

Univerzita Karlova v Praze

Fakulta sociálních věd

Institut ekonomických studií

Diplomová práce

2003

Eva Kreuzbergová

Univerzita Karlova v Praze
Fakulta sociálních věd

Institut ekonomických studií

DIPLOMOVÁ PRÁCE

Invisible Industrial Policy in the Czech Republic

Vypracovala: Bc. Eva Kreuzbergová

Konzultant: Doc. Ing. Pavel Mertlík, CSc.

Akademický rok: 2002 - 2003

Prohlášení

Prohlašuji, že jsem diplomovou práci vypracovala samostatně a použila pouze uvedené prameny a literaturu

V Praze 12.5. 2003

.....

Acknowledgements

I would like to express my gratitude to Doc. Ing. Pavel Mertlík, CSc., my consultant, for getting me interested in this topic within his lectures, and for his insightful comments and critique, as well as for substantial encouragement when supervising my thesis.

I wish to thank to Prof. Ing. Karel Kouba, DrSc. and Prof. Ing. Michal Mejstřík, CSc., for their helpful comments and suggestions; and to Ing. Miroslav Zámečník, for an insightful interview and valuable information.

I also owe thanks to my colleagues and friends from e-Merit, particularly to Bc. Roman Pazderník and PhDr. Tomáš Sedláček, for fruitful discussions. I am very grateful to Tomáš for inviting me to participate in the research project concerning the fall of IPB. Work on this project, especially extensive and open interviews with people from Czech banking and financial sector, gave my thesis particular direction.

Special thanks belong to the following people:

Colm M. Murphy, MSc., for his patience with proof-reading the thesis.

My mother, for her support and devotion during all the years of my studies.

Jan L. Melmoth, for many inspirations.

Invisible Industrial Policy in the Czech Republic

Abstract:

The thesis reviews state interventions in the industrial sector realized through the transformation institutions, mainly the Consolidation Bank (later the Czech Consolidation Agency) that was converted into an instrument of indirect, selective bailouts. The aim is to show that the state practised rather extensive unofficial industrial policy during the economic transition as well as in later years that was based on ad hoc state aid in selected distressed companies. The extent, methods and causes of unobserved state involvement are analysed as well as the results of the interventions and consequences for the overall economic environment. Cases studies of several supported enterprises demonstrate that selected companies were in fact subsidized with significant amount of state resources to be kept afloat without conditioning the bailouts with restructuring measures, and its effect thus did not last for long. It is also argued that the non-transparent conditions and vague rules of state involvement opened potential for rent-seeking practices and influences of interest groups. The revitalisation program in late 1990s is described as an attempt to avoid ad hoc solutions and introduce a system into government policy towards significant industrial companies, however, the program was gradually suppressed and paralelly the asystemic interventions were still carried out. It is shown that the phenomenon of invisible involvement realized through the state institution is deep-rooted and even at present it still can be detected (even with its negative consequences) in dealing with bad assets accumulated in Czech Consolidation Agency.

Neviditelná průmyslová politika v České republice

Abstrakt:

Diplomová práce mapuje státní zásahy v průmyslovém sektoru realizované prostřednictvím transformačních institucí, zvláště pak Konsolidační banky (později České konsolidační agentury). Cílem práce je ukázat, že stát prostřednictvím tohoto nepřímého nástroje uskutečňoval v době transformace, ale i v pozdějších letech, poměrně rozsáhlou neoficiální průmyslovou politiku založenou na státní pomoci poskytované ad hoc vybraným podnikům v tísnivé situaci. Práce analyzuje rozsah, metody a důvody tohoto nepozorovaného zapojení státu; prostor je rovněž věnován výsledkům intervencí a jejich obecným konsekvencím pro ekonomické prostředí. Případové studie podporovaných podniků demonstrují, že vybrané podniky byly de facto subvencovány s použitím značného množství státních prostředků, aby byly udrženy při životě. Pomoc však nebyla vázána na opatření směřující k restrukturalizaci a její efekt byl tedy pouze krátkodobý. Rovněž je rozebírán fakt, že netransparentní podmínky a vágní pravidla pro zapojování státu otevřely potenciál pro dobývání renty (rent-seeking) a uplatňování vlivu zájmových skupin. Revitalizační program na konci 90. let je popisován jako pokus vyhnout se ad hoc zásahům a vnést systém do politiky vládních zásahů ve významných podnicích. Tento pokus byl však postupně potlačen a navíc i souběžně s ním byly uskutečňovány nesystémové intervence. Práce ukazuje, že fenomén tohoto neviditelného zapojení státu realizovaného prostřednictvím uvedené státní instituce se v našem prostředí hluboce zakořenil a i v současné době jej (i s jeho negativními důsledky) můžeme objevit v rámci řešení špatných aktiv nahromaděných v České konsolidační agentuře.

List of Abbreviations

ČF	Česká Finanční
ČR	Czech Republic (<i>Česká republika</i>)
CZK	Czech Koruna
ČKA	Czech Consolidation Agency (<i>Česká konsolidační agentura</i>)
ČNB	Czech National Bank (<i>Česká národní banka</i>)
ČS	Czech Savings Bank (<i>Česká spořitelna</i>)
ČSOB	Czechoslovak Trade Bank (<i>Československá obchodní banka</i>)
EBITDA	Earnings before Income Tax and Dividends
EU	European Union (<i>Evropská unie</i>)
EC	European Commission (<i>Evropská komise</i>)
FNM	National Property Fund (<i>Fond národního majetku</i>)
GDP	Gross Domestic Product
HN	Hospodářské noviny (<i>Czech daily</i>)
IB	Investment Bank (<i>Investiční banka</i>)
IC	Investment company (<i>Investiční společnost</i>)
IF	Investment fund (<i>Investiční fond</i>)
IPB	Investment and Postal Bank (<i>Investiční a Poštovní banka</i>)
KAMCO	Korean Asset Management Company
KB	Commercial Bank (<i>Komerční banka</i>)
KoB	Consolidation Bank (<i>Konsolidační banka</i>)
MFD	Mladá fronta Dnes (<i>Czech daily</i>)
MPO	Ministry of Industry and Trade (<i>Ministerstvo průmyslu a obchodu</i>)
NPF	National Property Fund (<i>Fond národního majetku</i>)
NPL	Non-performing loans
ODA	Civic Democratic Alliance (<i>Občanská demokratická aliance</i>)
ODS	Civic Democratic Party (<i>Občanská demokratická strana</i>)
RA	Revitalisation Agency (<i>Revitalizační agentura</i>)
RTC	Resolution Trust Corporation
SBČS	State Bank of Czechoslovakia (<i>Státní banka Československa</i>)
SOE	State-owned enterprise
TOZ	Perpetually revolving inventories, perpetual working capital loans (<i>Trvale se obracející zásoby</i>)
ÚOHS	Office for the Protection of Competition (<i>Úřad pro ochranu hospodářské soutěže</i>)

