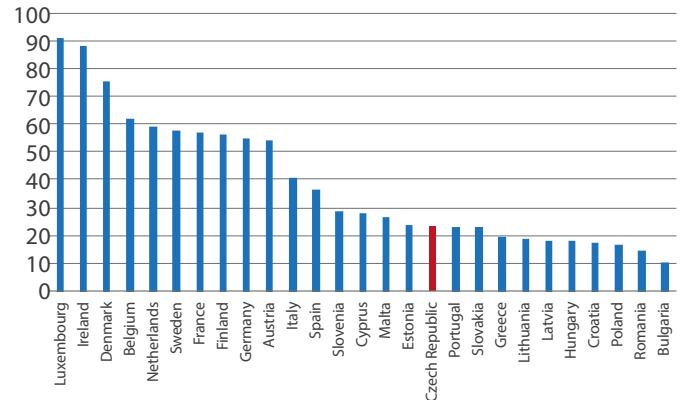
There are many indicators that can be used to measure labour productivity. One of them is GDP share (in PPP²⁶) to one working hour. However, when we try to analyse individual sectors, or companies, more deeply it becomes clear that measuring quantitative indicators of output would generate different results. Figures 2 and 3 display an example of how using different units can give different impressions. Figure 2, which is expressed in PPP, may be considered to be more ‘objective’. However, the GDP per working hour expressed in EUR corresponds more to the nominal wage level. The ranking displayed in Figure 2 (in EUR) will probably correspond to the reader’s expectations, with the most developed EU countries at the top, and countries in Eastern and Southern Europe nearer the bottom.

Figure 2 GDP per working hour, in purchasing power parity (PPP), as an indicator of labour productivity, 2019.



Source: Eurostat

Figure 3 GDP per working hour, in EUR, 2019.



Source: Eurostat

A typical example for comparison is the automotive sector, as it is so strongly present in the Czech economy. It would be nonsense to claim that the assembly lines in the Czech Republic are two and half times slower than in Germany, as labour productivity would suggest. The potential misinterpretation lies in the financial evaluation of the product. This evaluation can be done using PPP, or nominally in current prices using the current exchange rate. The difference between the results generated by these two methods is striking.

The aforementioned analysis by the ČMKOS led to the conclusion that there is one major factor which causes the variations in the expression of labour productivity, and that these variations are of high macroeconomic importance.

The most frequently given explanation is the products’ low level of technological sophistication. However, regarding the integration of Czech exports within global value chains and the influence of transnational corporations, it is improbable that this is really the case. The fact that the product has to be assembled from its parts (as a semi-product) into an automobile, or some other kind of machinery, shows that it has a high technological standard.

It is more likely that the major factor causing variations in the financial expression of labour productivity lies in the final price setting, which is controlled by the price maker. As the Czech Republic has a dependent economy, it finds itself under the wage ceiling. This means that Czech daughter companies of transnational corporations or even

(seemingly) independent Czech companies working as subcontractors for other transnational companies (thus participating in a global value chain) are not price makers, but price takers. The long distance from the Czech company to the final customer, mentioned in previous sections, supports this situation.

Being a price taker automatically results in a different type of economic behaviour. A strong reliance on exports (openness) to the world economy results not only in vulnerability, but also in a different attitude towards wages. In a more developed economy, wages are seen more as a source of domestic purchasing power. However, relying strongly on distant foreign markets and having little control over the development of the economy, means viewing wages as a cost. This type of thinking is one of the most persistent obstacles to wage development and wage convergence.

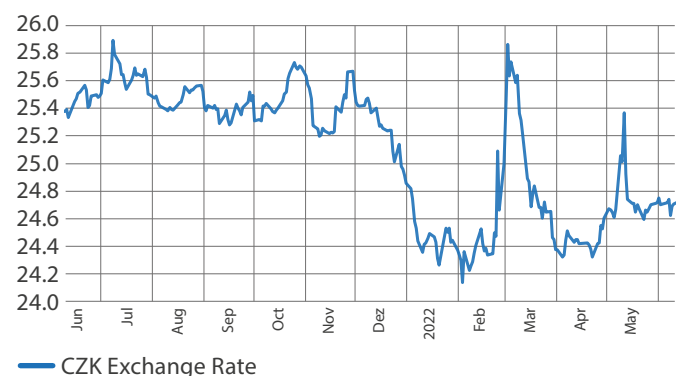
Of course, another important factor which at least partly explains the difference between the nominal indicator and PPP indicator of labour productivity, is the exchange rate. More precisely, the difference between the official exchange rate and the exchange rate according to purchasing power parity. In this context, it is necessary firstly to remember the disastrous consequences of the three deep devaluations in 1990. However, later, the Czech National Bank implemented the so-called 'asymmetric exchange rate peg', which was an instrument in the fight against deflation, and pro-growth. This monetary policy led to the depreciation of the CZK against the EUR to the level of 27 CZK to EUR. This policy was implemented from between 2013–2017.

In this regard, the economic reality of unequal involvement of Czech companies within the world economy, has been ignored. Theoretically, the depreciation of the CZK was supposed to boost exports. This assumption was highly doubtful, considering that Czech daughter companies are given specific details regarding production volumes, etc. This attempt to increase the volume of exports was rather naïve.

One of the results of this renewed depreciation for exporters was the accumulation of vast foreign exchange reserves which, unsurprisingly, did not play any strategic role in the modernisation of the Czech economy. Further consequences included the deformation of the exchange

rate channel. If the appreciation of the CZK against the EUR had been allowed to continue without depreciation, it would have put exporters under pressure, and could have contributed to the adjustment process in the value added, and thus in the whole economy. Instead 'time was frozen' once more, and companies continued with the economic model they were used to; prioritising cheapness.

Figure 4 The exchange rate Czech koruna (CZK) to EUR, period from 10 June 2021 to 10 June 2022.



Source: ECB

To summarise, low labour productivity is, in reality, the result of the transformation process. The mainstream reaction has been to blame the workers²⁷, rather than to accept the evidence. The ČMKOS stated that before the outbreak of the COVID-19 pandemic Czech labour productivity reached 37% of that of Germany, and nominal labour costs were 33%. This cannot be regarded as a failure of Czech employees, but rather as a failure of the transformation process and its decision-makers.

There is an ongoing fight between the forces that focus on wage convergence, and those that are afraid of changing the economic model and want to maintain it. The instruments used by right-wing oriented governments oscillate between direct attacks on: the minimum wage, trade unions, and the Labour Code. Recently it has been focused on attracting cheap foreign labour, which effectively contributes to wage dumping and loosening labour rights. Instead of restructuring, and promoting digitalisation and automation, energy is only put into providing cheap labour. The ČMKOS has presented the following vicious circle to illustrate the impact of failed economic policy:

Policies implemented endorsing cheap labour and undervalued currency – technological lagging behind – lower

manufacturing, subcontracting – lower evaluation of the product (economic structures as price takers) – lower value added – lower labour productivity – lower wages – policies implemented endorsing cheap labour and undervalued currency.

This vicious circle has become the backbone of the logic behind most Czech economic policies, and is also at the centre of the majority of political disputes.

The ČMKOS analysed the reactions of Czech employees to lower wages. One of the categories analysed was a comparison of working hours. The differences between the Czech Republic and Western European developed countries are striking, as shown in Table 10.

Table 10 Differences in working hours between CZ and Western European countries.

	Number of work days less than a Czech employee during one year (2017)	Number of working years more for Czech employees during their lifetime (2017)
German	59.4	11
Dane	51.8	10
Dutchman	48.9	9
French	36.7	7
Belgian	32.9	6
Swede	24.5	5
Austrian	23.4	4

Source: ČMKOS 2021b, p. 35

The indicator GDP per working hour in PPP shows an almost 19% difference between the Czech and German economies.

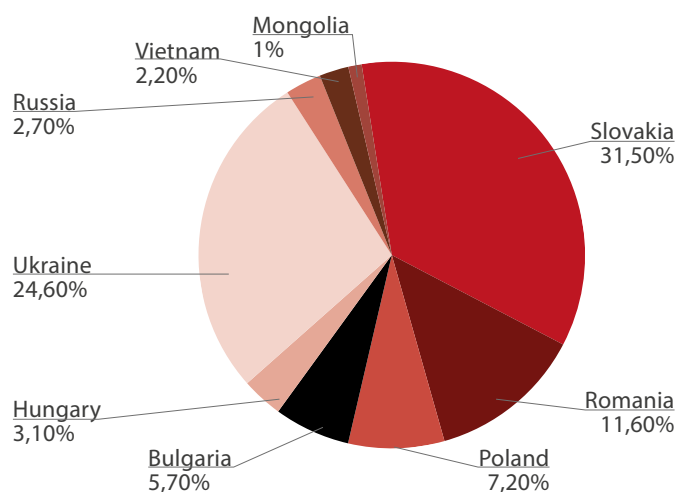
The much longer working hours confirm the extensive growth of the Czech economy, which corresponds to the 'need' to hire cheap foreign labour. There are disputes regarding the real number of job vacancies, as companies have the right to advertise a single vacancy several times. Thus, it happens that the same vacancy is presented, for example, three times, which may give the impression that the Czech Republic desperately needs a larger workforce.

Statistics from the Ministry of Labour and Social Affairs (data collected until the end of February, 2022) show that there are about 360,000 vacancies. Basic education, which in some cases does not need to be completed, is the only requirement for 260,000 of them (ca. 72%). This gives a true picture of the economic structure in the Czech Republic. It is clear that the economy is growing extensively and relying on numerous cheap workers working for extremely low wages, often near the minimum wage.

Wages and working hours are thus closely linked. Shorter working hours, given the structure of the Czech economy and preferences of policy makers, would result in pressure to find more workers, and lead to the further import of cheap foreign workers. The extensive growth of the Czech economy has created a firm link between low wages and long working hours.

Figure 5 shows that there were almost 650,000 foreign workers in the Czech Republic in 2020. About 60% were from the EU, and the largest groups were from Slovakia and Ukraine. In comparison to the other Visegrad countries, the number of foreign workers is very high. In 2018, prior to the pandemic and the conflict in Ukraine, the number of foreign workers exceeded 12% of employees. In Poland, Hungary, and Slovakia the proportion of foreign workers is about three to four times lower (ČMKOS 2021b).

Figure 5 Composition of foreign workers, in the Czech Republic, 2020.



Source: ČMKOS 2021b, p. 29

Regarding political economy, few indicators are more valuable than the comparison of gross operational surplus, and employee compensation. These two indicators show how output is divided between labour and capital. The weak position of labour is reflected in low employee compensation (in comparison with developed Western countries), and has its roots in the Washington Consensus policies.

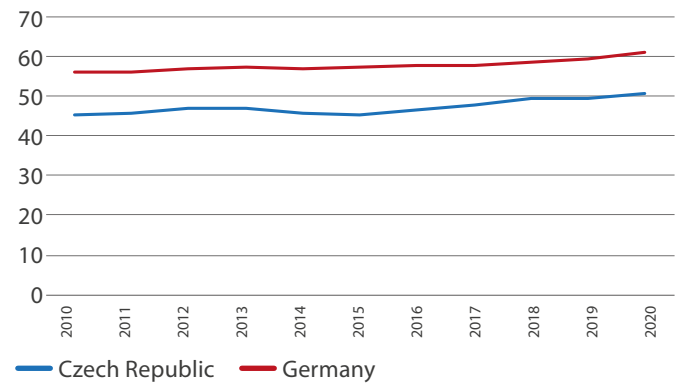
More specifically, at the beginning of the transformation there was a general agreement between the government, the trade unions and the employers that, according to economic expectations, real wages would fall by about 10%. However, the real inflation rate was much higher than predicted, so real wages fell by more than 26% in 1991.²⁸

The government did not react, and thus, from the start of the transformation process, the fall in wages became a 'wage cushion' which was further supported by restrictive fiscal and monetary policy, and wage regulation. The minimum wage was set below the level of life minimum. Due to the combination of these factors, low wages penetrated the Czech economy and, together with the exchange rate cushion, created the 'ideal' Washington Consensus environment of neoliberal policy. Low wages translated into a fall in employee compensation, and increase in gross operational surplus (profits) of companies. This was the start of the process in which low wages 'subsidised' the extremely high profits of companies, which was later reflected in the outflow of dividends, and extensive usage of transfer pricing.

The division of value added in the Czech Republic is actually reversed in developed countries, where the compensation of employees usually exceeds 50%. The low share of compensation for employees from the value added meant that the profits were extremely high, and being exported abroad. This is a typical feature of a colony.

It is important for the reader to understand the interconnectedness between the steps taken and measures involved in the transformation policies, as together they have created a system that is very difficult to alter. It is not possible to criticise only one aspect of the transformation process without criticising others which are interlinked, and also considering the future effects on the whole of the economy and, of course, society as well.

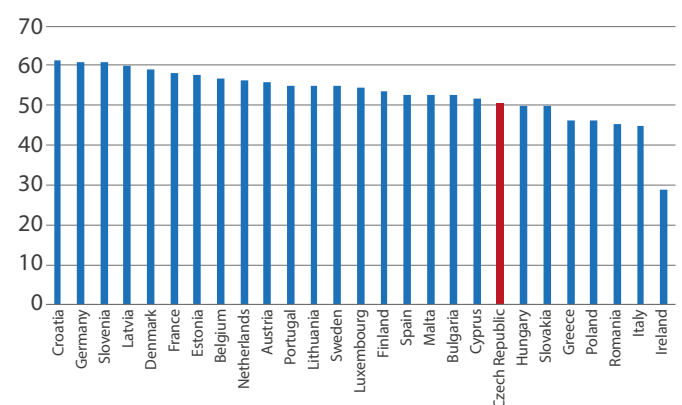
Figure 6 Compensation of employees, as % of value added, in the Czech Republic and Germany, 2010–2020.



Source: Eurostat

International comparison does not look good for the Czech Republic, despite the fact that during the years preceding the COVID-19 pandemic, there was a certain amount of wage convergence which was due to a combination of factors: The Social Democrat Party government (as a junior partner), pressure from KSČM, political tolerance, pressure on the labour market resulting in an increase in wages, ČMKOS's successful campaign: *Konec levné práce* ('End of cheap labour'), and an overall positive macroeconomic environment. Unfortunately, this positive trend was reversed with the breakout of the pandemic, due to the economic changes made during the crisis (see in later chapters). The inflow of Ukrainian refugees, as the result of the Russian military operation (invasion) in February 2022, was welcomed by the Czech employers and government, as an inflow of cheap labour to fill the vacancies mentioned above.

Figure 7 Compensation of employees in the EU, in % of value added, 2020.



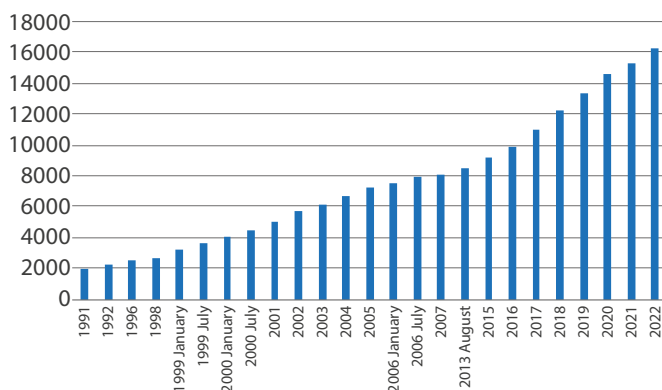
Source: Eurostat

There are several instruments which could be used by the state to support the wage level. Some of the more direct instruments include the setting of the minimum wage and salaries in the public sector (creating competition between the private and the public sectors), and the conduct of tripartite sessions. Further instruments are connected with structural policy (for example cancelling investment incentives such as Amazon, connected with jobs), active support of modernisation of the Czech economy, and enacting laws to boost employee participation. However, none of these can be expected from the current right-wing government. On the contrary, employee compensation is expected to fall dramatically, and wage convergence will also probably be reversed.

Figure 8 shows the development of the minimum wage. At times it was doubted whether the function of the minimum wage was necessary, highlighting the ideology of neoliberalism in which the individual negotiates their own wage.

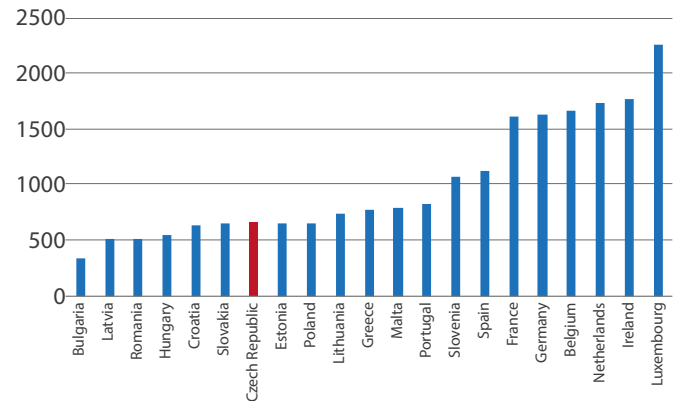
Noteworthy is the period of 2007–2013, when there was a strongly right-wing government, and the minimum wage did not increase at all. During this period of serious economic problems, partly connected with the impacts of the Great Recession, the government froze the minimum wage, which effectively removed its function. It was so low that it could not serve as protection for low-income workers. As for the current situation, there is still no pattern or formula to guide setting the minimum wage. It remains a subject for negotiations in the tripartite format, it should not be expected that the right-wing government will focus on increasing the minimum wage, despite the fact that inflation rates are very high, and the economic situation is worsening rapidly.

Figure 8 *Development of the minimum wage, in CZK, 1991–2022.*



Source: Ministry of labour and social affairs

Figure 9 *Minimum wage in the EU, in EUR, 2022.*



Source: Eurostat

Regarding the comparison of the minimum wage among the EU countries, it first has to be stated that not all EU countries were included, as there are some that have different institutional schemes (e.g. negotiations in the sectors via sectoral trade unions) and do not have minimum wage.

However, we can clearly see that the Czech Republic is one of the countries with the lowest minimum wage. The minimum wage is higher in some countries that have lower GDP per capita than the Czech Republic.

Before tackling the specific issues concerned with ‘wage convergence’, it is necessary to define and explain the term and look into its theoretical framework. To understand the term ‘convergence’ better in the EU context, the report by Eurofound (Mascherini et al. 2018) provides a useful guide. In the study, published before the COVID-19 pandemic, the authors state that convergence is a crucial term for the political legitimacy of the EU and for its social stability. To converge actually means to have the same direction. Statistically we could say that it means to decrease the distance separating two trends.

In economics, we distinguish between nominal and real convergence. Nominal convergence is connected with the economic and monetary union. Real convergence is connected with economic and social variables in real terms, such as GDP per capita or the analysis of productivity.

It is also important to pay attention to the time horizon; the convergence process cannot be declared on behalf of one indicator only. The Eurofound study states that in the period between 2005–2017 there were growing disparities

among countries. Upward divergence was seen in Austria, Denmark, Finland, Belgium, and Luxembourg. There was downward divergence in countries including Greece, Croatia, Hungary, Poland, and Cyprus.

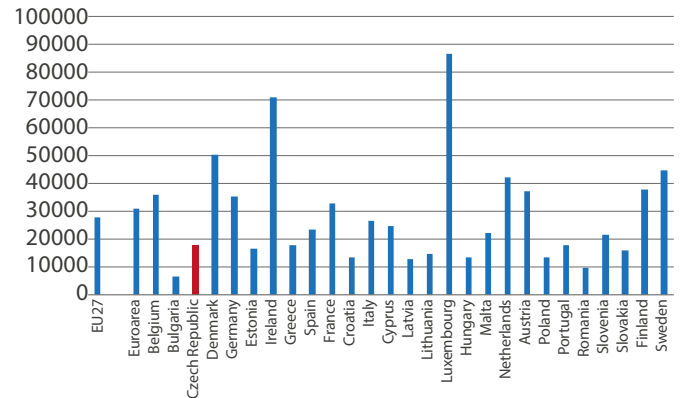
The study also states that the divergence was greater in the euro area. One of the key findings of the study is that social convergence does not automatically result in economic convergence.

From a theoretical point of view, taking the neoclassical model, wage convergence is connected with conditions necessary for equalising products' prices. There are two major factors influencing these conditions, and these are free trade and the mobility of factors. There is a free market in the EU. Despite the strong inner EU market, there are huge wage differences. Another study (Naz et al. 2017) found that average wages in the EU do not converge. Borders matter, which means that labour markets are, despite mobility of production factors and free trade, separated.

A further study (Goecke & Hüther 2016) found that it is the manufacturing industry, along with EU subsidies and their direction, which are important for convergence. Both these factors increase the probability that a region will converge with more developed regions. This study uses GDP per capita as an indicator of convergence. The authors came to the conclusion that GDP per capita decreases from west to east, and from north to south, establishing two de facto

peripheries in the EU – the southern and the eastern periphery.

Figure 10 GDP per capita, in EUR, 2021.

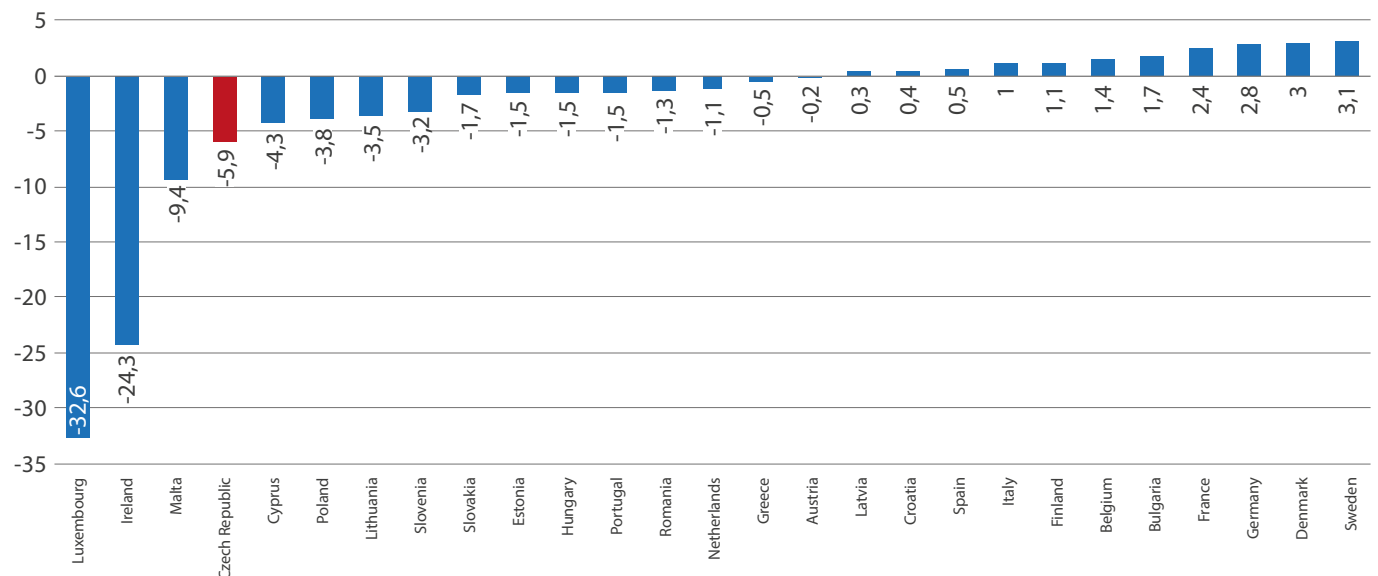


Source: Eurostat

Regarding GDP per capita, it must be stressed that it does not necessarily reflect wage level. For countries like the Czech Republic with large outflows of profits, the differences between GDP and GNI are substantial, decreasing the information value of this indicator.

Figure 11 shows that, regarding the difference between GDP and GNI, the Czech Republic is one of the countries with the widest gap; 5.9% for the year 2020. This difference between GDP and GNI is one of the consequences of the considerable profit outflows of the Czech Republic, which will be dealt with in detail in the following chapters.

Figure 11 Difference between GDP and GNI, in % GDP, 2020.



Source: Eurostat

Further research (Metiu 2015) (all research concluded before the pandemic) agrees with the conclusion that there is no real convergence in the EU. Instead, convergence clusters are described which resemble groups of the ‘old’ and the ‘new’ EU members. Convergence has a strong **geopolitical** dimension, and the countries of Central and Eastern Europe are on an altogether lower trajectory.

The Centre for European Policy Studies (CEPS) (Alcidi et al. 2018), a European think-tank, agrees that convergence within the EU has been used as a basic economic mechanism, and a condition for reaching socio-economic cohesion. CEPS states that the countries of Central and Eastern Europe are in the lead in the process of convergence, whereas countries in Southern Europe are developing at a below-average rate, and their position is worsening. However, the authors see huge differences between developed countries, and the Central and Eastern European countries, focusing on the disparities between capital cities and the rest of the corresponding country.

A World Bank study (Ridao-Cano & Bodewig 2018) acknowledges the importance of **geopolitical** position for the convergence process. Labour mobility is very low and does not serve as a channel of adjustment, and labour market integration is also low²⁹. The study does not however distinguish between the position of Central compared to Eastern European countries. Eastern European countries are, in most cases, at risk of losing their professional labour force (for example doctors).

A recently published study by Eurofound (Mascherini et al. 2021) discusses the effects of the pandemic. The study stresses the importance of institutional quality, which was shown to be very important during the pandemic. The authors claim that institutional quality will be the factor which channels economic convergence into social convergence. The importance of using the right political tools will also be important for further EU plans such as digitalisation and the green transition³⁰.

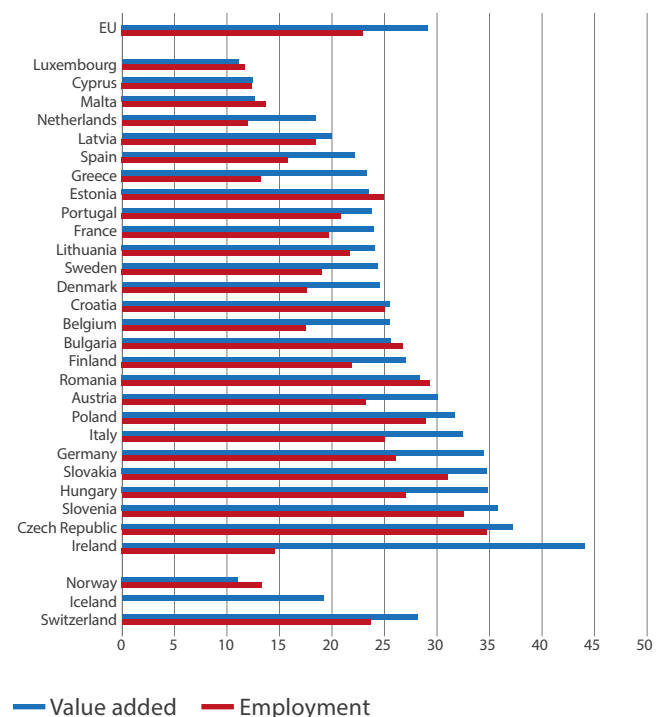
The situation in the Czech Republic is unique given that it neighbours Germany, which is the engine of economic integration within the EU, and in addition the Czech Republic contains a large proportion of the manufacturing industry. This should represent good conditions for the convergence process. Although workers do not leave the Czech Republic in

massive numbers (unlike in the Baltic states, which have lost a sizeable part of their population), the wage curtain corresponds to our western, and partly also southern, borders.

Figure 12 shows the exceptional position of the Czech Republic regarding manufacturing. Eurostat data shows that, regarding manufacturing, the Czech Republic together with Slovakia have a higher than 37% share of manufacturing on the value added. These countries are only surpassed by Ireland. As for employment, the Czech Republic has the highest share of all EU countries, 35% of Czech employees work in the manufacturing sector. The importance of the Czech manufacturing sector has historical roots, originating in the Austro-Hungarian Empire, where the Bohemian countries served as an industrial backbone.

The strong position of the Czech manufacturing sector has advantages, which are reflected in the high absorption of employment. The Czech Republic has low rates of unemployment, and even during the pandemic there were many vacancies (although as discussed previously, the quality of such employment is very low, associated with a low level of qualifications and thus also low wages).

Figure 12 *Relative importance of manufacturing in the EU, using the indicators of % share of value added and employment (NACE Section C), 2019.*



Source: Eurostat

It is difficult to understand what the position of 'most Western of the Eastern countries' could mean for the Czech Republic. The proximity to Germany could mean that Germany has interest in the political stability of the Czech Republic, this is however very different from upward wage convergence.

Maintaining 'attractive' wage differences in order to retain **geopolitical** closeness to the EU core, is neither the way out of the middle-income trap, nor out of the colonial position. This becomes especially clear in the context of the COVID-19 pandemic, and the current changes in the world economy due to the conflict in Ukraine.

There is a threat that trends such as reshoring and regionalisation (see further chapters) could result in financial capital being removed back to its home country. This could result in the Czech Republic becoming a country used for obsolete technologies.

To sum up the issue of convergence:

- **Geopolitical** position matters. The EU contains two peripheries; the southern and the eastern.
- Economic convergence does not secure social convergence, or wage convergence.
- Insufficient upward economic convergence is viewed as a European problem, threatening the political legitimacy of the EU.
- The neoclassical approach towards equalising incomes does not correspond to reality. Relevant studies show that borders matter and labour markets are separated. Wage differences cannot be solely explained by language or cultural barriers.

FDI, outflow of profits and transfer pricing

Foreign direct investment (FDI) is usually regarded as the ‘best’ of the various financial capital flows. FDI can overcome a lack of domestic capital, introduce new technologies, and upgrade the position of the domestic economy. However, there are various risks connected with FDI. It would be naive to presume that FDI, the main tool of transnational corporations, intends to modernise the host economy. It serves as a tool of economic expansion and control. Time is once more a crucial factor. The benefits of FDI decrease with time, whereas the costs increase. It is important to analyse the speed at which FDI maturing is reached, i.e., the point in time when outflows surpass the inflow of new investment, or reinvestment. This has happened early in the Czech Republic, FDI maturing occurred during the period between 2006–2007. Since then, the outflow of profits from the Czech Republic has been significant. There are various consequences of these outflows. Macroeconomically, they highlight the difference between GDP and GNI, as outlined in the previous chapter. The outflow of profits also signals that there are less resources for domestic wages, or investment.

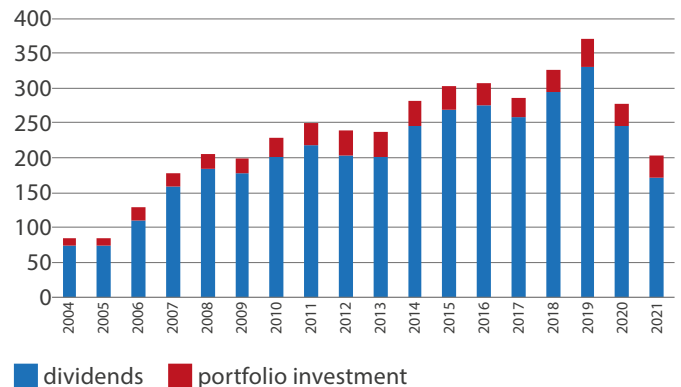
Figure 13 offers a long timeline describing the progression in the outflow of dividends (income from FDI). The timeline shows a trend in rising profits that are transferred abroad. The Figure also shows the outflow from portfolio investments, which is considerably lower, but also contributes to the loss of resources from the domestic economy. For ten years (excluding the pandemic years), the outflows have ranged from between 5-6 % GDP. The results of the pandemic, and recommendations made by the Czech National Bank (ČNB 2021) to restrain dividend payments, influenced the relatively low outflow of dividends in 2021.

It should be stressed once more that these statistics are derived from official data within the Czech National Bank database. However, outflows via transfer pricing and other methods of withdrawing money³¹ from Czech daughter companies, reach about 300-500 billion CZK on average, according to estimates. This would mean that the outflow of financial resources from the Czech Republic may exceed 10% GDP.

Such statistics should have been a key topic of discussion. And yet, ideological anchoring of governments which held up the premise of a successful transformation, never really allowed for an open macroeconomic debate. In the past

few years this topic has gained prominence, albeit with a severe time delay, however, there have been no macroeconomic changes in the direction of, for example, using the arm’s length principle for transfer pricing, or creating a specialised unit in the Ministry of Finance. In the election programmes for the parliamentary election in 2022, the topic of dividends and their outflows was present, however there were no concrete proposals, and nothing is being prepared by the Ministry of Finance regarding this topic.

Figure 13 *Outflow of dividends and income from portfolio investments, in billion CZK, 2004–2021.*



Source: Czech national bank, ARAD, Balance of payments statistics

It also makes sense to take reinvested earnings into account. Reinvested earnings cause many serious impacts on: The capacity of the economy, its development over time, and implementation of incentives for increased reinvestment.

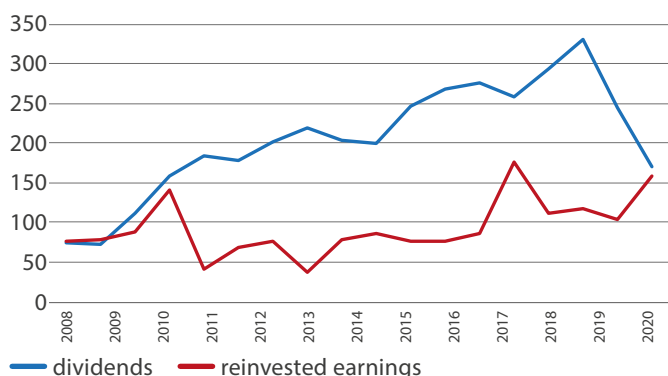
Figure 14 shows how fast FDI maturing in the Czech Republic³² occurred, and the size of the gap between the outflow of dividends and reinvested earnings.

Ten years ago, the Czech National Bank (ČNB 2012) admitted that reinvested earnings³³ were the biggest source of ‘new’ FDI in the Czech Republic. It was stated that the increase in outflows in the years of the Great Recession was connected with the lack of liquidity in mother companies (especially the banking sector). Furthermore, the CNB claimed that the decrease in reinvestment was one of the major reasons for the fall in the economic potential of the Czech Republic.

Ten years ago, the CNB stated that the potential for further privatisation seeking, FDI, and massive greenfield FDI had

been used up, as there were hardly any lucrative enterprises left for privatisation by foreign hands. Surely, this should have prompted a serious debate concerning the future of the Czech economic model.

Figure 14 Outflow of dividends and income from portfolio investments, in billion CZK, 2008–2020.



Source: Czech national bank, ARAD, Balance of payments statistics

The ratio of the current account balance to GDP is one of the most important indicators of external balance. Figure 15 presents data collected since the Czech Republic joined the EU, in 2004. The transformation period of the 1990s is associated with deep current account deficits. These deficits occurred for several reasons, starting with the fixed currency regime which did not correspond to economic reality (at least after 1995). Added to this was the low export performance regarding the value added, and an overall imbalance between the aggregate demand and supply. An in-depth analysis was presented in previous sections.

However, after 2000 the reasons for current account deficits changed in nature. The current account consists of four accounts; goods, services, primary, and secondary income. Although the balance for goods (and sometimes also services) was often positive, the main problem has been the primary income account. The primary income account is concerned with interest and dividends, and thus mirrors the flows of capital and labour. In the case of the Czech Republic, the primary income account often outweighed the surpluses achieved in goods (and services).

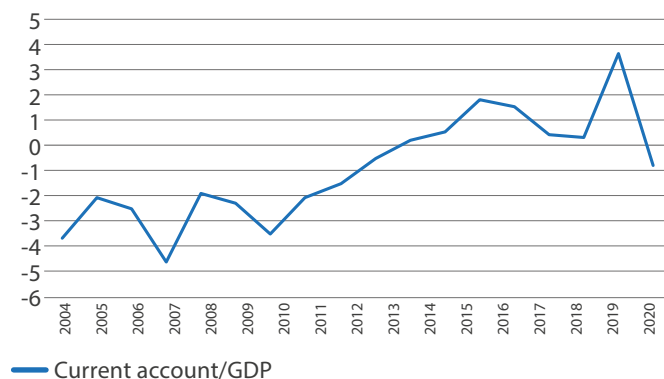
The outflow of profits from the Czech Republic continues to be a factor which threatens the whole external balance of the country. This is, in itself, a vicious circle – FDI contributes to exports, but at the same time FDI generates profits that

are withdrawn from the country. As previously described, Czech companies do not have sufficient economic power to influence exports. A wage ceiling exists for many of these companies, and they are distant from the foreign consumer of their products, therefore the value added corresponds to their dependent position in global value chains.

The years in which the current account had a positive balance correspond to favourable economic development; when exports were sufficiently high to compensate for the outflow of dividends from the country (as illustrated in previous figures). Development in 2021 was strongly influenced by the increase in commodity prices, especially oil and gas.

It is clear that in the model of FDI contributing to exports but also to profit outflow, changes have long been overdue.

Figure 15 Ratio of the current account balance to GDP, in %, 2004–2020.



Source: WEO Database, April 2022

A summary by Septimiu Szabo (Szabo 2019) provides an overview of the importance of FDI in the Czech economy. The author acknowledged the especially strong and important position of FDI in the Czech economy. He recounts the various incentives that the government has implemented, both for greenfield and brownfield investments. Investment incentives have lately been criticized, but the Ministry for Industry and Trade has been under steady foreign pressure not to abolish them. Incentives include tax relief, subsidies for jobs, and discounts for landed property.

Compared with the other V4³⁴ countries, the Czech Republic does not have any sectoral tax, and the right-wing government strongly opposes this idea.

Szabo acknowledges that the high outflow of profits has been a central theme in the domestic economy debate (to which the author of this book proudly contributes). Szabo also acknowledges that in the EU and OECD, the rate of return is one of the highest (see later). Szabo claims that 'since the EU accession, two thirds of total annual FDI income has been distributed as dividends.' Szabo also discusses the large gap between GDP and GNI, and concludes that this phenomenon is linked to FDI. Although Szabo regards the FDI outflow as 'natural', regarding profit seeking and the life cycle of investment, he also perceives that outflows are much higher than in the other V4 countries.

For the Czech Republic, the most important investors come from the EU; EU investments make up about 85% of FDI (this highlights the failure to develop extra-EU economic diplomacy, and to diversify exports). The most important investor countries are the Netherlands³⁵, Germany, and Luxembourg. Considering the non-EU countries, the US, Japan, and South Korea also provide FDI. Major investors who repatriate their profits to the largest extent are the UK, the Netherlands, and Switzerland. From the sectoral perspective, Szabo reveals that outflows from wholesale and retail are especially high. The amount of dividends distributed in the Czech Republic since 2004 reaches 100 billion EUR, making it the country with the largest amount in Central and Eastern Europe.