CONTENT

FOREWORD.....	11
1 EVOLUTION OF INVISIBLE INDUSTRIAL POLICY DURING ECONOMIC TRANSITION ..	13
1.1 INTRODUCTION	13
1.2 THE ESTABLISHMENT OF THE CONSOLIDATION BANK.....	13
1.2.1 The Original Intention: Relief from "Permanently Revolving Inventories"	13
1.2.2 KoB´s Conversion into a Stable Phenomenon of Czech Banking System	15
1.3 THE ROLES OF KoB AND GRADUAL CHANGES IN ITS STRATEGY.....	15
1.3.1 Debt-alleviation agency	15
1.3.2 Relaxing conditions for TOZ repayment.....	15
1.3.3 Anchor of the state´s helping hand	17
1.3.4 Participation in Property Rights – an Elegant Way of Industrial Policy Realization	19
1.3.5 Uncommon "Missions" of the KoB	24
1.3.6 Other Roles of the KoB	25
1.3.7 Česká Finanční – a New Transformation Institution	26
1.3.8 Summary: Increasing Importance of the KoB in Czech Economy	27
1.4 SUPPORTING ROLE OF THE FNM	28
1.5 ESSENTIAL ROLE OF BANKS	29
1.6 LINKS OF BANKS, COMPANIES AND TRANSFORMATION INSTITUTIONS.....	31
1.7 ACCUMULATION OF HIDDEN PUBLIC DEBT IN TRANSFORMATION INSTITUTIONS	32
1.8 FORCES BEHIND INVISIBLE INDUSTRIAL POLICY	36
2 STATE INTERVENTIONS IN DISTRESSED COMPANIES SINCE 1998	42
2.1 INTRODUCTION	42
2.2 MAJOR CAUSES OF INSUFFICIENT RESTRUCTURING PROCESS.....	42
2.3 REVITALISATION OF CZECH ENTERPRISES – AN ATTEMPT AT A SYSTEMIC APPROACH.....	45
2.3.1 Strategies Addressing Problems of Industrial Sector	45
2.3.2 Primary Revitalisation Plan.....	46
2.3.3 Second Revitalisation Plan	47
2.3.4 The Revitalisation Agency	47
2.3.5 Implementation of the Revitalisation Program	49
2.3.6 Case Studies of Revitalisation Companies	56
2.3.7 Results of Revitalisation.....	65
2.4 PARALLEL INVISIBLE INDUSTRIAL POLICY.....	70
2.4.1 ČKD.....	71
2.4.2 Aliachem	72
2.4.3 Spolana.....	73
2.4.4 Královopolská	74

3	RESULTS AND CONSEQUENCES OF INVISIBLE INDUSTRIAL POLICY	77
3.1	DIFFERENT METHODS OF STRUCTURAL POLICY	77
3.2	DEVIATIONS OF CZECH POLICY FROM THE STANDARD APPROACH.....	77
3.3	PRACTICAL PERFORMANCE OF THE STATE AS AN AGENT OF RESTRUCTURING	79
3.4	DISTORTION OF MARKET RELATIONSHIPS	81
3.5	MORAL HAZARD	82
3.6	RENT-SEEKING AND INFLUENCE OF INTEREST GROUPS.....	82
3.7	EXTREME VULNERABILITY OF THE SYSTEM.....	84
3.7.1	Opacity	84
3.7.2	Absence of clearly formulated criteria	84
3.8	STRUCTURAL POLICY PREVENTING STRUCTURAL CHANGE?.....	85
4	INFLUENCE OF EU STATE AID POLICY ON THE CZECH PRACTICE.....	86
4.1	EU STATE AID POLICY	86
4.2	EU RULES AND THE CZECH ENVIRONMENT	87
4.3	INSUFFICIENCY OF EU ´S INFLUENCE	88
4.4	EUROPEAN COMMISSION ´S DOUBLE STANDARDS	89
4.5	THE EU AS A CATALYST FOR CULTIVATION OF CZECH STATE AID	89
5	DEALING WITH ASSETS ACCUMULATED IN THE CONSOLIDATION BANK.....	91
5.1	PROGRESS IN BANK PRIVATIZATION	92
5.2	METHOD OF BANKS ´ RECAPITALIZATION – A FUNDAMENTAL MILESTONE	92
5.3	ACCUMULATION OF ASSETS IN THE KoB	93
5.4	ASSETS DISPOSAL STRATEGIES.....	95
5.5	EFFECTS OF KoB ´S METHODS IN THE CZECH ENVIRONMENT.....	97
5.5.1	Heterogeneity of Debtors.....	97
5.5.2	Badwill of ČKA	99
5.5.3	Czech Privatization Circle	99
5.5.4	Resurgence of Invisible Interventions	101
5.5.5	Political management of the Agency	101
5.6	COMPARISON WITH APPROACHES IN OTHER COUNTRIES	102
5.7	ADVISABLE MODIFICATIONS OF THE CZECH SYSTEM	105
6	THE PHENOMENON OF THE KOB/ČKA AS A STIMULATOR OF INVISIBLE INTERVENTIONS	107
6.1	SYMPTOMS OF A BUREAUCRATIC INSTITUTION	107
6.2	THE ČKA AS A SOURCE OF POWER	109
7	CONCLUDING REMARKS	112
8	REFERENCES	114

List of Tables

Table 1	Credit Allocation from the Consolidation Bank to Some Companies
Table 2	KoB's Equity Shares (1996)
Table 3	Rankings for Lending to, and Performance of Selected Industries, 1992
Table 4	Hidden Public Liabilities (bil. CZK)
Table 5	Companies Included in the Revitalisation Program (financial data in CZK mil.)
Table 6	State Interventions in Zetor (mil. CZK)
Table 7	State Interventions in Vítkovice (mil. CZK)
Table 8	State Interventions in Tatra (mil. CZK)
Table 9	Losses and Profits of Tatra (mil. CZK)
Table 10	State Interventions in Škoda (mil. CZK)
Table 11	State Interventions in ČKD (mil. CZK)
Table 12	Losses of Spolana (mil. CZK)
Table 13	State Interventions in Královopolská (mil. CZK)
Table 14	Summary – Other Cases of State Interventions in Industrial Companies
Table 15	Bad Debts in Poland, Hungary and the Czech Republic
Table 16	Summary of Pool Sales

List of Charts

Chart 1	TOZ Credit Repayment (bil. CZK)
Chart 2	New Credits from the KoB (bil. CZK)
Chart 3	Development of KoB's Equity Shares (bil. CZK)
Chart 4	Profit/Loss of Aero Vodochody (mil. CZK)
Chart 5	The KoB's Clients
Chart 6	State Intervention and Achieved Price in Revitalisation Companies (mil. CZK)
Chart 7	State Intervention and Sale Price in Selected Companies
Chart 8	Development of KoB/ČKA's Balance Sheet (CZK bil.)
Chart 9	Transfers of Assets from Banks (CZK bil.)