Key areas of FDI placement, according to Szabo, are the financial and insurance services, along with wholesale and retail, which has a dramatic impact on the Czech Republic's food self-sufficiency (see later). Szábo notes the dominance of Prague, which has serious political consequences, including the popularity of strongly right-wing parties (see the following chapters). Prague accounts for more than half of FDI stock, and also enjoys a relatively high share of reinvestment. The position of other Czech regions is substantially weaker. Prague is the centre for the service sector (especially finance), although the manufacturing sector is more evenly distributed around the country.

The official outflows from the Czech Republic are huge, even by international comparison, but there is also the problem of transfer pricing. Transfer pricing is another channel through which transnational corporations withdraw money from the Czech Republic. There are no official statistics, but transfer pricing has become such a problem that it was

widely discussed (even by right-wing parties) in the political programmes³⁶ preceding the elections. The banking sector is probably worst affected by this problem, gross estimates amount to 300-600 billion CZK per year in transfer pricing.

There are various methods of using transfer pricing. The foreign mother company may, for example, own the headquarters residence (in Prague), and force the daughter company to pay excessively high rent. Further methods include consultations (which can comprise practically anything), software, costs connected with intellectual property, etc.

Transnational corporations are responsible for a high share of the economic performance in the Czech Republic. The current data from the investment position reveals that the share of FDI stock to GDP was 82% in 2021; an unusually high share compared to Western European countries. Furthermore, the backbone of the Czech economy – the manufacturing sector (82.5%), especially the automotive industry (98%), – is dependent on transnational corporations (ČMKOS 2021b, 62).

Transnational companies, as has already been mentioned, would be able to implement research and development in the Czech Republic, however, they are more inclined to keep the activities with the highest value added in their own domestic economy. Table 11 shows, by sector, that although transnational corporation research and development expenses are not high, they still exceed the expenditure on research and development by domestic companies. This results in lower productivity for domestic companies, and causes the Czech Republic to lag behind developed countries even more.

Table 11 highlights many striking differences, especially in the automotive industry, which is the most important sector for the Czech economy. This fact is also supported by data provided by Coface (Coface Central Europe, 2020). It is very difficult to find a truly 'Czech' company in the ranking list. In second place, we see Škoda Auto (which of course belongs to the Volkswagen Group). Further down the ranking is the state company ČEZ³⁷, and also the state company Čepro³⁸, which could play a larger role in the current energy crisis, but the government is simply not capable of pursuing the required policies.

Table 11 Research and development expenses, by sector and ownership, in million CZK, 2019.

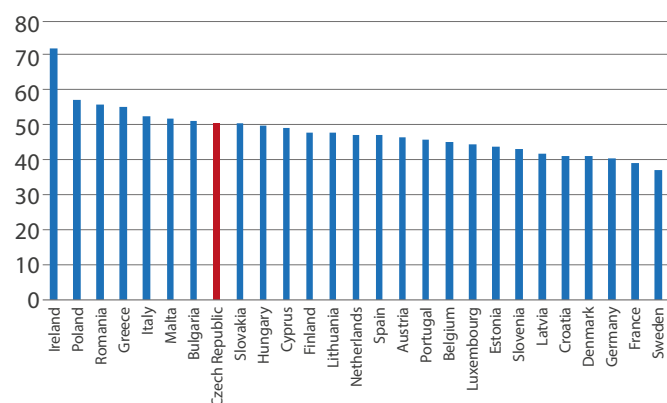
	Expenses for research and development	According to ownership		
		Public	Private domestic	Private foreign
Manufacturing total	36961	143	10415	26403
Chemical industry	1161	93	619	448
Pharmaceutical	1250	0	202	1048
Production of metal constructions	1566	1	1109	457
Computers, electronical and optical devices	3549	13	1573	1963
Electric machinery	4627	-	1179	3449
Automotive	13312	-	451	12861
Other transport vehicles and machinery	2898	-	1152	1746

Source: ČMKOS 2021b, 3

In previous sections we presented employee compensation as a key convergence indicator. Gross operational surplus is a reversed mirror image of this indicator. The EU comparison in Figure 16 shows that the Czech Republic is one of the countries with a relatively high gross operational surplus, which is also reflected in the extremely high rate of return shown by Eurostat, illustrated in Figure 17.

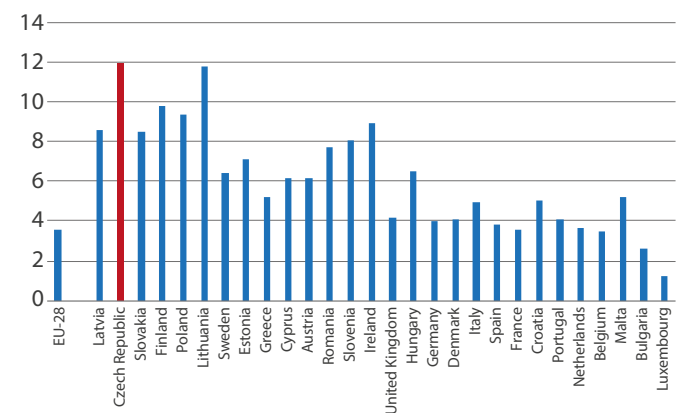
Figure 17 displays a comparison of the rate of return³⁹ in the given economy (in this case in the Czech Republic), the data was generated by non-EU members. The EU average rate of return is 3.6%, which emphasises the record high rate of return in the Czech Republic of 12%, followed by Lithuania with 11.8%.

Figure 16 Gross operational surplus, in gross value added, EU, 2020.



Source: Eurostat

Figure 17 Rate of return on FDI in domestic economy, in %, 2017.



Source: Eurostat

The combination of high outflows of dividends, the widespread use of transfer pricing, and extremely high rates of return, has led to the description of the Czech Republic as ‘the feeding-rack’ of Europe, which is not surprising.

The tax system and its distortions

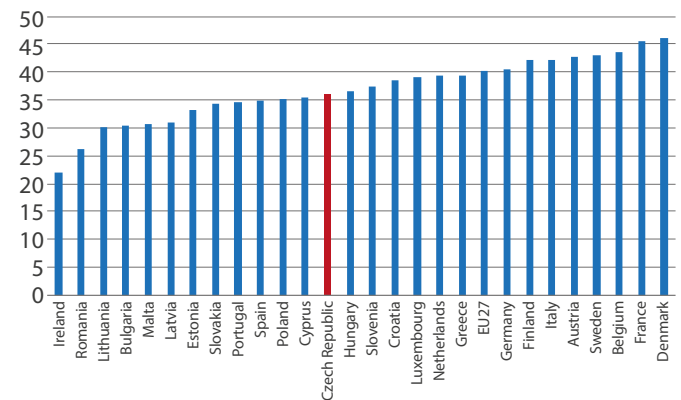
It is not the aim of this chapter to analyse the tangled development of the Czech tax system in detail. The right-wing narrative, which dominates the media, describes taxes as ‘punishment’ and states that they should remain as low as possible. Right-wing governments have abolished progressive features in the tax system, tried to introduce a flat tax system, privatised the pension scheme, and implemented private healthcare. Their efforts have been relentless, and are being continued by the current strongly right-wing government.

An overall description of the Czech tax system needn’t be long: the tax system relies heavily on the taxation of employees and on regressive taxation (VAT), it hardly includes any property tax, and the progressive features are very weak. The low tax rate has not enabled a strong welfare system, but despite this the right-wing constantly claims that the welfare state is ‘too generous’ and needs to be made leaner.

As the COVID-19 pandemic forced governments to react and implement new measures, in some cases to abolish or temporarily change their tax, it makes more sense to compare the tax systems for the year 2019, as presented in the data generated by Eurostat.

First, let’s look at the tax revenue (including social contributions) to GDP in percent. The Czech Republic clearly belongs to a group of lower tax countries when compared with the EU27 average – the difference is four percentage points. Future predictions by the study *Taxation trends in the EU* considers the vast changes that were implemented during the pandemic (and very often had nothing to do with the pandemic, as the pandemic was misused by various lobbyist groups to introduce tax changes that benefited them). The Czech Republic, together with Hungary and Denmark, is predicted to lose three percentage points of taxation revenue for 2020, 2021 and 2022.

Figure 18 Tax revenue to GDP, in %, 2019.



Source: Eurostat

Thus, it is important to stress that the Czech Republic had a relatively low tax revenue before the pandemic, but due to the changes made during the pandemic it is now expected to join the countries with the lowest levels of taxation. Although the fact that the low tax revenue is not compatible with the establishment of a strong welfare system is a problem, a worse problem is the complete lack of tax justice and the vast amount of tax distortions that are present in the tax system.

Regarding the classification (Eurostat 2021a) of direct and indirect taxes, and social contributions, we find that the Czech Republic has almost the same indirect taxation as the EU27 average (lower by 0.6 pp). However, there is a huge difference in the direct taxation category. Here, the difference between the Czech Republic and the EU27 average is a whopping 10.1 percentage points! This is partly the consequence of tax dumping being one of the elements of competitiveness prescribed by the Washington Consensus. It is the enormous share of social contributions that compensates for the very low level of direct tax. Within the tax systems of both Slovakia and the Czech Republic, the highest percentage share is made up of social contributions.

A further look into top personal income tax rates⁴⁰ reveals the experimentation with the flat tax regime in the Czech Republic. In the year 2019, the Czech Republic was one of the countries with the lowest top personal income tax rate of 15%. Similar or lower rates were seen in Bulgaria and Romania (10%), and 15% in Hungary. A simple average for the EU27 is 39.2%, which is a striking difference.

The system of the flat tax rate was presented as a truly motivational system, as it does not ‘punish the rich’ for their extraordinary achievements, nor does it discourage working. Although such neoliberal arguments may seem obsolete, they still constitute a huge part of public discussions regarding tax in the Czech Republic.

To illustrate the nature of the tax system in the Czech Republic, along with the associated decision-making process, let’s have a look at the super-gross wage, a unique tax.

In 2008, the right-wing government, true to its neoliberal beliefs, overhauled the tax system by implementing the flat tax rate of 15%. In contrast to prior expectation, it was to be applied only to natural persons. The progressive tax system (four brackets from 12% to 32%) was thus abolished.

It is remarkable that right-wing parties, which have always used the aggressive rhetoric ‘we belong to the West’ and despise everything from the East (for example, China), introduced an instrument that was typical of the Russian economy and also of other less developed economies (Bulgaria and Romania). For Western countries, progressive taxation is typical rather than the flat tax rate concept, although in many Western countries the progressive features are mitigated.

However, the biggest change, and an unparalleled tax distortion, was connected with the tax base. The political promise of ‘a motivational and low’ tax rate for both employees and the self-employed clashed with reality regarding the state budget. It was obvious that the state budget, which is built on employee taxation, wouldn’t be able to absorb such a shock without generating persistent deficits. It was thus decided that the tax rate of 15% had to be maintained, as it had been a political promise, but the tax base was also ‘widened’. Super-gross wage means that the employee’s income tax base was the employee’s gross salary, but with the addition of the social and healthcare contributions paid by the employer. The employee’s income tax base is thereby broadened, so that effectively the employee must pay tax on a tax. In reality, the tax rate was not 15%, but surpassed 20%, although the self-employed really got the 15% flat tax rate.

The criticism towards this special construction, which was contradictory to all theories and rules regarding tax, grew

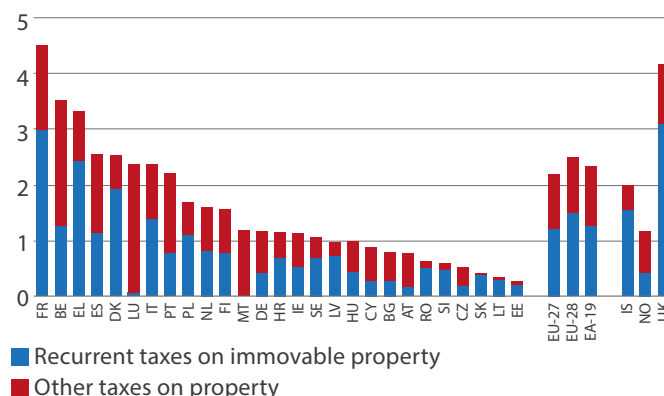
with time. Paradoxically, even those who implemented it became fiercely critical of this measure. This has become a political issue, yet the different political parties and their representatives disagree about what the abolishment of the super-gross wage should look like⁴¹.

The reasons given to justify this change were a farce. Supposedly, the purpose of the super-gross wage was to inform employees about the cost they represent for their employers, and once the employees had learnt how expensive they were, it would be possible to return to a simpler taxation method.

The story of super-gross wage does not end here, as it really was abolished, but probably in the worst possible way. The pandemic was used as a framework for implementing changes that would never have been accepted under normal circumstances. The abolition of super-gross wage, and its substitution by two rates, is responsible for the biggest loss in tax revenue of all the changes implemented during the pandemic.

Figure 19 illustrates a further distortion in the tax system of the Czech Republic. Property tax held a practically insignificant role even before the pandemic, which again provides a dramatic contrast to the EU27 average. The pandemic was used for the abolition of one of the remaining property taxes – real estate acquisition tax. This tax⁴² was abolished (during a state of emergency), resulting in the loss of about 18 billion CZK and the eradication of almost all property tax.

Figure 19 Composition of property taxes by EU Member State, % of GDP, 2019.



Source: Eurostat

A closer examination of the national tax system reveals that the largest source of tax revenue is in social contributions (15.5% GDP), followed by VAT (7.6% GDP). Regarding economic function, it is labour that is the most highly taxed. Labour taxation is divided into being paid either by the employer, or by the employee (10.0% GDP, 7.9% GDP). There is also the category of self-employment, which accounts for only 1.2% tax revenue to GDP.

Data generated by Eurostat (Eurostat 2022a) shows that the Czech Republic has one of the highest shares of self-employment among the EU members. Regarding the proportion of the self-employed without employees, the Czech Republic is the fourth highest, following Greece, Poland, and Italy. There are numerous reasons for this. It can be an additional source of income for the household, for example. However, in the Czech Republic the *švarc-systém*⁴³ ('Svarc system') has existed for decades. The name is derived from the entrepreneur, Švarc, who first developed the system, which focuses on false self-employment of employees who are actually working for an entrepreneur. In this manner, the entrepreneur does not have to pay social contributions or healthcare contributions for their employees, which becomes the burden of the 'falsely self-employed'. This method is actually prohibited, although it is still used in many professions. Journalism is a typical example, often 'self-employed' journalists carry out almost all their work for a single publisher. Considering the high level of self-employment, we should not forget that low wages have led to a model of intensive work with long working hours. The self-employed enjoy special tax treatment; the most recent changes made to the tax system (implemented during the pandemic) mean that the self-employed can choose between three tax regimes, and that their tax report is practically needless, as control is almost impossible.

When discussing taxation, the issue of deficits and debt cannot be omitted. The topic of debt has always been of major concern for right-wing parties (and sometimes even for those of the nominal left, when they wanted to show that they were 'responsible', or wanted to distance themselves from the 'communist past'). The topic of debt has been misused for political gain many times, one of the most significant cases was the crisis in Greece. The right-wing parties grasped this opportunity and claimed that the social-democratic government would lead towards a similar situation as that in Greece, and that state bankruptcy was imminent un-

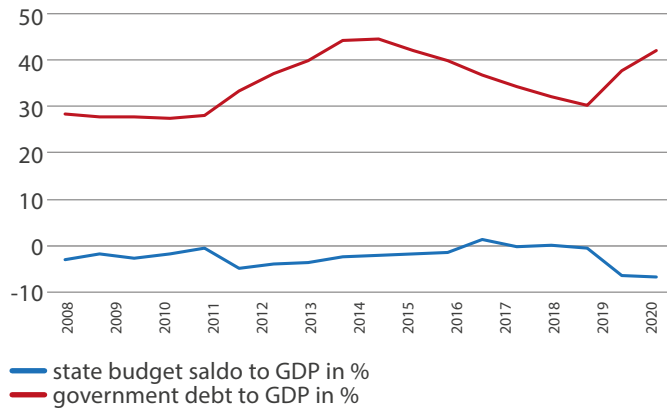
less the right took the steering wheel. When the right came into power however, political decisions resulted in crisis, demonstrations, and debt larger than ever before. However, the threat of debt is still effective, and has been used again and again, most recently in the parliamentary elections in October, 2021. It is strange to watch the representatives of the Civic Democratic Party (ODS) threatening rising debt as a consequence if they are not elected, when it was this party which massively contributed to record tax cuts, and which are at the root of the public finance problems.

When looking at the current programme declaration of the government, it is hard to find anything that could translate into macroeconomic policy, much less a strategic vision of the Czech economy, and the consideration of current trends. Right-wing policies seem to exist outside of time and space, stubbornly pursuing the goals of the Washington Consensus, while pretending to be responsible concerning future generations. With this in mind, hysterics regarding the development of debt, will be more comprehensible (see in later chapters⁴⁴).

Figure 20 shows that the biggest increases in deficit and debt (both categories comparable with the Maastricht criteria of 3%, or 60% GDP) are connected with economic crises. The first significant increase was due to the impacts of the Great Recession, followed by the attempts for fiscal consolidation. The cuts were so severe that they caused not only an increase in unemployment and vast protests in the streets (see previous chapters), but also a double dip; a homemade recession. In the years following 2013, there was a political change marked by an improvement in the state of public finances. Of course, the COVID-19 pandemic worsened the economic situation. However, it has to be noted that the resultant worsened state of public finances has been connected, not only with programmes fighting the pandemic (such as job preserving scheme Antivirus), but also and most strongly with the serious and unjustifiable changes made to the tax system.

Figure 21 offers an interesting comparison of EU countries. It is true that the comparison is more an indicator of the static than the dynamic, but it clearly shows that the Czech Republic has the sixth lowest government debt, relative to the other EU member states.

Figure 20 The development of state deficit and debt, in % GDP, 2008–2020.



Source: Czech statistic office, Macroeconomic overview

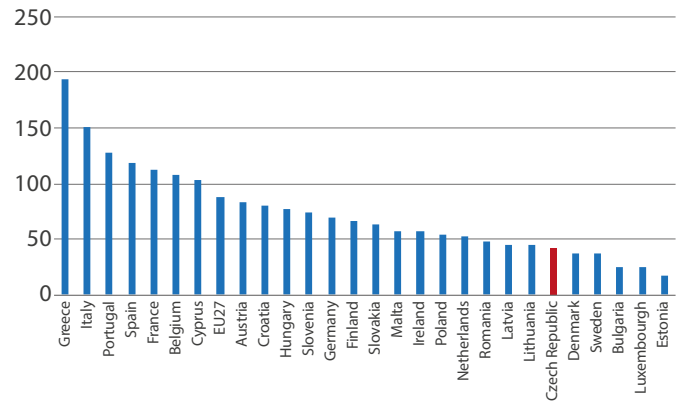
It is apparent that the countries that were hit by the debt crisis (it was in fact a euro crisis) had the highest levels of government debt. The consequence of fiscal consolidation was in fact a higher debt ratio (debt to GDP). The years of suffering, fiscal consolidation, and humiliation from the ‘fiscally responsible’ state had no other consequence than the rise in debt.

The countries which fulfil the Maastricht criteria are generally less developed countries with weak social systems. Exceptions are Sweden and Denmark, which have low levels of government debt. Both countries have high taxation, robust welfare systems, and both are outside the euro zone.

It is the social system, the salaries of state employees, and social services such as healthcare, that are threatened when right-wing parties are in government. Figure 22 provides convincing evidence that, in comparison with other EU members, the Czech Republic does not have a system of ‘excessive’ social protection which is ‘constantly misused’, as the right claims.

The government expenditure for social protection, as defined by Eurostat, includes state help for sickness and disability, unemployment benefits, security for old age, social benefits for families and children, and aid for situations of social exclusion and poverty.

Figure 21 Government debt to GDP, in %, 2021.

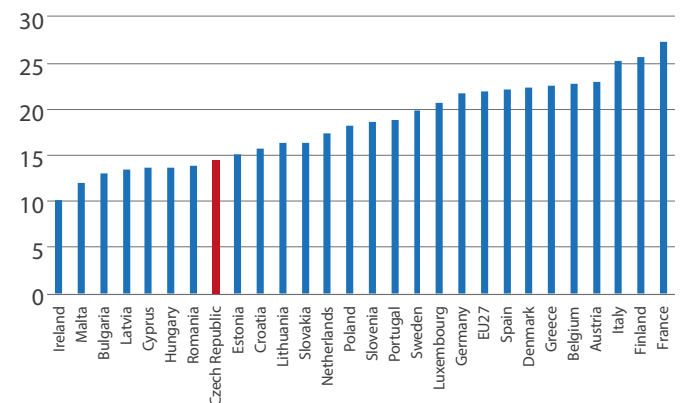


Source: Eurostat

Social benefits in the Czech Republic are seen very negatively (ČTK 2021), and applying for them results in stigma for the individual or household in question. This explains why only a small portion of families apply for housing benefits. According to the latest data, only about 10% of pensioners and one third of families who would be eligible for the housing benefit, actually apply for it. People are afraid that they would be stigmatised and as the system demands a lot of time, energy, and paperwork, they are also discouraged by the bureaucracy.

Regarding the comparison in Figure 22, it can be seen that Ireland has a unique economic system, as the other countries with low expenditure for social protection belong to the less developed EU countries. The fact that Ireland is included in this group is definitely not a sign of convergence.

Figure 22 Government expenditure for social protection, in % GDP, 2020.



Source: Eurostat

The transformation of the political landscape

It would be very ambitious, and for the main goal of this paper, also inappropriate to carry out an in-depth analysis of the development of the Czech political landscape over the last thirty years. Thus, this chapter focuses on the left-wing parties, which are represented by the ČSSD (Czech Social Democratic Party) and the KSČM (Communist Party of Bohemia and Moravia). In addition, this chapter will also briefly introduce the movement ANO, founded and led by the billionaire and ex-prime minister Andrej Babiš, as the movement successfully gained many left-wing oriented voters. After the last parliamentary election in 2021, ANO represented the strongest opposition party after both the Czech Social Democratic Party, and the Communist Party of Bohemia and Moravia dropped out of the Chamber of Deputies.

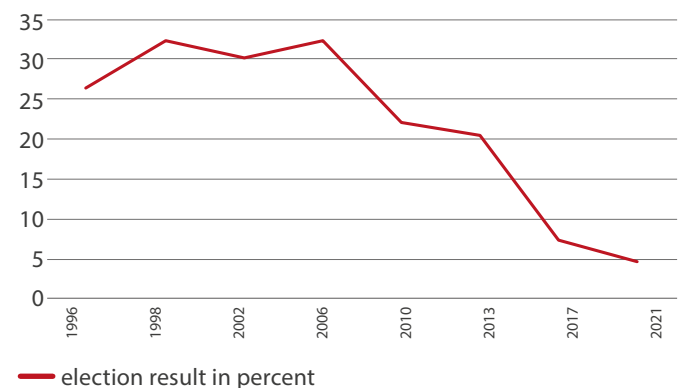
The role of trade unions is also mentioned, making the description of the Czech political landscape more complex. At the end of this section, the new strongly right-wing government will be presented with contrasting policies – on one hand a very low implementation of measures supporting companies and households in times of unprecedented crisis, and on the other hand taking measures to ‘regulate’ internet use, and implementing measures that represent censorship.

Since the fall of the Soviet Union and the Eastern Bloc, it has been difficult for left-wing parties as they are associated with the past (not only the KSČM, but also the ČSSD) and have always been viewed as a threat to the transformation process. However, following the failures of the transformation process described previously, the position of the ČSSD began to change. Under the strong leadership of Miloš Zeman, the Social Democrats won the parliamentary elections in 1998, and were able to build a minority government. This represented a milestone in the political landscape of the 1990s, although it was accompanied by open animosity from most of the media, who were, and still are, strongly right-wing. The KSČM has, for a long time, represented a protest party, as other parties did not want to openly cooperate with communists. Up until the present day, the Social Democrats have so-called *Bohumínské usnesení* (‘resolution of Bohumín’), which means that they are prohibited from establishing an official coalition with the

Communist Party at the highest (governmental) level. It is however possible at the level of municipalities.

The relationship between the two parties has been uneasy for a long time. The prime minister, Jiří Paroubek⁴⁵(ČSSD), effectively cooperated with the Communist Party in the Chamber of Deputies, despite the liberal right-wing party coalition at the time. He represented the peak of ČSSD popularity, with the highest election gains. Since then, the Social Democrats have been getting weaker and weaker, and in 2021 they dropped out of the Chamber of Deputies⁴⁶.

Figure 23 Parliamentary Elections results of Czech Social Democratic Party (ČSSD), in %, 1996–2021.



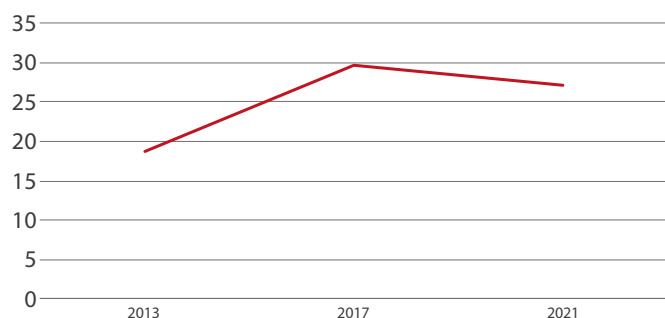
Source: www.volby.cz

There are many reasons for this failure of the oldest political party in the system. The Social Democrats are internally divided in their views on many themes, including NATO and the EU (typical ČSSD voters are critical of both), and there are also different attitudes towards the former prime minister and current party president Miloš Zeman. However, I believe that the most significant division is between the liberals and the conservatives of the party. The liberals are in favour of topics such as human rights, NATO and EU membership, and gaining voters in big cities like Prague, where the Social Democrats are traditionally weak. On the other hand, the ‘conservatives’ have a critical approach towards the EU and NATO, are not russophobic, and prefer social topics over human rights and liberal topics. Collaboration between these two groups has become increasingly difficult, and the party has become less predictable for voters. Internal disputes have become louder and damaged the image of the party considerably.

It is especially worrying to see the long-term declining trend of the party’s popularity. Its failures have mounted, but no changes have been made regarding the functionality of its teams of experts, focuses, or marketing. The inability to learn from its own failures, in the case of the ČSSD, is astounding.

The foundation of the movement ANO (Action of Unsatisfied Citizens⁴⁷, founded in 2011 by billionaire Andrej Babiš), has profoundly changed the whole Czech political landscape. The movement ANO was able to succeed in the premature elections in 2013, at which time the Social Democrats still played the role of the senior party. However, this changed soon afterwards, as the ANO movement began to dominate the political scene, gaining voters from both of the original left-wing parties.

Figure 24 Parliamentary Elections results of ANO, in %, 2013–2021.



Source: www.volby.cz

ANO presents itself as ‘centre movement’, most political analysts view it as a typical example of a populist movement, founded and financed by a billionaire. Apart from Andrej Babiš, the most visible representatives of the movement claim to be right-wing oriented (which is still believed to mean being ‘the good guy’, while having left-wing convictions could be compared to having leprosy). However, ANO often advocates left-wing policies, realising proposals put forward by the Social Democrats, and sometimes even the Communist Party.

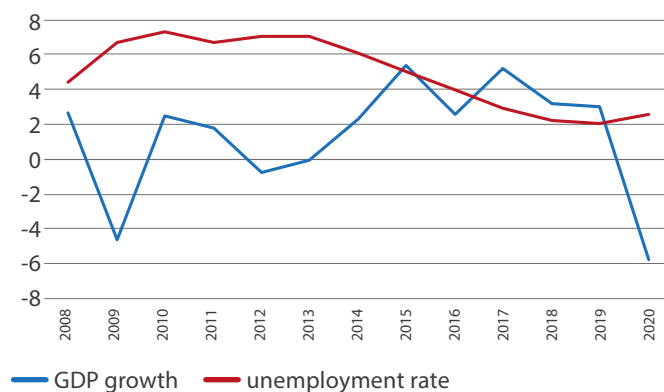
Babiš’s first cabinet became the governing body in 2017, until Babiš lost a vote of confidence, it was then succeeded by Babiš’s second cabinet in 2018. This government was comprised of ANO members, non-party experts, and Social Democrats, and was tolerant towards the communist party, which was again a big change in the political landscape.

ANO gained popularity because of the catastrophic performance of right-wing governments with their implementation of fiscal consolidation policy, severe cuts, humiliation of trade unions (which however fought back), and many other measures which damaged the social system. ANO presented itself as an alternative to the corrupt party system, not being left or right, and using expert knowledge. Backed by excellent marketing and a huge amount of money from its founder, ANO was able to gain votes rapidly.

It has to be mentioned (see Figure 25) that the years ‘under ANO’ have been, economically and socially, a positive contrast to the years governed by right-wing parties. ANO finished second in the election of 2013⁴⁸, and it can be seen that this was the year when the situation started to improve.

The social stability; increased wages, including the minimum wage; economic growth; and increasing standard of living⁴⁹, would have comprised a favourable probability for re-election. However, the Covid-19 pandemic meant that the government was faced with many extremely difficult issues. There were many mistakes, chaotic management of measures taken to deal with the pandemic, and unprecedented changes in the tax system pushed through by various lobbyist groups (analysed further in next chapters), together with a constant attack by the media led by Czech Television⁵⁰. The media campaign⁵¹ against Babiš was very aggressive, and resulted in the defeat of the ANO movement in Autumn, 2021.

Figure 25 Development of GDP growth and unemployment rate, 2008–2020.



Source: Czech statistical office

Five right-wing parties were then able to build a majority government, which meant the return of the notorious ODS (Civic Democratic Party), which is closely associated with

neoliberal policies. This coalition is highly popular with Czech Television, which has completely given up on presenting news objectively, and has been one of the key factors in the media support of right-wing parties. The right-wing coalition also holds a majority in the upper chamber, in the Senate.

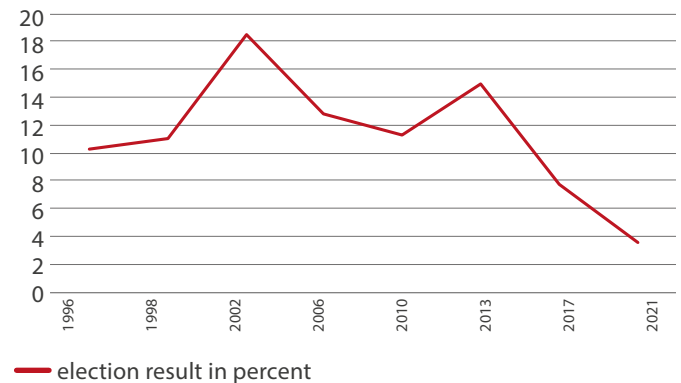
As previously mentioned, both left-wing parties, the KSČM and ČSSD, were unable to surpass the 5% threshold and, for the first time in thirty years, dropped out of the Chamber of Deputies. Both parties have serious issues which limit their functionality. Therefore, there is the question of a 'guardian' for the problems of normal citizens. There is high civil unrest, as the right-wing government is unwilling to implement measures to curtail the pressure of growing inflation regarding food, energy, and housing prices. It has to be stressed that in the autumn 2021 election about one million votes 'expired', as they represented votes for parties which did not surpass the 5% threshold. This is a record amount, and an important factor regarding social stability.

The Social Democrats face huge debts, which may require the selling of their property. Furthermore, there are strong divisions within the party, represented by the liberal and conservative approaches. Internal divisions regarding foreign policy, educational policy, and attitudes regarding human rights have resulted in the party losing thousands of voters. The influence of regional 'bosses' with high political influence, and the environment of corruption this has created is still strong. The party has been brought down by its dysfunctional internal structure, corruption, and the inability to create structures of media support, or expert advisors. The resulting party image is defensive, unconvincing, and chaotic. The political future of the Czech Republic is hard to predict. On one hand, the liberal wing dominating the Social Democratic party is largely unpopular among traditional voters. On the other hand, the disastrous conduct of the right-wing government could offer some votes to the Social Democrats in the upcoming municipal and Senate elections.

The KSČM also faces financial problems which have led, for example, to the replacement of their daily newspaper, *Haló noviny*, with the weekly journal *Naše Pravda*. However, the KSČM's financial problems are not as grave as those of the ČSSD. The main issue with the KSČM is the age structure of its members. The average age of a party member is

seventy-five, and although the current party leader, Kateřina Konečná, (also a Member of the European Parliament (MEP)) is dynamic in her efforts to modernise the party, the change of leadership may have come too late.

Figure 26 *Parliamentary Elections results of Communist Party of Bohemia and Moravia (KSČM), 1996–2021.*



Source: www.volby.cz

The parliamentary opposition consists of two parties, neither of which can be viewed as a 'standard' party. The first is the ANO movement⁵² which, having absorbed many of the voters of left-wing parties, was prepared to make a coalition with ODS, and become more right-wing. However, the ODS refused to even engage in negotiations with the 'populist' movement, which it has described as a threat to democracy, and so ANO became an opposition party. This is a very difficult position for Andrej Babiš who, being essentially a businessman, does not find much satisfaction as an opposition party leader without executive power. Although Babiš is a billionaire, he has the 'political touch', and is able to perceive political sentiments within society. He quickly grasped the political shift which had occurred, and tried to provide an alternative for the left-wing voters. He also claimed that it seems to be the ANO's fate to shift to the left⁵³. Although Babiš retains full control of the movement, the members of ANO often originally came from right-wing parties (ODS) and still claim to hold right-wing convictions. This discrepancy is obvious to the author who, as a member of the National Economic Council of the Czech government, witnessed the strong anti-socialist claims made by the finance minister of the time and member of the ANO, Alena Schillerová. There are many other right-wing representatives of the ANO, although, of course, they are less visible than its founder. Their absolute lack of political feeling and understanding of the changes in political landscape distinguishes them. The right-wing side of

the Czech political sphere is overcrowded, whereas on the left side a lot of free space remains.

The second current opposition party is the SPD (Freedom and Direct Democracy party), which is also viewed as a populist party. Led by the skilled rhetor, Tomio Okamura (of Japanese origin), the party is a typical protest party. Some political analysts even claim that it displays 'extremist' features. This party holds views opposing EU membership, and focuses on direct democracy and sovereignty. The leader, Tomio Okamura, supported Marine Le Pen in the French presidential elections. The SPD was also able to gain some voters from KSČM and ČSSD, however it probably does not hold governmental ambitions. It does not have a sufficient base of experts, and its popularity ceiling lies at around 12-15% of votes.

Right-wing parties, such as the ODS (previously founded by Václav Klaus, who now strongly opposes the party's direction), have always used fear-based campaigns. Firstly, it was the fear of 'returning back to before 1989' which was used. Following this, in the 2010 election campaign, the topic of the Greek economic crisis was strongly misused, and the Social Democratic government was accused of 'leading the Czech Republic to Greece', which was actually a hint of the severe cuts to come, evoking strong civil resistance. In the 2021 election the fear used was of 'Babiš'⁵⁴, his undemocratic development policies, and high debt. The right-wing parties could always count on media backing. The image of 'right-wing' as normal and decent, and 'left-wing' as lazy, incapable, state dependent, and stupid, has been present in the public sphere for thirty years and undergone little change. However, trade unions have been able to strengthen their position within the system.

There are two major Czech trade unions: ČMKOS (Czech-Moravian Confederation of Trade Unions) and ASO (Association of Independent Trade Unions) (ASO 2022). At times, there may have been some rivalry between them, however, during the difficult period of the economic crisis (2010-2013) they were mostly able to find common ground.

ČMKOS particularly has changed its image, from barely tolerable 'communist heritage', to a respected partner in tripartite negotiations. ČMKOS is also well known for its excellent macroeconomic background and its ability to analyse ongoing processes within the economy, offering

more precise predictions than official authorities, such as the Ministry of Finance, or the Czech National Bank.

Trade unions are losing the stigma previously associated with them, and the number of newcomers has grown in recent years. Since 2017⁵⁵ there have been 239 newly established trade unions organisation, with almost 55,000 new members. The ČMKOS also claims that wages in companies with trade unions are higher than in companies without trade unions.

The ČMKOS focuses on topics including wage convergence, working hours, job security, and adherence to the Labour Code. However, it also analyses macroeconomic issues, including the capacity to produce strategic material and studies.

The rise of the ČMKOS, and its media visibility and activities, are also reflected in the fact that the leader of the ČMKOS, Josef Středula, is considering applying as a presidential candidate.

There were also many civic organisations, resulting from the widespread dissatisfaction among citizens during the period between 2010–2013. Most of these organisations ceased to exist following the change of government in 2013, as their *raison d'être* had ended. Many were led by amateur citizens, who did not have any political ambitions, but could no longer stand aside. Although these organisations do not exist anymore, they were a school of civic activism, and contributed to the ability to organise demonstrations, speak publicly, and build social networks. One of the organisations which survived is the Alliance for Labour and Solidarity (SPAS (*Spojenectví práce a solidarity*)), comprised of mostly left-wing members. The years following 2013 showed how difficult it is to bridge left-wing differences and disputes. Left-wing cooperation is, at present, very demanding especially taking into account the liberal-conservative divide, which is also apparent in the attitude towards the conflict in Ukraine. The results of the 2021 parliamentary elections were disastrous, however, so far, these results have not translated into efforts towards left-wing unity and cooperation. It is possible that the upcoming municipal elections in September 2022 will offer some interesting coalition projects and new alliances.

One of the most worrying steps taken by the right-wing government is, surprisingly, not concerned with economic policy. It is the effort to implement censorship. At the beginning of the conflict in Ukraine, several web pages were closed although there is no law permitting such an act. Nevertheless, the government is now officially proposing a law giving itself the right to shut down webpages. The closed-down web pages were accused of spreading 'Russian propaganda'. The government has now introduced a governmental representative for disinformation, resembling the censorship prevalent in the communist regime. Furthermore, the government started an online campaign 'defend Ukraine, defend the Czech Republic', in which it encourages citizens to report those with 'dangerous' opinions, especially regarding the conflict in Ukraine.

Furthermore, at the start of the conflict the public prosecutor gave out a warning that agreeing with the Russian side would be considered a criminal act punishable by three years in prison. The police have started to investigate many cases of citizens denouncing one another.

The future political situation will be influenced by the results of the municipal elections, and partly by the Senate elections in September 2022 (although they are mostly viewed as unimportant and typically have a low turnout), and also by the presidential elections to be held in the winter of 2023.