List of Schemes

Scheme 1	KoB's Support No. 1 to Zetor (1994)
Scheme 2	KoB's Support No. 2 to Zetor (1996)
Scheme 3	Ownership Structure of Aero Holding after the Debt-equity Swap

- Scheme 4 Possible Links between Banks, Companies and Transformation Institutions (1994)
- Scheme 5 Financial Relationships of Off-budget Transformation Institutions
- Scheme 6 General Model of State Intervention in Revitalisation Companies
- Scheme 7 Overall Restructuring Strategy in Revitalisation Companies
- Scheme 8 Scenario of Škoda 's Revitalisation Program
- Scheme 9 Czech Privatization Circle
- Scheme 10 ČKA as a Source of Power

Foreword

The Consolidation Bank (later Czech Consolidation Agency) is often denoted as a vessel for failures of the former Communist regime as well as the post-Communist governments. This transformation institution indeed embodies a memorial of many transition setbacks. The institution is also referred to as a living chronicle of the Czech transition, and, if its records are once opened to public, we might finally get a more entire picture of Czech transition "uncovered".

However, although the role of the Consolidation Bank is sometimes hinted at, the essence of the institution is still somehow "veiled" and the eventful past is mostly neglected. Nevertheless, this state institution played a role of remarkable importance in shaping the Czech economic environment during the whole 1990s and its importance has not diminished even now.

This is the major reason why this thesis came into being. It aims to fill in a gap in economic research pertaining Czech transition, since nearly only information you can obtain about substantial state interferences within the Czech economy through the Consolidation Bank are fragmented hints in the press. The thesis thus attempts to provide a more complete picture concerning the development of the mentioned transformation institution.

Simultaneously, the investigation leads us to a closely associated phenomenon that is referred to as the "*invisible industrial policy*". The notion relates to state interventions in the industrial sector that were relatively hidden from the eyes of the public. What is meant by "hidden" or "invisible"? Firstly, the transactions were not based on any proclaimed industrial policy concept, which would justify or give reasons for the state involvement. Secondly, the considerable amount of actual state aid was provided through the Consolidation Bank and also other transformation institutions (National Property Fund, Česká finanční). State aid was granted especially to selected large and important companies through different means, above all, we can mention debt alleviations, debt-equity swaps or credit allocations. Circumstances of state involvement were thus cloaked and not providing an easy survey as the institutions grugged information and government rhetoric usually did not comply with the reality, i.e. it was refused to admit extensive state involvement. Considering indirect state involvement, we also must not forget the role of the (state) banks.

The thesis attempts to investigate the extent and methods of the "invisible industrial policy" as well as the results of the interventions. It is argued that the Consolidation Bank, in particular, became the ultimate rescue rope for the most sinister cases of distressed companies. However, the selected enterprises were supported simply to be kept afloat and the bailouts were thus not bound to any conditions, e.g. restructuring of the company. After some time, the impact of the state support thus disappeared and the situation required new intervention.

Except for being obviously inefficient in a long-term view, as particular cases of supported companies show, the "invisible industrial policy" had also other general consequences. It turned

into a handy instrument used by the government to prevent collapses of enterprises that were too big to fail and this way the state could reassert its influence in the economy. Moreover, space was opened for close interactions between political spheres and the enterprise sector, taking place in non-transparent conditions without clear rules regarding the use of public resources – an environment where rent-seeking and other practices of interest groups can indeed flourish.

The phenomenon of invisible interventions became deep-rooted in the economic environment and the same occurred with its main instrument – the Consolidation Bank. It seems that the phenomenon is hard to be dispatched. Although there was an attempt to create a systemic framework for this kind of government support, the practices of asystemic state involvement survived and can be detected even at present in connection with the role of the Czech Consolidation Agency related to dealing with bad debts accumulated in this state institution. Therefore, the thesis also addresses the issue of this particular form of the state involvement.

1 Evolution of Invisible Industrial Policy during Economic Transition

1.1 Introduction

There is a huge number of companies in the Czech Republic that stayed afloat during the 1990s thanks only to an "invisible" helping hand from the state. The help was granted either through direct or indirect subsidies or through credit distribution.

For many years, there hasn't been any industrial policy concept that would provide justification for the selective support of some companies. Nevertheless, ways were found to realize such a policy and to such a substantial extent, considering the volume of granted resources as well as the number of companies supported.

How could government surreptitiously carry out such invisible policy? This chapter describes the evolution and the methods of realisation of this nonstandard industrial policy in the early transition until the change of government in 1998. The chapter maps how a few transformation institutions were converted into instruments of indirect, selective credit-allocation, leverage for economically non-viable firms and their large-bank creditors. A few transformation institutions became key instruments of this nondefined but in practice performed policy – mainly the Consolidation Bank, but also the National Property Fund and later also Česká finanční. Government turned to these institutions to resuscitate failing industries and provide a bulwark against a large numbers of bankruptcies. The chapter provides an overview of the participation of the main transformation institutions that were in the government's, non-defined but in practice existing, industrial policy. Banks and their relaxed credit policy also played an important role to a large extent and thus we refer to their position in our context.

1.2 The Establishment of the Consolidation Bank

The Consolidation Bank (Konsolidační banka, s.p.ú., KoB) was established in 1991 by the Federal Ministry of Finance as a state monetary institution operating under the supervision of the Ministry without a network of branches and with a limited banking licence.

1.2.1 THE ORIGINAL INTENTION: RELIEF FROM "PERMANENTLY REVOLVING INVENTORIES"

The Consolidation Bank came into being due to the existence of credits covering the "permanently revolving inventories" – the so called TOZ (trvale se obracející zásoby).¹ These TOZ credits were a means through which the former state owned enterprises (SOEs) were gaining their working capital during the seventies and eighties. TOZ were unsecured, automatically rolled-over loans with interest rates initially set at 3%, later raised to 6%. As Mertlík (1998:112)

¹ Another English translation for TOZ credits is "perpetual working capital loans".

notes, the credits covering the working capital of enterprises were a speciality of the Czechoslovak economy of the seventies and eighties. In 1970 the government centralized the working capital of national enterprises in its budget, i.e. centralised most financial means of the enterprise sphere, in order to avoid the threatening budget deficit. However, it is important to note that "perpetual working capital loans" also became a fundamental tool of central planning.

The credits were allocated through the former mono-bank that was disintegrated in 1990. It was split into what became the central bank and a few state-owned commercial banks. These banks, finding themselves in raw capitalist environment, refused to keep operating in system of providing the special credit for the working capital; they began to work on regular principles and thus started offering the companies credits at commercial interest rates. The interest rates on TOZ shot up to some 23%, with penalty rate 36% if the credit was not repayed.

It was quite perilous that the TOZ credits, this heritage of the socialist system, were transferred to the new system and represented the core of "bad debts". The problem had two dimensions – firstly, most of the companies were not able to re-pay the debt service from the short-term credits that replaced the TOZ credits but they obviously could not operate without working capital. Secondly, the banks could not provide the companies with cheap credit, they could not write the "old debts" off, but the debt portfolio of the banks was extremely bad and was deteriorating. We will not exaggerate if we say that the economy was seriously endangered with a systemic crisis. The companies were getting insolvent and began to solve their troubling situation with practising mutual informal trade crediting, which resulted in a network of mutual indebtedness.