There are already many candidates, and the rapidly deteriorating socio-economic situation will certainly have an impact. In addition to the aforementioned Josef Středula, Andrej Babiš is also considering running for presidential office. His candidacy has not yet been confirmed, but Babiš is certainly in a good position respecting the potentially expensive election requirements⁵⁶, and fundraising. If Babiš did succeed (which I do not consider probable), he would have to leave the ANO movement, the future of which would be very uncertain without him. It is debatable, if ANO would be able to exist without its founder and financier. The most important members of the movement do not have the same political understanding as Babiš, and would push the movement towards the right, meaning that its unique 'central' position would be lost. This would mean that the left-wing side of the Czech political sphere would be completely vacant.

Impact of the COVID-19 pandemic: the Czech economy and policy

The COVID-19 pandemic took the world by surprise and represents a major holdup in the development of states, countries, and the whole global economic system. Although we cannot claim that the pandemic is over, we may at least partly evaluate how efficiently states have reacted and thus also discuss the topic of resilience, which will be one of the most crucial topics of the twenty-first century.

This section is devoted to the impact of the pandemic on the Czech Republic, both from the socio-economic and the political perspective. In the following chapters, the pandemic-induced changes in globalisation and international division of labour will be analysed, together with the opportunities and threats that these changes could represent for the Czech Republic. It is worth noting that the author of this ebook was heavily involved in the government's reactions to the pandemic, regarding the economy.

At the beginning of the pandemic, in March 2020, 'emergency' groups were established. These teams were led by the Minister of Interior, the former leader of the Social Democrats, and tried to deal with the unprecedented situation. The author was a member of the socio-economic team (macroeconomic reaction, help for employees), and as she was also advisor to the Minister of Social Affairs, she had the opportunity to closely observe the way in which various measures were being adopted.

Later, a special group of experts was revived, the so-called NERV (National Economic Government Council). The author was practically the only leftist economist present in this body. To begin with, NERV was very often consulted, but in 2021 this decreased, and the government stopped being interested in NERV's recommendations. It has to be admitted that NERV's composition of experts were very different from each other. It was mainly comprised of lobbyists, representatives of huge international companies (banks) and many people with strongly right-wing convictions. There were many heated disputes, and the author was threatened multiple times herself, for example in reaction to her suggestion of attaching conditions to aid provided to companies; if the companies received aid, the

conditions would have meant that they would not be eligible to pay out dividends abroad.

The standard procedures of tripartite were put aside, and ANO began to take on a strongly right-wing orientation, and started to abolish the results it had achieved during previous years (wage convergence).

The aim of this chapter is not to describe detailed day-to-day proceedings, but rather to identify the main trends that led to the high number of deaths and the very serious situation in public finances.

One of the first findings was how **completely wrong economic predictions and various economic models were, and how strongly they were influenced by various lobbyists**. At the beginning of the pandemic (February/March 2020), the Ministry of Finance underestimated the situation and did not want to intervene at all, playing up the qualities of frugality and accountability. It then became obvious that some kind of job saving scheme (in the style of German *Kurzarbeit*) would have to be adopted, however the Ministry of Finance blocked most efforts and allowed only ridiculously small amounts to be expended as financial aid for domestic households and companies. A few weeks later, the influence of lobbyists became obvious, and the Ministry of Finance changed its position to the other extreme. Billions of CZK were thrown at companies because 'models' predicted a dramatic loss in liquidity for companies, due to the lockdowns. Needless to say, large demands made by companies, for billions (later trillions) of CZK in liquidity, never occurred. This proved that the influence of lobbyists was much higher than the author had ever imagined.

The next finding is connected with **the readiness of lobbyists** to misuse critical and unprecedented situations. The preparation of proposals, and the speed at which lobbyists were able to introduce them, clearly revealed two serious flaws in the state administration: Low resistance towards consistent lobbying, and the deficiency of the state. There was very little data the state could use to support decision-making; thus, many politicians were inclined to follow 'secure' advice offered by representatives of foreign

companies and banks. The pandemic tragically highlighted how **deficient the state was** when it came to:

- Data collection and analysis.
- Decision making in crisis situations.
- Political will to take on responsibility.
- Protection from the power and influence of lobbyists, who were ready to misuse the situation to introduce economic changes (especially in the tax system) that would have otherwise been impossible to implement.
- Consistency, as adherence to discordant principles and decisions made very recently (sometimes even the day before) resulted in chaotic decision making, and a loss of public confidence.
- Inability to enforce regulations. Later the situation became so serious that companies publicly boasted about not adhering to state regulations (closure of pubs) and the state was not even able to punish them, for example by seizing their license for entrepreneurship.
- Willingness to evaluate the efficiency of regulations, and ability to change the course of policy predictably and systematically. Up to the present day, no evaluation of the changes made to the tax system has been carried out, and it seems that nobody really cares. There has also been no systemic evaluation of the healthcare system and its preparedness for the next pandemic, or its capacity to care for those suffering from long Covid.

The resilience of the state and its ability to make good decisions was proved to be disastrously low. This was not solely connected with the previous government led by Andrej Babiš, but more to do with the deficiencies of the public administration system in the Czech Republic. Such a state of affairs represents one of the biggest obstacles for any government attempting to upgrade the Czech economy and implement reforms (for example, reforms to support food self-sufficiency).

These deficiencies of the state were misused by lobbyists, but they also prompted many spontaneous grassroots movements, which tried to improve the situation. Teams of experts were formed, consisting of medical experts, hygiene experts, epidemiologists, mathematicians, etc. However, the government was not always willing to listen to them.

Furthermore, it was obvious how the problems, and crucial decision-making responsibilities were 'poured down' to

lower levels. This is what happened to the overburdened hygiene offices, which are made up of few people with little resources, and suddenly became one of the most crucial elements for managing the pandemic.

The same went for the labour offices (under the Ministry for Social Affairs), who had to work weekends, and were constantly overworked trying to process all the demands from households, individuals, and entrepreneurs. They were practically the only structure that was able to react at all to the situation and distribute financial aid⁵⁷.

Even worse was the situation for doctors and nurses. They were heroes, often working non-stop for days, trying to curb the horrible and tragic consequences of the waves of the pandemic which followed one after another. There were also volunteers, who helped out in hospitals, carrying out tasks such as cooking for medical staff. It is only due to our robust healthcare system that there were 'only' about 40,000 deaths.

It was grassroots activities which prevented the situation from deteriorating into total collapse. This also represents a small piece of hope for the future.

Taking a closer look at the healthcare aspects of the pandemic:

Luckily, in early March 2020 the prime minister was convinced that the situation may become extremely serious and acted correspondingly. Unfortunately, this sensible course of action did not last long and the measures taken concerning the pandemic were abandoned, due to pressure from businesses and various lobbyist groups. Following this the proceedings became very chaotic; five different healthcare ministers were appointed one after another during the pandemic, and following the resignation of the fourth, the first or original healthcare minister was then reappointed.

The situation was, of course, extreme. There was a lot of fear and, at the beginning, a high rate of solidarity in society. This solidarity vanished quickly, and measures like obligatory mask wearing had already begun to be criticised and disregarded in the summer of 2020. It is therefore no wonder that there were many waves of the pandemic and, up to the present day, about 40,000 deaths (confirmed cases

of infection reached almost four million, although the true number is likely to be twice as high (WHO 2022)).

The phrase 'best in Covid' which the prime minister Babiš used to present the Czech Republic as one of the most successful countries in mitigating the pandemic, was turned upside down. In later months and in 2021, it was used ironically, as a symbol of the governmental failure in the fight against the pandemic.

Later, protests and various movements opposing vaccination, lockdowns, mask wearing, etc. gained strength. However, with the start of the conflict in Ukraine, the issue of COVID-19 practically vanished from the public sphere, and measures have been gradually loosened.

Economic impacts

In this chapter, the main economic impacts (ČMKOS 2021a) of the pandemic are summarised, including major trends predicted to shape the economic future of the Czech Republic.

The pandemic has ended the convergence process, severely impacting not only the economy, but also the manoeuvring space for economic policy.

It is, however, necessary to stress that the direct impacts of the crisis are not as severe as predicted⁵⁸. Table 12 presents several economic indicators for the pandemic years of 2020 and 2021.

Regarding Table 12, there are several important points which should be emphasised. Whereas household consumption has recovered (or been enabled by the loosening of lockdowns and other restrictive measures), this cannot be said for fixed capital formation. In addition, a huge increase in household savings is evident; before the pandemic, the rate hovered at around 12-13%. These savings were accumulated due to restricted consumption, but also as a precaution. There were (already in 2020) fears in society concerning inflation, or even monetary reform, and a subsequent increase in investment in residential housing, so as not to lose money through inflation. The abolition of real estate acquisition tax contributed to this behaviour, which only for richest could afford to take part in.

Table 12 also shows that the decline in economic activity in the services sector was worse than in the industry sector. The unemployment rate remained low, not only because of the many vacancies existing before the outbreak of the pandemic, but also thanks to the success of the programme 'Antivirus', which was established by the Ministry of Social Affairs. This programme has been evaluated as the most successful of all programmes established by the government⁵⁹.

The inflation rate had already surpassed the inflation target set by the ČNB in 2020, but it rose still higher in 2021, and was even worse at the beginning of 2022. The ČNB predictions regarding inflation showed how much the bank underestimated the inflation situation, it had to significantly adjust its predictions.

The budget deficit and the corresponding increases in government debt have already been mentioned, however the debt in 2019 was only 30.1% GDP. This confirms that it is the dynamic of debt increase which is important, the level of debt itself is not the problem.

Table 12 *Main economic indicators, 2020–2021.*

	2020	2021
GDP growth	-5.8%	3.3 %
Household consumption	-7.0%	4.4%
Fixed capital formation	-10.3%	0.6%
Rate of gross household savings	21.5%	20.4%
Industry	-6.1%	10.8%
Services	-11.7%	7.6%
Unemployment rate	2.6 %	NA
Gross real wages	-0.1%	2.2 %
Inflation rate (annually, average)	3.2%	3.8 %
Current account to GDP	2.0%	-0.8 %
State budget balance in CZK	- 367.4 bil. CZK	-419.7 bil. CZK
State budget balance to GDP	-6.5%	-6.9 %
Debt of governmental institutions to GDP	37.7%	41.9 %

Source: Czech statistical office

There was a decline in GDP of 'only' 5.8%. This proved that the Czech economy was more resilient than expected. At the same time, it is obvious that the entire economy was not hit. Key sectors were still functioning, with rather minor limitations. The sectors which really closed down (the hospitality sector) had far less meaning for the Czech Republic than was predicted by the media. It is not the shutdown of pubs, nor hotels that would cause the Czech economy to collapse. However, lobbyists from these groups with strong media support were able to carry out state capture and rent-seeking. As the ČMKOS states, the impacts of such policies could be fatal for the Czech economy.

The main reason for the high risk is, perhaps surprisingly, not the various support programmes which were imple-

mented during the pandemic. Although many of them were controversial, considering the bureaucratic burden, their reasoning, amount of aid supplied, etc. the main problems were on the income side of the state budget. The lobbyist groups grasped their unique chance and were able to push through many changes to the tax system, these changes are not temporary and will have a lasting influence on income tax and state function.

Under normal circumstances, such measures would have been impossible to push through. A perfect example is the abolishment of real estate acquiring tax. This kind of tax had nothing to do with the pandemic, but it was abolished during the state of emergency very fast, and without the need to present a clear explanation, including impacts on the state budget, etc. Unfortunately, there are more such examples, such as the permanent implementation of the institute of the tax loss carryback. This series of dramatic tax overhauls was 'crowned' by the abolition of super-gross wage tax, which meant a huge loss in tax income for the state.

Therefore, Babiš' government effectively contributed to the destruction of the measures which used to represent its flagship, such as EET⁶⁰ (Electronic Records of Sales). This measure contributed to the complex fight against tax non-compliance. The EET was 'temporarily' shut down, and the last phase of its implementation was halted. The current right-wing government plans to abolish EET completely, because it is seen as 'hostile to entrepreneurs'.

Further tax measures included the permanent implementation of loss carryback⁶¹. Further distortive measures included the adoption of lump-sum tax for the self-employed⁶², the food benefit lump sum⁶³, lowering VAT for culture and hospitality services⁶⁴, and reduced excise duty on naphtha.

The destruction of state revenue from taxation is vast, and the ČMKOS was not alone in openly putting forward its concerns. It is feared that this situation of permanent deep deficits may result in the privatisation of the public health-care and pension systems. Lobbyists and financial groups have always been interested in these systems, trying to use 'responsibility of the individual' as a ground for opening the way to privatisation, and subsequently their own engagement (for example through the implementation of obligatory pension savings via banks).

The adoption of such dramatic, unjustified measures created a situation where the budget deficit was higher in 2021 than in 2020, whereas the situation regarding GDP growth was statistically better in 2021 than in 2020. According to the ČMKOS the situation shows:

- Measures regarding tax income, implemented during the pandemic, will have a deep and lasting effect on public finances and will create systemic deficits.
- The Ministry of Finance has given up on managing public finances, which was reflected in a very passive proposal of state budget for 2022 (more built on accounting theory than macroeconomic policy).
- There is no realistic fiscal consolidation plan⁶⁵.

The economic impact does not only concern public finances. Another crucial impact is the slowdown of wages and salaries growth, and the reversal of wage convergence. This is reflected in the Ministry of Finance macroeconomic predictions, which expect the profitability of companies to rise steeply, while the compensation of employees is expected to decline considerably from its 2020 level of 46%, to 43% by 2024! (Ministerstvo financí České republiky 2021) This will effectively erase the gains of previous years.

Surprisingly, this fact was treated as no cause for concern, as the topic was almost completely ignored in the public debate.

The growth in real wages and salaries is threatened by:

- The freezing of wages and salaries, which the Babiš government actually proposed (hoping for a coalition with right-wing party ODS, which did not happen), reasons given included that the workers 'got more money through the abolition of super gross wage'.
- The impacts of the pandemic.
- Constant inflow of cheap workers (from Ukraine, Balkan states, Mongolia etc.) due to pressure from business representatives such as the Chamber of Commerce.
- The conflict in Ukraine; the refugees were first welcomed as cheap labour that would help to fill vacancies (although the majority are women with small children). Furthermore, the conflict is misused by the current government⁶⁶, who describes it as an 'extreme situation' and thereby delegitimise the demands of workers, who should not be too outspoken during a war situation. Workers' criticism regarding government inaction in mitigating real wage decline is presented as being 'pro-Russian' and destroying the unity in society.

- Rapidly increasing inflation (see in later chapters), belonging to the highest in the EU and impacting basic goods – energy, housing, and food. It is obvious that the year 2022 will be marked by a steep fall in real wages.

Looking into the changes to the tax system in more depth, there are several factors that will influence the economic situation for any future government. The tax reforms, which were adopted through the ‘per parts’ method (in Czech often called the ‘salami’ method) represent a huge de facto overhaul of the entire tax system. However, this point is almost completely ignored by the media.

The tax reform has led to high deficits, even during periods when the economy is growing. This is an unsustainable development. At the same time, it is obvious that to try to reduce deficits (if that should be a priority) is not possible without considerable measures taken on the income and expenditure side of the state budget. However, as the official declaration of the current right-wing government confirms, these changes are difficult to realise concerning income. It is politically improbable that following a record decrease in tax, the next step will be to increase it again. Thus, there are justifiable fears that any adjustment would be taken on the expenditure side, leading to the aforementioned privatisation of the healthcare system or pension system.

The tax system remains highly unfair. The ‘invisible’ reform of the tax system has abolished property tax, and increased the importance of degressive tax, such as VAT. Such a tax system is typical for developing countries.

The tax system is strongly connected with wage growth, which is the basis of purchasing power. Besides the natural person income tax, where the taxation burden is disproportionately carried by employees, and the self-employed pay practically no taxes at, there is VAT and social security contributions. All these taxes are connected with employment and wages.

The abolition of the super-gross wage⁶⁷ needs some explaining. It is one of the most important changes in the tax system that has been implemented in the last thirty years. The abolition of this tax per se was a step in the right direction. As mentioned in previous chapters, the super-gross wage was used to deceive employees, seemingly preserving a low tax rate, but broadening the tax base. The problem is not

in the abolition of this tax, but in its substitution; two tax rates were introduced (15% and 23% for very high incomes). Through this manoeuvre (together with the increase in tax bonus), employees pay less tax. However, the construction is such that the largest ‘gains’ are in the upper middle-income group. Those with a low income gain several hundred CZK, but those with a high income will gain several thousands.

The first problem is that the tax system is not able to sustain 15% personal income tax (employees), as only those with very high incomes (4 times that of the average wage) are eligible to pay 23%. Because there has been no compensation for this decline in taxation, it automatically generates high and persistent budget deficits. It is true that employees earn higher net wages⁶⁸ (although unequally spread), but at the expense of further increases in debt.

Moreover, the movement ANO presented the abolition of the super-gross wage as a way for companies to avoid increasing wages paid to their employees⁶⁹ – meaning that as the state has increased the net wage, wage convergence need not continue. This was confirmed by predictions made by the Ministry of Finance, which at that time was in the hands of ANO. To view ANO as a leftist alternative is thus fundamentally wrong, but the weakened position of traditionally leftist parties enabled ANO to hold this position.

Unfortunately, the abolition of the super-gross wage returned the tax system to the old right-wing idea of a lean state which cannot offer any substantial security net. In addition, the abolition has weakened the path towards wage convergence, strengthening the focus on providing cheap labour. It can be judged as one of the biggest mistakes made in thirty years. Its full consequences remain to be seen.⁷⁰

To sum up: the pandemic was misused to implement tax and budget changes that would have ordinarily been impossible to push through. The changes have seriously damaged the sustainability of public finances, opening the way for the privatisation of the pension and healthcare systems. The changes have mostly benefited the rich, and contributed to the weakening of wage convergence. Thus, the model of cheap labour as the main competitive advantage of the Czech Republic has been returned to, and the modest gains in wage convergence achieved in the period before the pandemic have been erased.

Global COVID-19 pandemic impacts

The COVID-19 pandemic caused millions of deaths⁷¹ around the world, weakened international trade and foreign direct investment, and resulted in poverty for millions of people, mostly hitting the most vulnerable countries which could not afford to implement stimulus programmes (UNCTAD 2020a). In the second quarter of 2020, manufacturing output fell by more than 11%. Declines were unevenly distributed between countries, goods, and economic sectors (food and pharmaceuticals were not severely hit).

It is obvious that the pandemic has changed the world profoundly and its effects will be felt in many years to come. There are several important issues connected with the impact of the pandemic which should be discussed. Deglobalisation is a topic that has been discussed for some time, and the disruptions caused by the pandemic will result in the reconfiguration of the international division of labour. This is very significant for countries like the Czech Republic which are closely connected with the world economy in various ways.

Deglobalisation, or variations in globalisation have been long connected with the COVID-19 pandemic. Following the Great Recession of 2009, the pattern of trade and GDP development altered (shown by data from the World Trade Organisation (WTO)). Prior to 2009, during a period of intense globalisation, trade volumes grew two to three times more quickly than world GDP growth, this trend ceased after 2009. Thus, up until the Great Recession more and more goods were destined for international trade, there were more semi-products, and the importance of cheap container shipping was essential. Transnational companies were also essential in orchestrating this complex division of labour, sometimes transporting and assembling goods across three continents.