The solution of this situation was found in the establishment of the Consolidation Bank (KoB) that took over the credits from commercial banks covering the "permanently revolving inventories" and some other pre-1990 credits (i.e. some cheap long-term investment credits with low interest rates).

In 1991, the KoB purchased these loans in the amount of Kčs 110 billion from the largest Czech and Slovak commercial banks (Komerční banka, Investiční banka, ČSOB and Slovak Všeobecná úvěrová banka) for 80% of their nominal value, effectively taking over a large portion of loan collection from more than six thousand bank clients at a 13% interest rate (to be changed according to fluctuations in the discount rate). Czech share of the TOZ credits was 80.5 billions.²

The portfolio of commercial banks was enhanced at once but this step was not the final solution for the companies as they had to pay off the debts. However, the conditions for paying off those credits were more acceptable.

² The bank separated into Czech and Slovak parts after division of the country in 1993.

1.2.2 KoB's Conversion into a Stable Phenomenon of Czech Banking System

The Consolidation Bank was originally set up to serve as a "hospital" for non-performing loans. It began as a short-term solution to the problems of bad debt devised by the Ministry of Finance and central bank. The KoB was initially given a temporary licence to operate for 125 days, which was later extended to six months. Within a single year, however, its temporary licence was finally extended to 10 years. The KoB thus became a permanent fixture of the Czech banking system, and it gradually moved also into other banking activities (see below), i.e. not only administering the former TOZ credits.

1.3 The Roles of KoB and Gradual Changes in Its Strategy

1.3.1 DEBT-ALLEVIATION AGENCY

The Consolidation Bank became a debt-alleviation agency not only for TOZ credits. The original purchases of loans for enterprise inventories were completed to clear up banks' balance sheets by removing credits which, due to inflation and high interest rates, threatened large industries uniformly. However, the KoB continued to purchase loans from the large commercial banks. In 1992, it purchased an additional Kčs 15.1 billion in loans from KB (9.7 bil.) and IB (5.4 bil.) at 80% of their nominal value. Also these loans were related to the previous economic system.

1.3.2 RELAXING CONDITIONS FOR TOZ REPAYMENT

The KoB's approach to its clients was a uniform one for a long time until 1994. Clients were basically divided into two groups – one consisted of companies that were paying their duties on time and those were either left "in peace" or were getting advantageous bonuses. The second one was the group of firms who were not fulfilling their commitments. The KoB was either imposing sanctions on those companies or proposed bankruptcy proceedings.

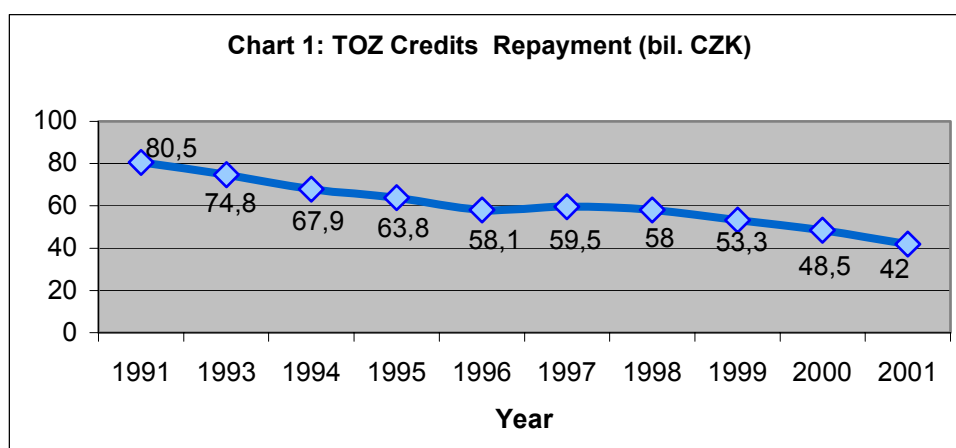
Then, in 1994, the bank decided to change its strategy and proceed in a system based on a more individual basis.³ It was clear that some of the companies won't be able to pay off their debts until the end of 1999 which was the original deadline. Therefore, the bank announced that it was willing to restructure loans in some cases and it began closing new agreements. The Consolidation Bank was already administering the loans with moderate interest rates, significantly below the commercial interest rate level (Mertlík, 1998:112) and these new circumstances again resulted in relaxing the conditions for the payment discipline of the relevant companies. The sanctions interests were decreased, the common interests stayed on the level from 1991 - 13%.

³ Ekonom, August 24, 1995, Konsolidační banka mění strategii, p. 24

What were possible reasons for the change in the bank's strategy?

- One mentioned⁴ reason was the fact that the debtors were more or less former SOEs now after privatization and transformation. The debts should have been re-paid by new owners who were plunged in other worries than paying off the debts inherited from their ancestors. And, as was the prevailing spirit of the time, those new owners were to be treated in a very delicate way. The original conditions for TOZ repayment may have been too tough from this point of view, the political pressures might have been one of the decisive factors.
- Another reason could have been to enhance the payment discipline. However, the KoB's representatives stressed that they didn't expect this, they just assumed that these softer conditions will enhance the situation of the enterprises.⁵
- Also, as described below, the KoB became directly involved in restructuring of some companies via its participation on property rights or on some projects. Therefore the bank had obviously amplified motivation to enhance the conditions for the company.

In 1996 conditions for TOZ loans repayments were again relaxed. As the then general director of the KoB noted, it had to be counted with some big enterprises not repaying the debts until as late as 2002. The reason was the expected process of restructuring of some enterprises and also the growing problems of some companies. Therefore the credit repayments were prolonged and the sanctions were decreased.⁶ Another reason probably was the deteriorating situation in the companies and the whole economy that was heading into recession.



The numbers show the volume of TOZ credits not repayed until the relevant year.

Source: Annual Reports of Consolidation Bank/Czech Consolidation Agency

⁴ Ekonom, August 24, 1995, Konsolidační banka mění strategii, p. 24

⁵ Lidové noviny, Příloha Koruna, April 20, 1995, p. 15

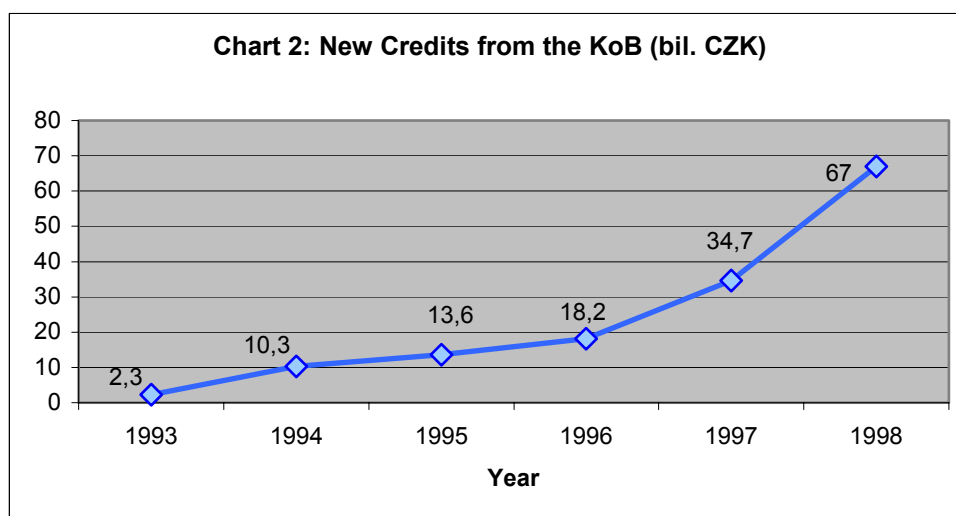
⁶ MFD, July 29, 1996, Splácení starých úvěrů KoB se pravděpodobně protáhne, p.14

1.3.3 ANCHOR OF THE STATE'S HELPING HAND

The KoB declared that it had no intention to provide common commercial credits which was the field of the commercial banks. Instead, the bank wanted to proceed into the area which the commercial banks were supposed to avoid, particularly for the non-acceptable risk stemming from involvement in such areas.

The Consolidation Bank had the intention to: "support big enterprises from the production sphere"⁷ and "to finance restructuring programmes of selected big Czech enterprises". The KoB was willing to allocate credit to companies that were not able to receive any further credits from other banks. Also, it declared that it will be taking on the credits of some companies and exchange them for equity⁸ (debt-equity swaps).

Two major cases falling into the category of credit allocation and debt alleviation are shortly described below. It is interesting that both cases happened even before the KoB declared the above mentioned vision of being a supporting element of Czech production sphere. Except for these two cases we can mention the support of many enterprises with credit allocation from the Consolidation Bank (see Chart 2 and Table 1).



Source: Annual Reports of Consolidation Bank/Czech Consolidation Agency

⁷ Ekonom, August 24, 1995, Konsolidační banka mění strategii, p. 24

⁸ Lidové noviny, Příloha Koruna, January 21, 1995, Pozice Konsolidační banky se vyjasňuje, p. I

Table 1: Credit Allocation from the Consolidation Bank to Some Companies

Company	Credit (mil. CZK)	Approx. date	Note
Aero Vodochody	1300	1996	
Aero Vodochody	1000	1997/1998	
České dráhy	1600	1997	
ČKD	n.a.	n.a.	Went bankrupt
Explosia	800	until 2000	
Holding Kladno	1900	n.a.	Went bankrupt
Koželužny Otrokovice	500	n.a.	Went bankrupt
Královopolská	1500	n.a.	TOZ credit alleviation
Let Kunovice	1000	1996	
Letov	600	Until 1997	
Liaz	622	Until 1996	
Meopta Přerov	15	VIII/1996	
MEZ Vsetín	38	n.a.	Liquidation
Moravskoslezská Vagónka Studénka	n.a.	1996	Credit restructuring
Škoda Plzeň	min. 500	1994 - 1998	Went bankrupt
Tatra	700	1994 - 1998	
Tesla Vacuum Components	n.a.	n.a.	Went bankrupt
Vlněna Brno	44	1996	Went bankrupt
Zbrojovka Vsetín	100	1998	
ZPS Zlín	2700	until 1999	Went bankrupt

Source: Selected hints found in daily press: 1994 - 1999

Case 1: Chemické závody Sokolov – a Successful Exception

The first big action of credit allocation to an ailing company was provision of credit CZK 900 millions to Chemické závody Sokolov (CHZS), a medium-sized chemical company in Western Bohemia, at the end of 1993. The company was in distress after an unsuccessful privatization to an American company that promised to finance a new part of the factory which was already being built. These development plans, and even the company itself, were therefore endangered.

The case of CHZS is exceptional in two respects. First of all, as the later years showed, this time the state's helping hand indeed saved a viable company. Otherwise, the company probably wouldn't have survived without this help. Secondly, in the succeeding years, the government turned its attention to reorganizing and privatizing the petrochemical industry and was only a passive owner of CHZS. The business of CHZS became solely a matter for its own top management to decide. However, the management didn't misuse its position and the company was finally privatized to Eastman Chemicals (Bauer, Streblov, 2001). Consequently the company is, at present, prospering.

Case 2: Škoda Plzeň – a Showcase of Double Standards

Debt-alleviation of Škoda, a flagship of the Czech industry, represents another case of support provided by the government through the Consolidation Bank. Whereas the previous case of the company Chemické závody Sokolov showed the support of a state owned enterprise (it was owned by the National Property Fund), Škoda had been private since 1992. In the same year, the government decided to erase 1.888 billion⁹ of its debts. Škoda and its new owner had therefore significantly better starting conditions than other companies that had to pay off the old debts.

1.3.4 PARTICIPATION IN PROPERTY RIGHTS – AN ELEGANT WAY OF INDUSTRIAL POLICY REALIZATION

Being a creditor of approximately four thousand firms, the KoB had a unique opportunity of having access to information about the situation of many, especially big, companies. A significant number of these enterprises were going through complex changes and the KoB was taking part in this process through its credits. In 1995 it was admitted that the form of the participation on property rights in combination with the position of the creditor was ideal for promoting the interests of the Consolidation Bank.¹⁰ The aim should have been to restructure and revitalise some big enterprises on a selective basis.

As was mentioned above, the KoB didn't want to enter the field of commercial banks. It was aimed at enterprises that were unable to receive any further credits. Therefore, the allocation of credit or the purchase of non-performing debts of such enterprises in fact meant a rescue from bankruptcy proceedings.

The representatives of the KoB often stressed that only those companies that have perspective potential for the future are eligible for KoB's assistance.¹¹ However, such statements are highly disputable from our ex-post point of view as will be seen from the case studies of supported companies.

⁹ HN, July 17, 1995, Škoda Plzeň se zajímá o významné podíly v českých výrobních firmách, p.2

¹⁰ Ekonom, August 24, 1995, Konsolidační banka mění strategii, p. 24

¹¹ Lidové noviny, Příloha Koruna, January 21, 1995, Pozice Konsolidační banky se vyjasňuje, p. I