The Great Recession knocked the system off course. However, before the long-term impacts could be clarified, the pandemic struck and brought about the consequent rise in commodity prices. Today we are feeling the impacts caused by the conflict in Ukraine. This 'perfect storm' was strengthened by increasing levels robotisation and automation, which resulted in the trend of 'reshoring'; the return of production facilities to developed countries, as the wage difference didn't much matter anymore. The efforts made by

various countries and regions to fight climate change (especially within the EU) opened paths for a green transition; restructuring the economy towards the production of environmentally friendly new materials, upgraded recycling, and new energy mixes and technology. This combination of factors means that the pace of change is very difficult to follow. It is thus also very difficult to present possible scenarios of future development. The conflict in Ukraine may have 'simplified' the situation as it increases the probability of the establishment of political and economic blocs⁷², and the development of hostility and tensions.

The pandemic has highlighted the weaknesses of globalisation. It became clear how rapidly external shocks, such as contagious illness, can spread across the globe and how difficult they are to curtail. The complex global value chains which had represented a huge advantage for transnational companies, suddenly became an obstacle. One minor problem, one factory closure, could cause the collapse of the entire chain and disrupt production across the globe. Many disruptions are still being felt today, for example the problem of semiconductors which has repeatedly limited car production in many European countries. Transport problems highlighted the inability of seemingly developed regions, such as the EU, to produce basic goods such as masks in sufficient quantities. The strong production capacity of China (responsible for about a third of the world's manufacturing output) showed the real strength of this emerging world power.

The countries also differed widely in their responses towards the pandemic, which became a cruel test of their capabilities in implementing supportive and economic measures, strengthening their healthcare systems, and enforcing rules during lockdowns. It is times of crisis which truly reveal who we are, and the same goes for governments and their ability to act.

Moreover, the pandemic has also been a test of resilience for societies and economies. There are huge differences in government strategies for fighting the pandemic, and also in the reaction of different societies to rules, obligations, and lockdowns. Resilience does not only refer to effectively dealing with shocks, but also using them positively for future improvements and modernisation for society and the

economy. There are still many lessons to be drawn from the pandemic regarding individual states, their policies, and their ability to communicate effectively with their citizens.

UNCTAD (UNCTAD 2020b) was one of the first major international organisations that tried to predict possible future scenarios, considering the already existing trends and changes, such as automation, additive manufacturing (using 3D print), digitalisation and the green transition. Although these scenarios were presented before the conflict in Ukraine, some of them recommend a higher rate of protection (including sanctions), and more state interventions.

It should be stressed that these trends are not always compatible, for example the emergence of a bloc system (with possible decoupling of Russia and also China from the West) is hard to combine with a green transition, at least in the middle time horizon. Similarly, strategies involving a higher rate of military expenditure, will limit resources for social stability.

In the months and years to come, countries will try to find their position within the new international division of labour and develop appropriate economic strategies, which will reflect their ability to act during times of crises. The pandemic will create a division between those countries which can handle the external shock and increase their resilience, and those which cannot.

It is no wonder that UNCTAD used the term 'perfect storm' for this new situation (before the conflict in Ukraine), predicting supply and demand shock, disruption in production and supply chains, and a global recession. Long-term impacts were presented in four possible scenarios or trajectories.

The first is **reshoring**. This scenario involves a massive return of offshore production back to its mother country. The automation process will change cost patterns and cheaper countries will no longer be as attractive. Reshoring would dramatically alter the current trade flows and production patterns. For developed countries it would mean re-industrialisation, but it would not involve a vast number of new jobs, because of the automation processes. Reshoring may also result in protectionism as the new position of developed countries may include (in the case of EU) efforts to catch up with China and its rapid production development. UNCTAD predicts that in this scenario, supply chains would become

far shorter, the value added very concentrated, and global outsourcing and offshoring would decrease substantially. Many emerging and developing countries would have to re-think their industrial strategies and economic policies.

The second trajectory is **diversification**, which, according to UNCTAD, would result in even more fragmented supply chains. In this scenario, outsourcing and offshoring of services would increase, along with the usage of platforms, teleworking, and increased digitalisation.

Regionalisation is a trajectory already being followed by the ASEAN⁷³ countries. Regionalisation means shorter value chains concentrated in the region, which presupposes strong interconnectedness. However, there would still be a hierarchy, with some countries occupying a better position with higher value-added than others. This scenario would involve the establishment of a bloc with its own economic structures, dominant currencies, etc. Regional integration would be connected with nearshoring, which would support sustainability and limit the negative environmental effects of long-distance trade.

The final trajectory is **replication**, although I would rather use the term 'local economy'. In this scenario, self-sufficiency is one of the most important goals. Usage of 3D printing or additive manufacturing enables customisation. Trade is getting less important, and the demands of local workers, citizens, and companies are more reflected in production patterns. This scenario does not completely exclude international cooperation, but the cooperation would be on an intellectual level, associated with sharing manuals, proceedings, designs, etc. whereas the production would be local, using modern decentralised technologies.

It cannot be expected that only one trend will prevail across the globe, it is more probable that within different sectors production will undergo changes and proceed along individual paths. It would be advisable for the Czech Republic to play a role in guiding its own future trajectory, as it will constitute a new framework for industrial policy.

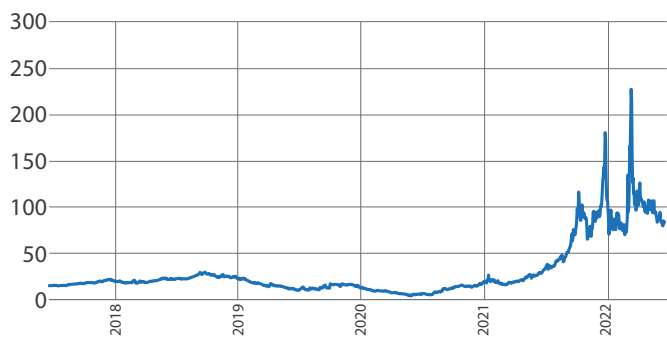
The first reaction of transnational corporations to the pandemic was to examine their internal logistic structures; container shipping, logistics facilities, etc. It could be assumed that their next priority will be to find production substitutes to increase the resilience of global production chains. How-

ever, some companies are already opting for reshoring. The production patterns will vary which, of course, increases inflation due to the serious changes in the international division of labour, combined with increased transport costs, etc.

High inflation resulting in increased energy prices and commodities is not exclusively connected with the conflict in Ukraine, as the inflationary pressures were visible at least a year before February 2022. The efforts towards establishing the green transition have increased the demand for materials such as copper, aluminium, and cobalt, which are necessary for electric cars, or renewable facilities. With increasing demand and limited supply, the prices have soared. If the green transition is not carefully planned and extended to a longer time frame, the prices will continue rising.

Sharp increases in energy prices have multiple causes and cannot only be explained by the conflict in Ukraine; the dramatic increase in the price of natural gas had been visible a year before the conflict. Price inflation is also visible in a vast spectrum of commodities, including metals, and industrial commodities.

Figure 27 Natural Gas EU Dutch TTF price development, in EUR/MWh.



Source: tradingeconomics.com

Figure 28 Crude Oil Brent price development, in USD/Bbl.



Source: tradingeconomics.com

Figure 29 Copper price development, in USD/Lbs.



Source: tradingeconomics.com

The FAO has recently published the highest food indices since they began collecting data (March 2022). Record prices were reached for vegetable oil, meat, and cereals. The high prices of oil and natural gas translate into agriculture as well (via fertiliser), and the whole situation is made more dramatic by the conflict in Ukraine. Both Russia and Ukraine are important exporters of wheat.

Figure 30 Wheat price development, in USD/Bu.



Source: tradingeconomics.com

It will be a huge challenge for governments to mitigate the impacts of long-term high inflation. The phenomenon of cost (or supply driven) inflation has not existed in developed countries since the 1970s. High inflation has prompted new ideas concerning the appropriate monetary reaction, and also concerning various supportive governmental measures such as social benefits, company subsidies, and direct intervention in prices via price regulation. In developing countries, the situation could become much more dramatic; it could result in food insufficiency and social conflict. Some governments may find themselves with inadequate fiscal space, decreasing their ability and willingness to act.

The reactions of central banks to the inflation situation vary, some countries do not feel strong inflationary pressures (Japan). This means that the economic policies implemented to deal with the situation will differ among countries, reflecting specific needs and manoeuvring space for active economic policy. Besides the classical tools of monetary and fiscal policy, it will be important to analyse approaches towards structural policy, for example the position of energy utility companies and state regulations. The rapidly increasing costs of living have prompted most EU governments to act. As we will see in the next chapter, the Czech government has so far been reluctant to act regarding this serious situation.

Table 13 *Inflation rate and main interest rate within the economy, by country (data collected on 7 May, 2022).*

	Inflation rate	Main interest rate
USA	8.5%	1.0%
Euro-area (average)	7.5%	0.0%
China	1.5%	3.7%
Japan	1.2%	-0.1%
India	6.95%	7.8%
Russia	16.7%	14.0%
Brazil	11.3%	12.75%

Source: tradingeconomics.com

The pandemic has also altered consumption patterns, boosting and speeding up digitalisation, e-commerce, and online services. The effects are visible in conference tourism (which has continued to use flexible tools such as the Zoom application following the pandemic); education (distance learning meant the necessity of equipping students and schoolchildren with internet connection and computers, Microsoft Teams skills, online cooperation, etc.); tourism (virtual reality); food and other goods (ordering online resulted in a rapid increase in transport services); and remote working (or working from home).

Many countries were forced to rethink the position of their healthcare systems. The consequences of the pandemic included delays in treating the ordinary non-Covid patients, and at the same time treating millions of people suffer from long Covid. There has also been an increase in psy-

chological problems, revealed by the increase in searching for help and psychological support online.

Digitalisation was also an advantage in public administration, as it substantially simplified processes connected with government aid and support programmes. On the other hand, for governmental systems poor in digital communication and data sharing, the lack of sufficient data on which to base decision-making made matters worse. This stresses the importance of using modern technology to improve the quality of governance.

In the ILO's (International Labour Organisation) World Employment and Social Outlook report, (ILO 2022) it is stated that the return to pre-pandemic state labour markets will not be possible for most of the world. However, the situation is the best in developed economies. The ILO presents an employment deficit of 52 million jobs worldwide, with global unemployment expected to reach 207 million by 2022. A loss in employment translates into income losses, which may become critical in some countries and regions due to the rising costs of essential goods.

The pandemic has highlighted inequalities in the labour market. The ILO also brings attention to many structural changes in the labour market brought about by the pandemic. These trends include remote work, temporary working contracts, employment in the informal sector, etc. It is obvious that countries which could afford to implement job protection schemes are in a very different situation from countries which traditionally rely on informal jobs, or have inadequate fiscal space to introduce job protection measures.

The classic 8.00-17.00 office job will change as governments find ways to incorporate remote work into labour codes. Companies may also no longer require large headquarters and workspaces. A search for balance in working from home/office/anywhere in the world, will be an important feature in the following years, both for employees and for companies.

All these changes are taking place in an environment characterised by a considerable lack of multilateral approaches (as it was before the pandemic), and a tendency to use protective trade measures, including an increased rate in sanction use. With concerns regarding strategic autonomy,

and dependence on 'dangerous' countries, such as Russia and China, the shift in production patterns could be accompanied by new tools of economic and industrial policy. This would represent a chance for countries like the Czech Republic to upgrade their position in the world economy.

However, the challenge is enormous and requires well-thought-out macroeconomic policy. As we will see in the next chapter, none of the preconditions necessary for success are met. The current government refuses to act, nor even to discuss the possibility of opportunities in the multiple crises. It is therefore probable that this opportunity for upgrading the Czech economy will be wasted.

The current socio-economic situation in the Czech Republic

The macroeconomic context in the autumn of 2021, at the time of the parliamentary elections, showed several serious problems. The COVID pandemic was far from over and its consequences were being felt, especially in healthcare and also in education; Czech school pupils spent almost a year and a half studying from home. The pandemic also changed consumption habits and many restaurants were complaining about the lower number of guests. It would only be logical to talk about new ways of incorporating the ongoing changes in the world economy into the Czech economy, how to evaluate the mistakes made during the pandemic, and how to handle the persistent problems in the healthcare sector. However, such discussion was very limited. The election campaign centred around 'democracy', Babiš being an oligarch, who allegedly misused money from the EU. Another major issue was classically right-wing; the state of public finances.

Public finances comprised a huge part of all debates, with the right-wing politicians protesting: 'our children will have to pay for Babiš' prodigal policies'. However, as explained in previous chapters, the main problems of the public finances' sustainability lies in income. The ODS was one of the five parties forming the new coalition which had voted for the abolition of the super-gross wage. This step alone led to tax income losses of about ninety billion CZK. The same party was giving hysterical warnings against state bankruptcy, the problem of public finances was almost completely shifted to the expenditure side. It was these same right-wing parties who, when in opposition, had constantly claimed that government was not doing enough to support self-employed entrepreneurs and businesses. Of course, they did not much mention employees. An outstandingly anti-socialist member of a party of the later-established coalition, TOP09, a liberal conservative centre-right party, came up with the proposal that in times of crisis, companies should be allowed to lay off workers without giving a reason, and the state would compensate.

It had already become clear during the election campaign that the priorities of the new government seemed to be upside-down, which was later confirmed by the government declaration, which described the main steps the government planned to take during its four-year period in office.

Another huge issue were the central bank policies. The central bank has revised its predictions many times, as real-world developments showed how far they had misjudged inflationary development. Of course, this has had large repercussions for the development of tax income (it is much higher than anticipated due to inflationary income). Babiš, ANO criticised the CNB for being extremely hawkish and destroying economic growth, following this the right-wing parties interpreted this criticism as a 'political threat to the independence of CNB', supporting the hawkish policy of increasing interest rates. Because of their ignorance of economics, they were not able to see the consequences of such policies for their own governmental plans.

The CNB, despite growing criticism, continues to increase interest rates. Despite the fact that inflation is predominantly imported, and thus of supply-side nature, restrictive policy⁷⁴ continues. It is well known that a small central bank like the CNB cannot fight against world prices of wheat, oil or natural gas. Thus, the decline in price level can only be achieved through cooling the economy; through recession and its effects. However, the right-wing government still believed the Czech economy to be 'overheating', and that this policy is needed. There are also no disinflationary effects associated with this policy, despite the fact that the inflation rate in the Czech Republic represents one of the highest in the EU. Table 14 describes the situation in more depth.

Table 14 CZ inflation, various price indices.

CPI ⁷⁵ , average	2021	3.8%
CPI	March 2022/March 2021	12.7%
CPI	March 2022/February 2022	1.7%
PPI ⁷⁶ , industry	March 2022/March 2021	24.7%
PPI, agriculture	March 2022/March 2021	27.2%
PPI, construction	March 2022/March 2021	10.4%
Import price index	February 2022/February 2021	14.0%
GDP deflator	2021	4.0%

Source: Czech statistical office

The data above show that inflationary pressures are still far from reaching their peak. The double-digit numbers of PPI indices will probably, with some delay, be reflected in increased CPI. The CNB has had to increase its inflation predictions constantly. The inflation (CPI) for June reached 17,2 %. The worsening economic outlook is actually heading towards stagflation, with a predicted growth of 0.8%.

As the statistics regarding inflation are among the worst in the EU, it is necessary to have a deeper look into the most important categories. The largest (annual) price increases were recorded for the fuel, housing (mostly electricity, gas, water), and food sectors. It is obvious that these are essential items, and the possibility to make substantial savings in these categories is severely limited. It should be noted that the rapidly increasing interest rates are also making the repayment of mortgages⁷⁷ extremely difficult, and taking out new mortgages practically impossible. It is thus not only the low-income groups that have little chance of buying their own property, the middle class also has to rely on rental housing (which it is not used to).

March numbers (ČSÚ 2022b) show that the largest increases were in fuel (more than 50% annually!), electricity at 25%, and natural gas at 38%. From the food category, substantial increases were recorded as 30% for flour, 20% for milk, 32% for butter, and 21% for potatoes.

Table 15 Comparison of inflation rates and interest rates in the EU, by country.

	Inflation rate (HIPC), March 2022	Interest rate
EU average	7.8%	
Lithuania	15.6%	0.0%
Estonia	14.8%	0.0%
Czech Republic	11.9%	5.75% (May 2022)
Netherlands	11.7%	0.0%
Poland	10.2%	5.25%
Hungary	8.6%	5.4%
Slovakia	9.6%	0.0%

Source: *tradingeconomics.com, statista.com*

It is obvious that the interest rate policy does not have any effect on the inflation rate (or at least not so far, the CNB claims the policy 'needs time' and will be effective in a year, or a year and a half). Slovakia has a similar economic structure to the Czech Republic, but has a lower inflation rate with a zero-interest rate.

It may have been thought that higher interest rates would increase the CZK-EUR interest rate differential and could contribute to the appreciation of the CZK, which would lead to a curb in imported inflation. However, this policy still does not make much sense. Firstly, it is much easier to implement direct exchange rate interventions, as the CNB has sufficient exchange rate reserves to start to strengthen the CZK against the euro. Secondly, the attractive interest rate differential may no longer be enough incentive for investment, as the Czech Republic is viewed to be relatively close to the conflict in Ukraine, which may shake investors' confidence.

The macroeconomic framework in place before the election was thus of doubly restrictive nature; firstly, due to the attempts to curb the deficit (through cuts), and secondly the restrictive monetary policy. The economic manoeuvring space was thus very limited, no wonder the right-wing parties welcomed it.

The parliamentary elections in 2021 resulted in a change in government, and thus a change in the direction of economic, social, and also foreign policy. Both left-wing parties dropped out of the lower chamber, as they were not able to reach the 5% threshold. The ANO movement led by Andrej Babiš succeeded, however Babiš was not able to build the government himself, as the other (right-wing) parties refused to negotiate with him. Thus, for the first time, the coalition was built from five parties, all of them more or less right-wing with strong NATO inclinations, and some of the parties with a record of anti-socialist policy making. The dominant party, holding the post of the prime minister, is the ODS, originally founded on neoliberal grounds by Václav Klaus. The coalition has a comfortable majority both in the lower and upper chambers. However, it is worth mentioning that one million votes 'expired', this is a record number and hints at a large quantity of unsatisfied citizens whose votes were made invalid.

The socio-economic aspects of the government declaration are rather vague and do not offer much concrete in-

formation. There is no mention of macroeconomic context, and no overview of the changes in the world economy. It is thus not surprising that the main body was devoted to the state of public finances. The government declaration was presented before the conflict in Ukraine, but it barely includes any reflections on the pandemic, or its long-term consequences. The declaration is mostly an ideological document that would fit well into the 1990s. It represents the essence of neoliberal policies that exist out of time and space, as if the pandemic and the changes in the world economy had never happened.

The main focus was placed on the sustainability of public finances, and typically for the right-wing parties, there is a prevailing tendency to try to solve complex macroeconomic issues using primitive accounting. Macroeconomic policy is thereby limited to the topic of sustainable public finances. The right often claims that the state is like a family and should behave as a family regarding public finances, which is, macroeconomically, nonsense.

The government's priorities are clear; the goals of the public administration are to 'support entrepreneurship', and create favourable conditions for employers. This is reminiscent of the 1990s, when the entrepreneurs, in accordance with neoliberal approaches, were seen as those who 'create value', while the employees were seen, at best, as not worth mentioning.