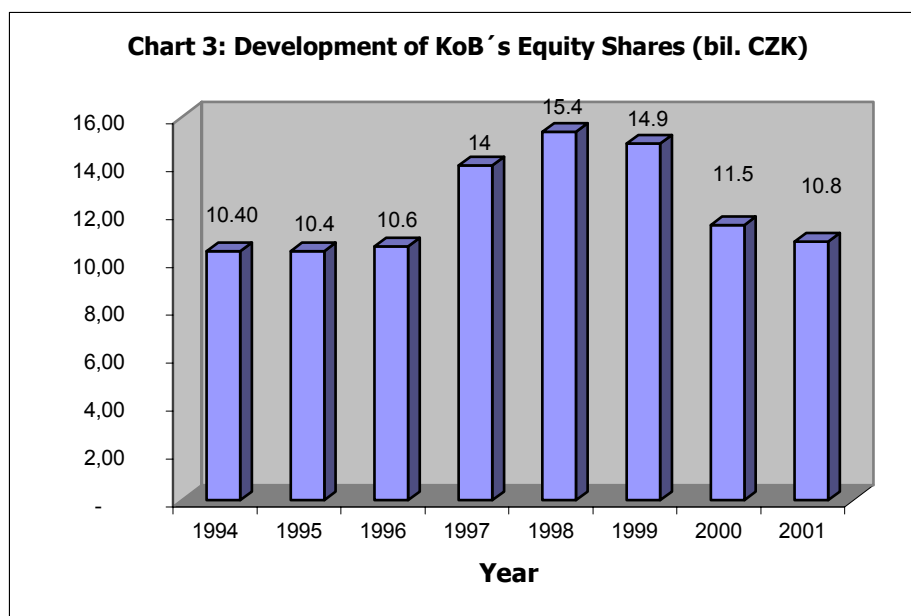
A most important role of the Consolidation Bank for this research was therefore the recognition that it can be an ideal institution for special cases where it was considered necessary to combine state and private property or projects.

To summarize, the new approach of the KoB, described in this chapter, should have been more active. And the state (represented by the government) discovered an elegant way to realize its industrial policy. The Consolidation Bank became more and more engaged as an institution that helps to resuscitate big industrial enterprises. It is also important to stress that the bank served as the most important government's instrument of partial or in some cases de facto full re-nationalization of certain beforehand privatized enterprises. In 1996 the KoB was a majority or at least significant owner of companies Zetor, ČSA, or five companies from the Aero Holding.

Table 2: KoB's Equity Shares (1996)

Company	Share
České aerolinie, a.s.	16.32%
Škoda, automobilová a.s.	30.00%
AERO Vodochody, a.s.	31.46%
LETOV, a.s.	31.46%
Výzkumný a zkušební letecký ústav, a.s. (VZLÚ)	31.46%
UNION Group, a.s.	6.86%
Bankovní institut, a.s.	2.29%
Technometra Radotín, a.s.	27.25%
Zetor, a.s.	79.38%
ZKL Klášterec nad Ohří	100.0%
PRISKO, a.s.	100.0%

Source: Annual Report of the KoB (1996)



Source: Annual Reports of the Consolidation Bank/Czech Consolidation Agency

Case 3: Zetor

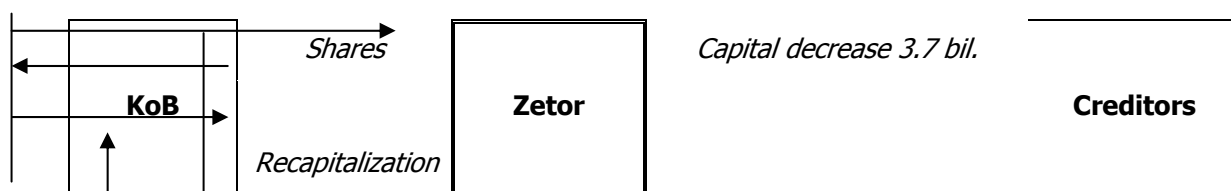
The case of Zetor, a company from Moravia producing tractors, is an example of a rescue from bankruptcy. Nobody was willing to allocate credit to this deeply indebted company any more. In November 1994, the KoB purchased its debts (1.9 billion CZK) from other banks and capitalized them. The bank gained a 79.4 % share of the company for 1.37 billion CZK for the recapitalization. Through this operation, the company got rid of the necessity to pay high interests and was saved from the certain possibility of bankruptcy for some time.

Scheme 1: KoB's Support No. 1 to Zetor (1994)



There were some negotiation about selling the company during the next two years. However, the company was still deeply in loss. Therefore, a second supporting action by the KoB followed. At the end of 1996 the assets of the company were decreased from CZK 4.12 billion to 453.2 million. This was used to cover the debts of the company from previous years. Immediately, shares for 3.686 billion were issued and bought mainly by the Consolidation Bank which gained 96 % share in the company.

Scheme 2: KoB's Support No. 2 to Zetor (1996)



The representatives of the Consolidation Bank have always justified their action in Zetor with the opinion that the tractors from Zetor are able to compete on the Western markets. Therefore, according to declarations in the media, it fulfilled the declared vision of the KoB that it will support only companies that have perspective potential for the future. However, another fact was obviously considered as most important; that is approximately ten thousand persons that would lose their jobs if the company went bankrupt.

Case 4: Aero – a Cursed Company

Aero represented the first case when an already privatized company was bought back by the government, i.e. re-nationalized.

Aero was one of the biggest and most indebted Czech companies. The companies of Aero Holding were in heavy financial troubles, they lost their traditional Eastern and third world markets, and also some pre-agreed contracts. In addition, their re-orientation to Western markets and restructuralization was a difficult, long-lasting, and a very costly process. It is doubtful if the restructuring could have been successful without massive governmental support.

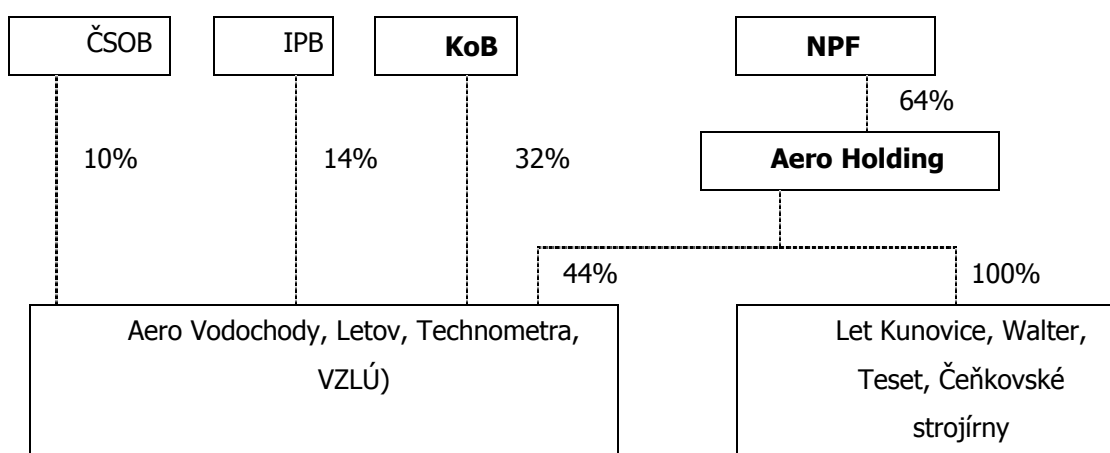
Instead of restructuring, however, the companies of Aero Holding were put aside to be offered to the voucher holders in the first large privatization wave, only partially, while the controlling package was left in the hands of the National Property Fund (FNM). This situation was only supposed to be temporary but the FNM still held a 64% share of the company after privatization.

Aero's own equity reached CZK 4.6 billion and it had approximately 7500 employees in 1995. However, loss of the entire holding increased to CZK 412 million in 1994 (in 1993 it was "only" 12 million).¹²

Support of Aero Holding

In 1995, when the situation was getting untenable, three Czech banks (KoB, ČSOB and IPB) decided to exchange 2 billion of their liabilities for 56 % equity share in Aero's daughter companies Aero Vodochody, Letov Praha, Technometra Radotín and VZLÚ Letňany that were relatively well-off. The Consolidation Bank received 32 % share and hence the company was directly controlled by the government. In addition, the KoB credited the company under special conditions, i.e. below standard market interest rates and terms of debt service – it meant that the company was in fact subsidized (Mertlík, 1998:91).

Scheme 3: Ownership Structure of Aero Holding after the Debt-equity Swap



¹² Denní Telegraph, July 28, 1995, Aero Holding navrhne na příští valné hromadě snížení jmění, p.6

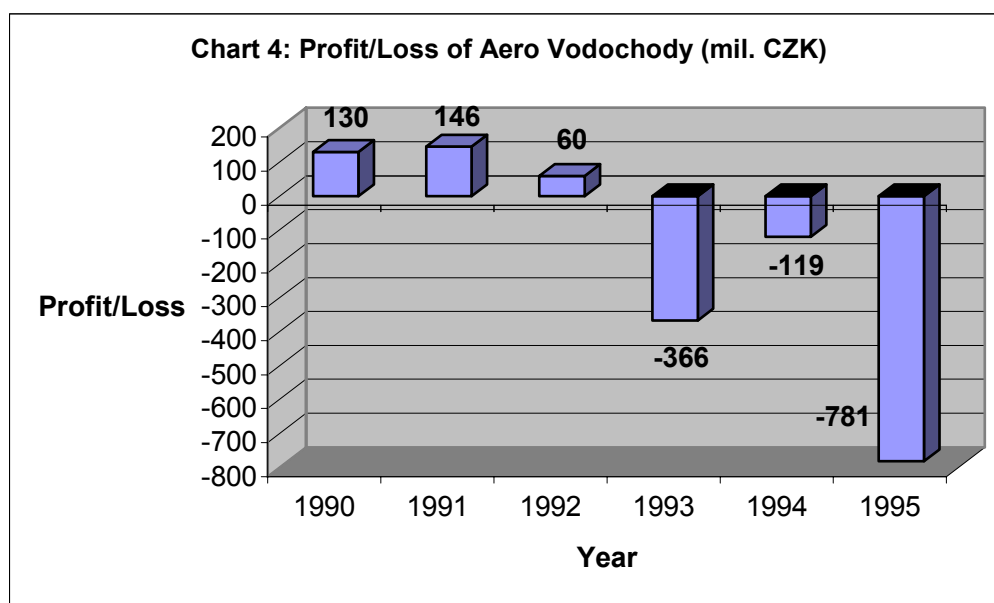
The Holding itself got rid of its debts due to the mentioned settlement. According to a statement by the then Minister for Industrial and Trade Vladimír Dlouhý, the state had contributed 6 bil. CZK to Aero Holding up to 1996.¹³

However, the financial situation and market position of Aero was not improving, and the future of the company was getting dark because the daughter companies stayed indebted. It was argued that the elimination of Aero Holding's debts enhanced only asset portfolios of the banks but did not help the company substantially. The Holding and its daughter companies didn't get a responsible owner. Solutions were above all sought for the problem of the daughter companies – as was the case of Aero Vodochody.

Aero Vodochody

This company's production comprised 80% of state's armament exports and it was the country's most important aircraft producer. Possible fall of the company would start bankruptcy proceedings of other aerial production companies. According to the then director of Aero Vodochody, this company was the only one in the Holding that had contracts.¹⁴

In 1996, the government decided to restructure the debts of the company that reached CZK 3.7 billion.¹⁵ Part of this debt was 1.3 bil. credit from the KoB.¹⁶



Source: *Ekonom*, April 8, 1998, p. 6

In October 1996 the government approved a plan for financial restructuring of Aero Vodochody. The company's equity was decreased by 962.8 mil. to 19 mil. CZK. Then, the KoB and NPF again increased it to 1.7 bil. (NPF – 960 mil., KoB – 720 mil.). This way, debt of Aero Vodochody

¹³ Lidové noviny, August 28, 1996, O Aero je zájem s podmínkou, p.12

¹⁴ Právo, July 29, 1996, Zbrojařina se u nás dělá spíš jako zájmová činnost, p.1

¹⁵ Respekt, August 12, 1996, Perspektivní podnik před krachem, p.6

¹⁶ Svět hospodářství, August 29, 1996, Záchrana Aera Vodochody je nadosah, p.7

should be eliminated and the KoB got additional share in the company. In addition, the KoB would also lend CZK 1 bil. to the firm and a strategic partner was supposed to increase the equity.

In December 1996, shareholders approved the strategy. The NPF had to create a new company for the purpose because this institution could not invest according to the law.

Then in 1997, the government started negotiations with Boeing and McDonnell Douglas that wanted to purchase Aero Vodochody as strategic partners in consortium with České Aerolinie. The negotiations took long since the probable strategic partner wanted all of company's debts to be eliminated and government's guarantees for 32.7 bil. Aero's credits.¹⁷ The government agreed on these conditions in March 1998.

The efforts of the government in dealing with Aero seem to be incomprehensible to a certain extent. Instead of being restructured, the company was partially privatized. Instead of being sold, the company was re-nationalized. Instead of being restructured, the company was only disposed of debts (and was finally sold).

The KoB was able to influence the management of the company for a few years but Aero's conditions never improved. Although the state kept the decisive influence in this industry, there was no concept for restructuring the company, the government just showed an effort to eliminate the mother company's enormous debts, which permanently endangered with bankruptcy not only the Holding itself but also all the daughter companies. It was also unfortunate that the management in the company was influenced by its major creditors (the banks) and because the state as a majority owner obviously gave in their pressures - the banks had even stronger representation in the Aero's board of directors.

Finally, it is also necessary to note that in 1996 there were companies that were interested in buying Aero Vodochody – e.g. Omnipol or Czech Airlines in connection with Boeing. Omnipol even won the privatization tender for the shares of the banks, however, the KoB didn't want to sell its share. On the other hand, it must be admitted that rational and serious strategic investor would hardly buy the company with its billions of debts.

1.3.5 UNCOMMON "MISSIONS" OF THE KoB

There are some special interferences by the Consolidation Bank within Czech industry which can't be classified according to the above characteristics.

Case 5: Example of an Indirect Support of a Czech Industrial Flagship

In 1995, the Consolidation Bank allocated credit for renewal of Czech Railways' locomotives. The locomotives were bought from Škoda Plzeň. If the KoB hadn't extended the credit, Czech

¹⁷ Svět hospodářství, April 9, 1998, Aero Vodochody už nemělo na vybranou, p.6

Railways would hardly find a creditor to finance this purchase. This way, the KoB killed two birds with one stone, i.e. the support also helped the Czech private industrial giant Škoda. Škoda participated extensively on negotiations about this business between the KoB and Czech Railways.