The next sections of the declaration are connected with various restrictive regulations which will practically disable active fiscal policy for any future government. The government will not only seek to fulfil the Maastricht criteria⁷⁸, but will also attempt the implementation of an expenditure ceiling, implementation of constitutional law on balanced budget, and implementation of law on fiscal responsibility. These measures have nothing to do with the current pressing problems in the Czech Republic, and are essentially neoliberal policies – one size fits all, with no deep structural analysis, and prioritising a balanced budget. The implementation of these neoliberal policies is likely to lead to a 'lean state' which is unable, and unwilling, to help its citizens during times of need. There are minimum efforts being made to look for new ways to modernise the Czech Republic. It seems that these considerations will be left to Brussels, thus the most important decisions

regarding policy (industrial policy) will be left to external actors once more.

The governmental declaration is a vague sum of ideas, randomly put together. There are no calculations, no time frame, no concrete proceedings. The declaration also includes further support of the self-employed through a lump-sum increase (although there is already practically no self-employment tax). As there are no numbers presented, it is more a less a set of strange promises that do not hold together. For an expert in domestic politics, it would not be difficult to identify which parts were written by which of the five coalition parties. In the declaration, despite the official hawkish stance towards public finances, there are several promises (both on the income and expenditure side) that will further deepen the state deficit, a rough estimate suggests by around 100 billion CZK! Various measures that are identified as 'savings' (digitalisation, green transition) would actually mean tens and hundreds of billion CZK as a starting investment. Although one part of the declaration is named 'support of employees', there are no measures presented apart from 'resolving the situation of people dealing with distrust'.

One of the first measures of the new right-wing government was to freeze the salaries of state administration employees, as to be 'fiscally responsible' and fight against inflation. These ridiculous arguments mean that large groups of employees will suffer a very steep decline in their purchasing power. The freeze also hit groups which have worked extremely hard and dutifully, including employees from the hygiene and labour offices.

The government then planned to overwork the state budget, so as to find a new trajectory for public finances. Cuts had always been intended; this was the main promise made to the voters for the coalition. In the final version of these regulations, accounting 'tricks' were used to shift the largest cut to the lowering of the state contribution for healthcare by 14 billion CZK. Such a policy would have been hard to defend during the pandemic (although the coalition practically decided to ignore that there had ever been or still is a pandemic). It is also absolutely unjustifiable viewing the influx of refugees from Ukraine, who are entitled to a healthcare system. The correct political reaction to the pandemic would be to support the healthcare system through financial aid. It is not necessary to analyse the newly proposed

budget, as because of the situation in Ukraine, and the still rapidly increasing inflation, it had to be adapted, however it had already become practically useless again by the time the adaption had been completed. There is one more point worth mentioning as it represents an important macroeconomic issue. Inflation has increased tax income in a way that the government did not (or did not want) to predict. On the other hand, the government is very reluctant to use this inflationary income to support companies and households. In this sense, the government is extremely neoliberal and pursues demonstrative policy with many strong words (especially against Russia) – but with no practical action.

The rising costs of natural gas, electricity, etc. moved most EU governments to action. Governments started to introduce measures concerning decreased tax (on fuel, for example), household benefits, subsidies or guarantees for companies, financial aid for renewable energy sources, etc. It would be difficult to find any government in the EU that does so little – practically nothing – for its citizens.

The government is reluctant to act for many reasons. In the case of demonstrative politics, the demands of Czech citizens and households were practically viewed as ‘illegitimate’, because the main priority was to take care of Ukrainian refugees and support them. Such policies, including preferential housing treatment, when socially weak Czech families are ineligible only deepens tensions within society and also increases hostility towards Ukrainians.

The demands for government intervention were confronted with a lot of arrogance. The demands for an increase in the minimum wage (very low by EU standards, see previous chapters) was evaluated as a ‘strongly pro-inflationary’ measure, and thus dangerous for the economy. The leader of TOP09, Markéta Pekarová, whose anti-socialist behaviour is without comparison, said that the government ‘should not take care of its citizens’⁷⁹, as this is not the role of the government. Further, she claimed that ‘people are living beyond their means’ and further wage increases are not possible (Danda 2022). A popular saying of the rather invisible prime minister is ‘nobody said it would be easy’.

So far, the measures taken by the government have been very modest. The housing benefit was altered to support families hit by the extremely high prices of natural gas. However, there is lot of bureaucracy connected with this benefit.

The family has to present many documents, and at the end the financial benefit may be very low, sometimes ridiculously low. There is also stigma associated with demanding social benefits, which is a reason why many families do not claim this benefit, many families also do not know about it, or they are put off by the bureaucratic process (ČTK 2021).

The government is refusing to use price regulation, or the state stakes in energy companies (unlike France). There is a law for price regulation to be used in exceptional circumstances. So far, monitoring of margins is being carried out at fuel stations⁸⁰ and in supermarkets⁸¹. However, there have been no consequences. The Minister of Agriculture did not like some of the margins, but we have learned that it is hard to act, as margins are not profits⁸².

The Czech Republic is a net exporter of electricity, but the production costs are in strong contrast with the prices achieved at the exchange in Leipzig. Again, the government is not able to do anything about it. The natural gas reserves are in private hands. Prices are going to grow rapidly, and estimates made by private companies foresee serious problems for half of Czech households, and many companies. There have been concrete proposals, for example to set a ceiling on the wholesale price of electricity (Kubátová 2022), but again, the government does not act and completely ignores the seriousness of the situation. It is a paradox when representatives of big companies urge the government to act, because they are the ones aware of the real situation in the world market⁸³. Furthermore, many suggestions made to the government, such as price regulation and interventions in the energy market, would require little or no expenditure, this makes the situation even more contradictory considering the government’s promise to be ‘fiscally responsible’.

One of the latest, and so far only, measures discussed, is the one-off child benefit of 5000 CZK. This proposal has not yet been prepared, as the Ministry of Social Affairs is struggling with how to define a household. As there is strong resistance in the government towards across-the-board benefits, there was a search for a ceiling. It seems that families with one million CZK gross income will be eligible⁸⁴. Of course, such limitations mean that the labour offices will be under pressure once more, as they will have to process all the documentation involved. One of the criticisms concerning this benefit is that it will be implemented just before the Municipal and Senate Election in September 2022.

Society is very worn out from the pandemic and won't be able to bear much more pressure. To try to shut down the voices of the concerned and of those dealing with difficult situations, because 'we have to help Ukraine now', is counterproductive.

Households (Šitner 2022) are being hit by many shocks: high inflation which spreads into the whole of the consumer basket of goods, but is especially strong in essential items, which are impossible to do without or decrease beyond a certain point, such as energy and food; the decline in real wages; and the non-existent governmental aid. There is one more factor which has to be taken into account: The situation for Czech companies which are dependent on cheap natural gas (from bakeries to iron and glass works). These companies won't be able to compete with others (because in other countries these energy intensive sectors receive government aid), and will have to start laying off workers. The extremely restrictive monetary policy destroys investment, and also represents a huge risk for many households with mortgages.

The households with five-year fixation will be the most severely hit. Current estimates suggest about 40,000 clients who originally took out mortgages with a very low interest rate and now will have to face much higher interest rates – the difference could be in the region of many thousands for a one-month instalment. Together with the rising energy and food prices, this is a deadly cocktail. In June 2022 the average interest rate for mortgages reached 6,24 %. Together with further increases by the ČNB, this has resulted in home ownership becoming inaccessible for the middle class.

The seriousness of the situation is reflected in the current withdrawal of deposits. In March 2022, the balances on current accounts decreased by 34 billion CZK. This could signal that the middle class is using its savings to pay for increasing energy bills⁹⁵. Needless to say, it is a very worrying sign, we saw similar developments in 2012 and 2013, the years of the 'domestic recession'.

It is advisable to be careful about the interpretation of savings in Czech society. Overall, savings have grown. However, as we know, savings are very unevenly distributed across society. The latest data from 2019 (ČSÚ 2022a) (economic expansion before the pandemic) show that only

the top quintile of households had a strong buffer against economic shocks. Only a small amount of savings was seen for 80% of households, while in the lowest quintile, the savings were negative. Such statistics do not predict strong resilience to shocks.

It is thus clear that the living standards of the majority of the population will decrease dramatically, it must be stressed that this does not only refer to low-income groups such as single mothers or pensioners.

The modus operandi of right-wing governments has been the same for thirty years: To serve their clientele, privatise state property, cut social costs, and blame the poor (and employees) for all troubles. For example, the right-wing government has accused the trade unions (Český rozhlas 2022) of supporting a too rapid increase in wages (despite the fact that the real wage is falling). In the Czech Republic, it is clear that inflation has an imported cost character.

The government is strong in the above-mentioned demonstrative policy of many strong declarations of war against Russia, etc. The government has also introduced several worrying measures which threaten the freedom of speech. Some websites were closed (without any legal basis), and the government actively encourages people to denounce others for 'dangerous opinions'. There has been a new governmental representative introduced, in order to 'fight against disinformation'. Some teachers have been laid off because they expressed different opinions about the Russian-Ukrainian conflict, their pupils then recorded it and denounced them. The atmosphere in society is worsening every single day.

No wonder that anger in society has been increasing rapidly. The trade unions have claimed that they are ready to act, the Chair of ČMKOS (Vachtl 2022) has threatened a general strike or a blockade of Prague. It will be very interesting to see which party is able to successfully channel the growing dissatisfaction of citizens, as both leftist parties are out of 'big politics'. The Social Democrats are practically invisible, and more concerned with the sale of their property to repay their huge debts. There are efforts for mutual coordination and cooperation among various small leftist parties and movements, however speaking from my own experience, I remain highly sceptical.

Conclusion

How the Czech Republic became a Colony has taken the reader from the basics of the centrally planned economy, to the current situation in the first half of 2022. Some of the topics discussed may have been specific only to the Czech Republic while others, regarding for example the Washington Consensus, would also be applicable to the other former Eastern Bloc countries.

The chosen path of transformation – the combination of the neoliberal policies of the Washington Consensus and disrespect for institutions – failed very quickly. However, it played a central role in shifting the economy towards its current dependent position with the main competitive advantage of ‘cheapness’ in many forms. The original head start of the more developed Czechoslovakia was wasted, many domestic structures were ruined, and a welcome for transnational corporations was thus prepared.

There have been very limited debates about this path of socio-economic development. The frame of the neoliberal ‘acceptable attitude’ is the reverse of that from the communist era – there should be no doubts about the path, and those who have different ideas are dangerous communists who are trying to subvert the process and return us back to before November 1989 (the revolution). It took many years (and the process still has a long way to go) to be able to speak freely about different opinions on how the economy should be steered and how economic policy should be formed. Unfortunately, the ‘legacy’ of the transformation neoliberal years is extremely strong; it penetrated most economic universities, almost all of the media, and much of the public sphere. During crisis years, such as the pandemic, and now the conflict in Ukraine, it is clear that there are tendencies to blame employees, trade unions, or ‘socialists’, who live above their means, are extravagant, and destroy our children’s futures because of their demands for higher wages. This public pressure may not be easy to understand for those readers who are used to normal, and perhaps radical, public debates.

The failed transformation set the stage for the dominance of transnational corporations and the preference of their interests; the formulation of policies regarding domestic priorities and strategies were described as useless, or even illegitimate. The consequences of this are visible on many

levels, beginning with the huge difference between GDP and GNI. Other consequences include the long-term high outflow of dividends, misuse of transfer pricing and wide usage of other ‘creative’ methods to get money out of the Czech Republic. The wage ceiling contributes to very slow (and now practically reversed) wage convergence.

These distortions are reflected in the international division of labour, and in labour productivity. As most companies are very distant from their final customer, and in the position of price takers, the wage ceiling is a strong feature of the Czech economy. Even companies that are nominally Czech are usually included in some form in the network of transnational corporations, where they play an inferior role. One of the consequences of the strong influence of transnational corporations in many areas (wholesale, retail, banking, finance, basic infrastructure, industry, automotive, etc.) is that major decisions about the future of the Czech economy are made abroad.

Economic distortions, such as the enormous gap between economic performance and the wage level is either considered as something normal, or as the consequence of ‘communist rule’ (more than thirty years after the change of regime!). Most Czech politicians and ‘expert economists’ show very limited interest in foreign countries, their economic models, and their search for optimal economic policy. Together with ignorance regarding tendencies in the world economy, the Czech Republic is comparable to an open-air museum of failed neoliberal recipes.

The left-wing political parties hardly ever represented a true alternative to the neoliberal system, many times collaborating with it and limiting their efforts to increase social benefits for the poor. The Czech political landscape is in turmoil, with no clear actor that could shape the rising anger in society. This is worsened by the generous policy towards Ukraine citizens, while there is almost no aid for Czechs, and the rapidly rising inflation, which especially affects essential items like housing, energy, and food. The energetic crisis has not been properly reflected by the government, although the prime minister himself acknowledged that the prices of electricity and gas „will be a shock” for many households. The problems of energetic intensive industries are omitted.

It should be stressed once more that inflation rates had already been increasing well before the start of the conflict in Ukraine in February 2022, as shown by the previous figures regarding oil and other commodities. There were other factors at play, such as post-pandemic recovery and the Green Deal.

Instead of stabilising the situation through measures such as price regulation, tax measures and social benefits, the government is acting extremely arrogantly, preferring to implement censorship and encouraging citizens to denounce each other. The contrast between the swift and generous help for Ukrainians and almost no help for Czech families may lead to hostility and further radicalisation of the Czech society towards Ukrainian refugees.

The search for alternatives is extremely difficult. Domestic structure, the cooperative structures in rural areas, have been destroyed. Building ties and confidence among regional actors takes a lot of time, although there are signs that there is still hope. The trust issues regarding the state are even more hopeless. As the pandemic has shown, the state is a **rather** ineffective actor, inclined to absorb prepared suggestions from well-formed lobbyist groups. It is well known that any modernisation and upgrade strategy require a well-functioning state, with the support of its citizens for reforms. However, we see the exact opposite – citizens do not expect anything from the state (only problems and bullying), knowing it works mostly for the benefit of the rich, or the foreign. The distrust towards the state and the widespread attitude of ‘that is not possible’ (in Czech ‘*to nejde*’), a buck-passing excuse that nothing can really change, or at least not for the benefit of the citizens, makes the strive for change very difficult even for those political actors who may have such ambitions. The Czechs thus flee into their private lives, which was also what happened during the normalisation era, from the 1970s until the revolution in 1989.

The current interregnum, connected with the vast and profound transformation of the world economy, would actually offer a unique chance to alter the functionality of the state and form new economic strategy that could boost the economic sovereignty of the Czech Republic. This would allow the state to define its strategic goals and support (it’s high time) domestic and not foreign economic structures, including democratic ones like cooperatives. Rising infla-

tion offers the chance to more closely examine the function of energy markets, the role of foreign retail chains, and sustainable housing policy. The increasing deficits present a possibility to change the tax mix, so as not to favour the richest groups and set all tax income on the social contributions paid by employees and regressive tax. Local economy, in which the consumer and producer belong to the same community, is one of the most relevant features in the process of deglobalisation. I could continue with relevant proposals, however there is no political power that would change these suggestions into political programmes. The citizens’ disconnection from the state continues.

The current situation reveals the inability and ideological blindness of right-wing parties to do anything for their citizens, along with their absolute inability to solve pressing problems. Instead, there is demonstrative policy, moral crusades against citizens, and the beginning of repressive policies against those with different opinions. Such a situation could offer a boost for left-wing parties. However, they have their own inter-party squabbles and often force their progressive liberal opinions on citizens who do not share them. The left-wing parties do not have a comprehensive programme for such a complicated situation and it is questionable if they would be able to come up with one. Thus, it cannot be denied, there will be more radicalisation in society, and left-wing parties will not be the ones to benefit from this.

We do have a lot of positive experience with grassroots activities. It was actually not big politics that saved our nation and its language in the nineteenth century. It was the activity of each and every one of the national revivalists, their clubs and associations, and later cooperatives. In this way we were able to publish books in Czech and save the Czech language from Germanisation, create Czech credit unions, cooperatives of rural electrification, and the National Theatre.

However, we are no longer in the nineteenth century, and our connection to our own homeland is not what is used to be. In which case, the last one switches out the lights.

Endnotes

- 1 The Eastern Bloc was a group of countries which was led by the Soviet Union during the Cold War. The Bloc consisted of communist countries from Europe (Czechoslovakia, Poland, Hungary, Yugoslavia, etc.), Asia, and some interpretations also include states from America, such as Cuba.
- 2 The Washington Consensus dates back to 1989. It was created as a set of economic policy prescriptions for reform within developing countries, backed by the International Monetary Fund, the World Bank, and the US Treasury.
- 3 The perestroika (literally reconstruction) was a process to reform the political and economic systems of centrally planned economies. The process is mostly connected with Mikhail Gorbachev.
- 4 The Prague Spring reforms included political reforms, such as freedom of the press, economic reforms with workers' participation within factory management, and liberalisation with more orientation towards consumer goods, etc.
- 5 The European Economic Community (EEC) was a regional organisation that aimed to bring about economic integration among its member states. It was established by the Treaty of Rome in 1957. Upon the formation of the European Union in 1993, the EEC was incorporated into the EU and renamed the European Community (EC). In 2009, the EEC formerly ceased to exist, and its institutions were directly absorbed by the EU. This makes the EU the formal successor to the EEC. See more <https://en.wikipedia.org>.
- 6 For details see pages 18-21.
- 7 Triumphalism was also seen in the quest for a unipolar world by the US, which failed badly. We are currently witnessing the consequences of this policy.
- 8 The author uses the term 'capitalist', however, in the 1990s discourse, the term 'capitalism' was largely avoided. Instead, politician and economists used the term 'market economy'.
- 9 The Marshall plan was an American plan, officially known as the European Recovery Program, to provide postwar aid to Western European countries.
- 10 Václav Klaus was a right-wing economist, a fan of Margaret Thatcher and Milton Friedman. His political career is more than impressive; he was a minister of finance, prime minister and later president.
- 11 The revolution (critically viewed as a directed regime change) occurred in November 1989 and led to the fall of the socialist regime.
- 12 The GATT was signed in 1948 and was a legal agreement supporting, and removing obstacles from free trade.
- 13 See glosary concerning *tunelování* ('asset stripping'). An important step was the inclusion of the pension fund in the state budget, where the surplus pension funds 'disappeared'. Later, as president, Václav Klaus granted generous amnesty, so that the crimes of the 1990s would never be punished.
- 14 It is worth noting that neoliberal economists actually considered capitalism as something totally inherent to human nature.
- 15 Tomáš Ježek was a Czech economist, one of the fathers of the privatization by vouchers. In the 90's he was minister for state property and its privatization.
- 16 Petr Kellner was a billionaire, one of the richest Czechs. In the 90's he created and investment fund and was actively engaged in many privatization processes.
- 17 The amnesty from 2013 was very broad and the crimes were forgiven for about 30 000 people! Mostly, crimes from the privatization era were forgiven.
- 18 Many of them operated in high-risk schemes, as the small banks themselves obtained loans from the larger banks and subsequently granted these loans to newly established companies.
- 19 The discount rate was 10.5%.

- 20 OECD – The Organisation for Economic Co-operation and Development (www.oecd.org)
- 21 GDP describes the goods and services produced on a given territory, GNI describes the goods and services produced by residents of a given state (e.g. the Czech Republic), wherever they may work.
- 22 For a foreign reader it may seem daring to compare the Czech Republic with Germany, however one of the most strongly resonant transformation slogans which influenced the expectations of ordinary citizens was: ‘We will tighten our belts, and in five years’ time we will catch up with Germany.’ Lack of consideration for the long-term (never-ending) wage gap, together with the fact that many food products are cheaper in Germany than in the Czech Republic, made many citizens angry.
- 23 Mainstream media were very reluctant to engage in debates about socio-economic issues from any perspective which was not strongly right-oriented. The author of this book well remembers personal attacks and ridicule, from the media at the time.
- 24 One of the typical features of the government was hatred against the unemployed who were systematically bullied, had to report at post offices, and were subject to attacks from the government. The reaction was an unprecedented united front of many activist organisations, trade unions, senior clubs, etc.
- 25 One of the main mottos was: government against people, people against government. There were quite a lot of civic organisations that came into being because of the government policies. Most of them do not exist anymore. To begin with, discussions and demonstrations were ignored by the Czech television, which supports the right-wing government, however, soon the demonstrations became so huge that it was not possible to ignore them.
- 26 The purchasing power parity is a useful tool that enables us to compare indicators such as GDP, taking the prices levels of individual countries into account.
- 27 Václav Klaus has recently stated that Czech workers ‘do not deserve’ higher wages.
- 28 The higher inflation was largely caused by the deep devaluations of the Czechoslovakian crown. For details see *Konvergence trhu práce a mezd k vyspělým zemím* (ČMKOS b 2021).
- 29 It is highly questionable if the US should be used as an example, as US citizens move residences about twelve to fifteen times in their lives. Besides the language barrier, Europeans have an attachment to their nation and community, which by no means should be regarded a negative thing.
- 30 Future plans will be considered in the following chapters. Of course many plans will have to be changed because of the conflict in Ukraine.
- 31 For example, when the mother company owns the headquarters and the Czech daughter is paying excessively high rent. There are more sophisticated methods in wholesale and retail.
- 32 Reminding the reader again of the special nature of the year 2021, influenced by the CNB recommendation.
- 33 However, reinvested earnings are not necessarily always translated into new investments, they are also sometimes ‘left aside’.
- 34 The Visegrad countries: the Czech Republic, Slovakia, Poland, and Hungary.
- 35 Some originally Czech companies have their official headquarters in the Netherlands for tax reasons. Both the Netherlands and Luxembourg are offshore centres, and it is probable that they also host non-European company headquarters.
- 36 However, there are different approaches as to how to tackle the problem. The right-wing coalition does acknowledge the problem (which it refused to speak about for many years) but views the best approach as making reinvestment more attractive, especially regarding taxation. Proposals from other parties included using the arm’s length principle, and supporting the revenue authorities. In some programmes there were also remarks regarding the structural overhaul of the Czech economy, or implementation of structural tax-

- tion, aimed for example at the banking sector. (Švihlíková 2021)
- 37 ČEZ means Czech electrical plants, it is the largest producer of electricity and one of the most influential companies in the Czech Republic. More than 70 % of the equity is held by the state. Despite being a state company, its conduct has nothing to do with following the strategic interests of the country.
- 38 Čepro is responsible for transport, and storage of oil products. It has its own distribution network of fuel stations, EuroOil. It should also protect the state strategic reserves.
- 39 The rate of return is calculated as a ratio of net income generated by FDI in period $t+1$ to the FDI stock in period t .
- 40 However, as demonstrated later in the text, tax rate is not the only component of personal income tax, the tax base is also significant and also those to whom it applies.
- 41 The movement ANO preferred to lower the tax rate and, together with the ODS, returned to the previous right-wing proposals. The Social Democrats (ČSSD) preferred more progressive features in the new constructions, pirates were in favour of increasing the tax credit for individual tax payers, etc.
- 42 It is one of the most obvious examples of how the COVID-19 pandemic was misused. The real estate acquisition tax was abolished. A positive impact on housing prices is nowhere to be seen, and the ownership of housing is now financially out of reach even for the middle class. On the other hand, the speculators who already own property really did appreciate the abolition of this tax.
- 43 This system is, of course, also a huge obstacle for any pension reform. Employees carry a much higher tax burden than the self-employed, if this is not taken into account, employees will also end up financing the pensions of the self-employed.
- 44 The government claims that it cannot do much for the citizens, regarding the current high inflation and rapidly rising costs of energy and food, as the 'debt is too high', therefore we cannot afford it.
- 45 Between 2005-2006. Despite the short period of time, he is still viewed as one of the most successful Social Democratic politicians.
- 46 The Chamber of Deputies is the lower chamber of the Parliament. The elections of the lower house are considered to be the most important, with the highest turnout of voters (together with the presidential elections). From these elections, the government is built, has to gain a confidence vote in the lower chamber.
- 47 ANO in Czech means 'yes'. One of the most successful ANO slogans, attractive especially after the difficult time of right-wing coalitions was *Ano, bude líp* ('Yes, it will get better').
- 48 A popular saying is that if the election had taken place two weeks later, Babiš would have won.
- 49 Many of these policy measures were originally elaborated by the ČSSD, although ANO took the credit. ANO also connected with pensioners, one of its major groups of voters. ANO helped to change their image, as right-wing governments viewed them as a burden or parasites, whereas ANO made them into a valuable group of voters, whose interests needed to be taken seriously.
- 50 The Czech Television is very biased despite the fact that it is public and financed via license fees, which are obligatory for anyone owning a TV set.
- 51 There have been many protests against Babiš. The main criticisms were that he presents a threat to democracy because of his wealth and influence, alleged misuse of European subsidies, his pragmatic alliance with the president, etc. There was one movement Millions of Moments that proclaimed to support 'democratic parties' (right-wing) and constantly organised demonstrations against Babiš' government, enjoying strong support by Česká televize. This movement also motivated right-wing parties to create coalitions. The change in voting laws then cleared the path for their victory in 2021.

- 52 which by peculiarities of the voting system finished second, but has the biggest number of MP's.
- 53 in a personal interview with the author.
- 54 Babiš himself used to explain, that he was the 'heritage' of the right-wing policies that woke up the rather sleepy society. His success was only enabled by the corruption, rent-seeking of the right-wing governments.
- 55 Official numbers used at the ČMKOS congress in April 2022 (ČMKOS 2022)
- 56 The candidate needs to have support from the members of Parliament (twenty from the lower or ten from the upper chamber, if not, he needs to have a petition signed by at least 50,000 citizens). The elections are costly, thus as Babiš can easily finance himself, it is a great advantage for him.
- 57 The new right-wing government 'rewarded' both of them by freezing their salaries (in a situation of unprecedented inflation) as a 'restrictive measure'. The workers at the labour offices were in strike emergency, when I wrote this part.
- 58 Which highlights the failure of the 'economic models' mentioned above and also made by the previous president and prime minister, Václav Klaus, whose prediction was economic decline by 20%.
- 59 Later on, a vast scale of programmes was introduced. Whereas Antivirus, a Czech version of *Kurzarbeit* was implemented by the Ministry of Social Affairs, other programmes belonged under the Ministry of Industry and Trade. These programmes benefited the self-employed, specific sectors (COVID-culture), reimbursement of rent costs, etc.
- 60 Needless to such, such system of evidence is very common in most of EU countries and definitely cannot be described as 'bullying entrepreneurs and the self-employed'.
- 61 The implementation of loss carryback threatened the economic emergency team, and their recommendations luckily influenced the votes made by members of Parliament, which put some limits on the usage of loss carryback. The Communist party representative, unbelievably, supported the measure of loss carryback with the logic that 'big companies employ many people'. One of the biggest worries is that this measure could effectively encourage transnational companies to shift their losses to the Czech Republic.
- 62 Which means the self-employed effectively do not have to pay any taxes. Their pensions will be minimal, because there is no connection between the Ministry of Finance and the social system. However, the lump sum is a strong incentive for working in the 'švarc systém'.
- 63 Another disastrous decision that functions as a tax optimisation channel, and contributed to lower chances of workers buying lunch in restaurant for workers. Now the representatives of restaurants criticize it.
- 64 Again, the measure was not limited in time. The VAT for staying in a hotel is lower than the VAT on food.
- 65 The current right-wing government did not present any realistic plan, and just keeps on repeating that there will be no tax hikes, which naturally increases worries concerning the privatisation of public systems.
- 66 The right-wing government completely ignores the suggestions of the opposition (which may be not surprising), but also suggestions made by energy experts, company representatives, and even members of the Chamber of Commerce. Instead, the prime minister and the members of the government pursue demonstrative policy, including emotional article writing and having photos taken with foreign statesmen, etc.
- 67 The super gross wage abolition was carried out by ANO and the ODS. It was a sign of their possible future coalition. The junior partner in the government, the Social Democrats, were against it however they were neither willing nor able to leave the government.
- 68 It is highly questionable if the government would act just to increase net wages for employees, the author believes that there is probably an ulterior motive.

- 69 It has been very difficult to criticize this new construction. The popular saying 'Babiš got me few hundreds more' is very hard to fight against.
- 70 As will be discussed in further chapters, there is no fiscal consolidation plan from the current, right-wing government. The inflation is increasing the tax income substantially, the government is spending very little on citizens, and real wages are in freefall. For the right-wing government this may actually be the 'optimal' way.
- 71 WHO data claim 6,25 million deaths due to COVID-19.
- 72 These blocs would be connected both politically and economically. They would mostly engage in trade with other countries in the same bloc, and have a dominant country with dominant currency, share technology inside the block and have limited and hostile relations to the other block/s. As decoupling is obvious in the case of Russia and partly also China (more as a Western reaction, than a reaction from China), this possibility is gaining probability.
- 73 Association of south east Asian nations, consisting of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam.
- 74 The president is going to name a new governor soon. There are various names being discussed, however Aleš Michal may be one of the choices. His policy would probably be different and he could change the course of monetary policy.
- 75 Consumer price index, measuring inflation according to the consumption basket of households. CPI is the measure for the ČNB regarding inflation targeting.
- 76 Producer price index, measures changes in selling prices over time for producers. Usually, the increase in PPI signals a future increase in CPI.
- 77 The estimates are around 40,000 clients who will need to refinance their mortgages this year.
- 78 It would be quite difficult to find countries that are member of EMU and fulfil these criteria.
- 79 Just to mention that the government has eighteen ministers, so that requirements of all five parties would be met. So much for fiscal savings.
- 80 Fuel prices in the Czech Republic belong to the highest in the whole of the EU. The government is either not able or not willing to use its own state company Čepro, or state fuel stations Eurooil to set a ceiling on the fuel price.
- 81 I can remember the Minister of Finance, a member of ANO, publicly stating that lowering VAT for food is not wise, as the prices of food would probably not get lower because the supermarkets would increase their margins.
- 82 There is a long record of poor performance for the Office for the Protection of Economic Competition (ÚOHS). The Office did not react to a cartel in the mobile phone operators sector. There was also no reaction when fuel stations, which increased their margins immediately after price hikes of oil on the world market, despite having old stocks of the cheaper oil. When Czech farmers complained about the unfair practices of foreign retail chains which destroy them, again there was no action taken.
- 83 Even the President of the Chamber of Commerce is talking about the necessity to increase wages and urges the government to be more proactive.
- 84 To be a recipient of state benefits comes with stigma, as even minimal levels of social support come under attack from neoliberal journalists, economists, etc. Thus, the right-wing government keeps talking about 'targeted help', even though it is absolutely clear that the situation is so grave, a large segment of the middle class will be severely hit as well.
- 85 The state-owned energetic company ČEZ announced further dramatic increases in electricity prices, but at the same time it will pay out record bonuses to CEOs and other managers.

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Glossary

- Centrally Planned Economy** = economy closely interlinked with the priorities of the ruling party. Planning played a crucial role in production and distribution, as the market was viewed as a destabilising factor.
- Collectivisation** = used when referring to agriculture, change from private ownership to collective ownership (usually cooperatives). Unfortunately this process largely discredited cooperatives, which were spread in Bohemia and later Czechoslovakia since the second half of 19th century.
- Comecon (the Council for Mutual Economic Assistance)** = organisation that aimed to facilitate development and economic cooperation among Eastern Bloc countries. Members included the Soviet Union, Bulgaria, Czechoslovakia, Hungary, Poland, and Romania. Later, the German Democratic Republic, Vietnam, Cuba, and Mongolia joined.
- Convergence** = getting closer to more developed countries, e.g., in terms of GDP per capita, wages or other indicators. Convergence towards more developed European countries was one of the key promises of transformation.
- FDI** = Foreign Direct Investment. Made by transnational companies with the aim of controlling the given affiliation (daughter company) and with an equity share of more than 10%.
- Gradualisation process** = one of the approaches towards transformation. The gradualist approach pays more attention to the legislative framework, strategic goals, and more socially stable processes.
- Great Recession** = a major disruption in the capitalist economy, which started in the US and strongly impacted Western countries. The Great Recession is generally understood to have spanned from 2007–2009, however its consequences go much further beyond that period.
- Minimum wage** = Lowest acceptable remuneration for work in work relations. It is generally explained in the Labour Code. There is no formula (yet), thus the minimum wage is a subject of negotiation in the tripartite. The life minimum is the minimal amount of money necessary for alimentation and other basic needs.
- Power Purchasing Parity** = economic concept that enables the currencies of different countries to be compared through baskets of goods. The concept is used for measuring the economic performance of countries, among other things.
- Privatisation by Vouchers** = one of the forms of privatisation. Citizens were able to buy shares in some companies, using a “voucher book”. It was supposed to lead to a “people’s capitalism” but resulted in an unprecedented concentration of wealth in the hands of the few.
- Progressive taxation** = taxing those with a higher income disproportionately more. Progressive taxation can be applied to various taxes, e.g., income taxes for natural persons.
- PZO** = Enterprises for Foreign Trade. State organisations that helped with contacts abroad in the framework of the centrally planned economy. These organisations were highly professional and organised foreign activities for other state enterprises.
- Shock Therapy** = one of the approaches towards transformation. A fast and uncompromising introduction of the capitalist economy, such as trade liberalisation, ending state subsidies, price controls, etc.
- Švarc systém** = Czech invention during the transformation period. Employees are officially registered as self-employed. Despite these individuals working mostly for one employer, the employer does not pay social or health contributions, instead putting this burden on the employees. This system of tax avoidance is named after its inventor, the entrepreneur Švarc.
- Trade liberalisation** = removal of barriers for trade, such as tariffs, orientation towards free trade and withdrawal of various forms of state support.
- Transfer pricing** = pricing technique used when goods are traded among companies that have the same owner and are typically daughter companies of a transnational company. Transfer pricing is often used to avoid taxation.
- Tripartite** = The official name is Council for economic and social accordance, is an institutionalized platform for social dialogue among employers (represented e.g. by Chamber of commerce), employees (represented by trade unions) and the government.
- Tunelování (Asset-stripping)** = literally translated as ‘tunnelling’ and refers to the stripping of assets and the resulting closure of a company.

Biographies

Ilona Švihlíková is vice-rector at the University College of Business in Prague. She holds a PhD in Political Science and specialises in the global economy. Her work focuses on the political and economic aspects of globalisation. She has authored or co-authored a number of monographs, including *How the Czech Republic Became a Colony*, *The Greek Tragedy*, and *Capitalism, Socialism and the Future*. In 2010, she founded the civic organisation *Alternativa Zdola*, focusing on local economy and citizen participation. In 2017, she founded the analytical website *!Argument*. She works as a macroeconomic analyst for the Bohemian-Moravian Confederation of Trade Unions and was a member of the National Economic Council of the Czech Government (NERV), a governmental advisory body.

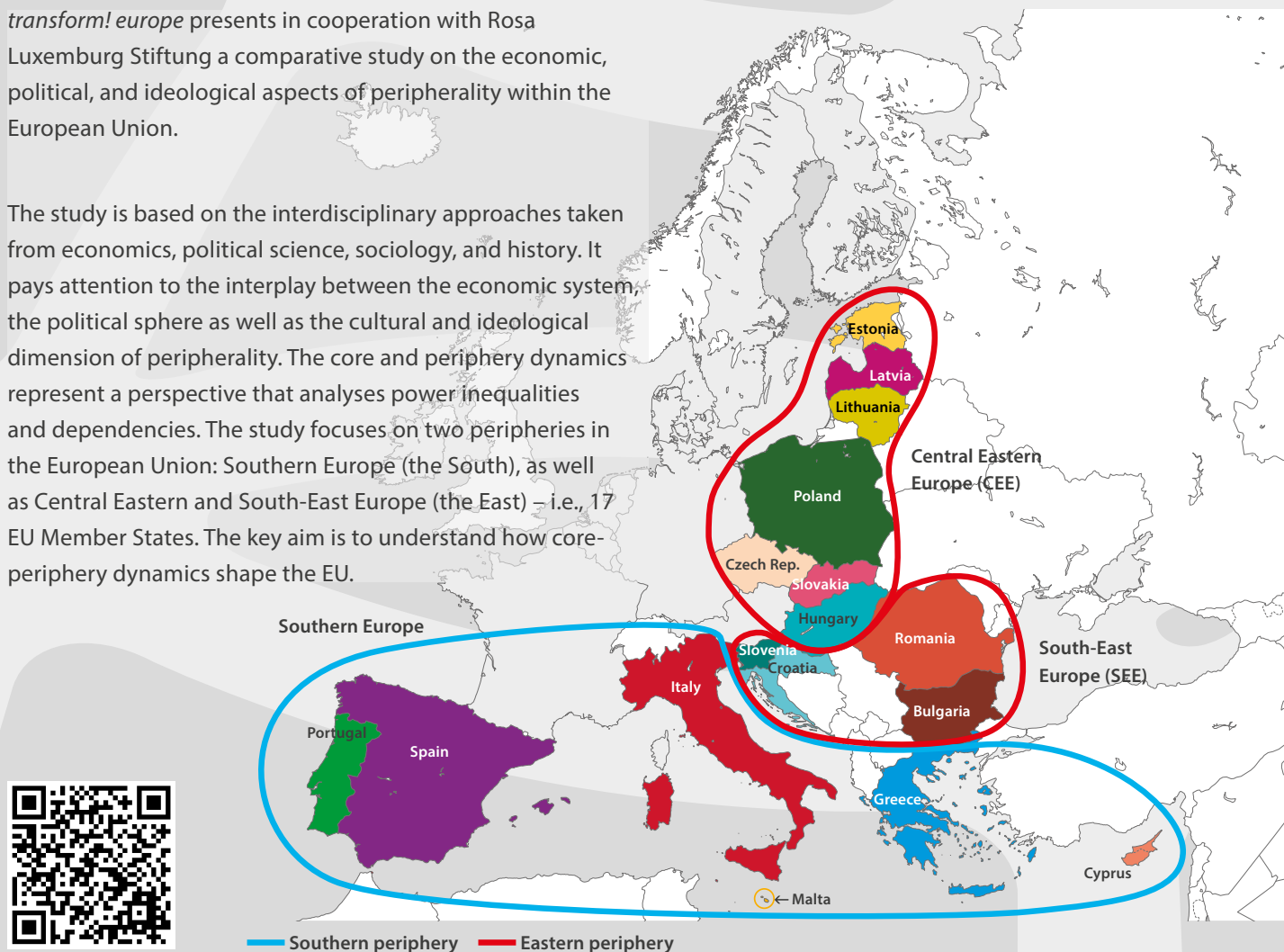
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100 SHADES of the EU

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