Case 6: Questionable Credit for Privatization of Třinecké Železárny

The press, a few times, expressed the probability that the KoB granted credit amounting to CZK 1 billion to Moravia Steel, a company which bought Třinecké železárny – a steel mill – for 2.643 bil.¹⁸ The privatization was criticized but the KoB's involvement was rejected by the representatives of Moravia Steel. It was confirmed, however, that the KoB purchased a portion of bonds of Třinecké železárny that were issued in the amount of CZK 3 bil. in 1996.¹⁹

1.3.6 OTHER ROLES OF THE KoB

1.3.6.1 Development Bank

The KoB also took the role of a development bank. A program was proposed by the Ministry of Industry and Trade for the KoB to provide credits for exporters and firms involved with infrastructure project – telecommunication, transport, utilities – to be guaranteed by the government (FNM). By the end of 1994, CZK 3 billion in loans were allocated for these purposes (Desai, 1995:35). The Consolidation Bank took part on modernisation of transport infrastructure, especially as for railways, and also on some environmental projects together with the Ministry of Environment and European Investment Bank.

1.3.6.2 Stabilization of Health Insurances and Banks

It is obvious that the role of the Consolidation Bank was a multiple one. However, we still didn't mention all of its parts. The bank also helped to stabilize the situation with private health insurance companies that were going bankrupt.

In 1996, the KoB became a crucial institution helping with resuscitating the banks that were heading to bankruptcy. First, the KoB became an owner of Ekoagrobanka. Subsequently, Ekoagrobanka was sold to Union Bank (a share of which was also held by the Consolidation Bank and a few other crucial industrial companies – e.g. OKD and Nová Huť). When the government introduced a supporting program for small and medium sized banks that had problems with deteriorating portfolio of classified loans in autumn 1996 ("Stabilization Program"),²⁰ the KoB happened to be a provider of resources to its subsidiary – Česká finanční, which was managing the program. In 1997, Česká finanční also started to manage the so-called "Consolidation

¹⁸ Český týdeník, March 1, 1996, Moravia Steel si půjčí od státu, p. 23

¹⁹ MFD, July 12, 1996, Třineckým železárnám se podařilo prodat všechny vydané dluhopisy, p.14

²⁰ Government resolution no. 539, October 16, 1996

Program" introduced by the Central Bank with similar purpose – stabilization of banking sector due to purchase of assets from ailing small and medium sized banks.²¹

1.3.7 ČESKÁ FINANČNÍ – A NEW TRANSFORMATION INSTITUTION

The small and medium sized banks had a chance to transfer some portion of their classified assets for their book value to Česká finanční.²² The Consolidation Bank was financing the program through providing resources for the asset purchases. These bad loans should have been repurchased by the same bank after five or seven years when its situation stabilises. Potential losses were supposed to be paid by the NPF.

In this way the state in fact received further credits, and later also shares, in enterprises due to capitalization of their debts. Therefore, this represented another channel for state involvement in the private sector and for its influence in the industry. As the director of Česká finanční put it: "*Česká finanční can indirectly influence the management of companies whose debts it acquired*".²³ In fact, the consequence of the program was another possibility of re-nationalisation which was indeed happening.

Česká finanční took over 17.5 bil. CZK of classified credits until the end of 1997. It also became an owner of 4.7 bil. CZK of shares, e.g. it was a shareholder in a big chemical company Spolchemie, it owned a significant share in Vítkovické stavby, Mopex, Ústecké pivovary and ŽDB.

Case 7: Spolchemie

The case of Spolchemie is presented here to illustrate the state involvement in a company renationalized through Česká finanční. Spolchemie is a medium sized chemical company in the North Bohemian town Ústí nad Labem. The company was owned by the state until 1995 when it was finally privatized. However, the privatization was not successful – a responsible and stable owner was not found and dubious financial operations of the then management lead to deterioration of company's economic results.

When Česká finanční acquired bad assets from a small ailing bank, Foresbanka, in 1997, it also gained a majority share in Spolchemie. In 1998, Česká finanční organized a tender to find a consultant for realization of Spolchemie's sale to a strategic partner who would ensure long-term prospering future for the company.

The tender was won by Patria Finance, a Czech consulting company; its mandate was also broadened to restructure the company in 1999. The process continues until now which is a little bit surprising. The company is still in state hands, effectively controlled by Patria. The process of

²¹ Source: web page of Česká finanční, www.czfinanc.cz

²² There is also a company called Česká inkasní, s.r.o. with a mission alike the Česká finanční. Česká inkasní was founded in 1994 to relieve the Československá obchodní banka (ČSOB) from the burden of non-performing credits.

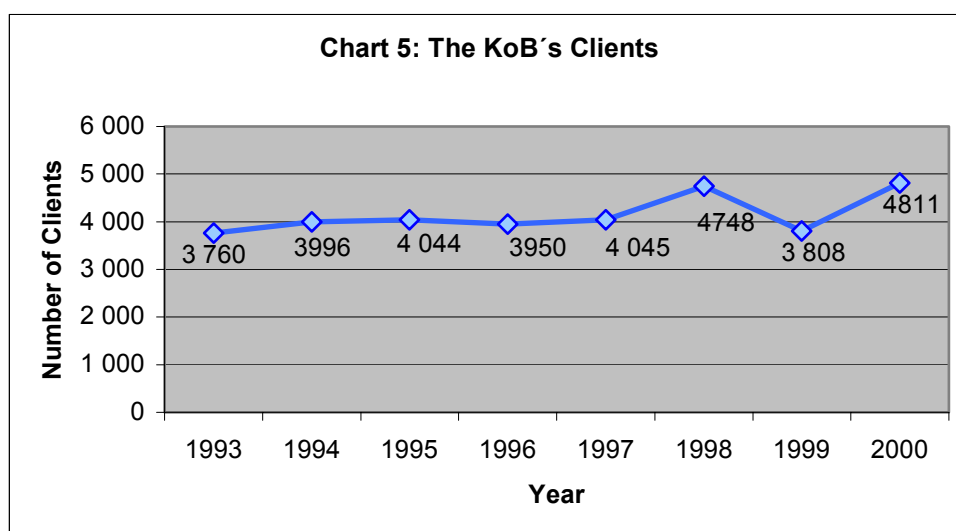
²³ Bankovníctví, July 25, 1997, Pomocná ruka z České finanční, p.5

Spolchemie's sale has taken more than five years, which possibly shows that sometimes a contract between a state and private institution might be convenient just for the latter one.

1.3.8 SUMMARY: INCREASING IMPORTANCE OF THE KoB IN CZECH ECONOMY

To summarize, the role of the Consolidation Bank in the Czech transformation began to be multiple. Except for managing the portfolio of the old debts, it took over other non-performing debts of commercial banks and provided enterprises with soft loans.

The importance of the state institution in the Czech economy was not diminishing. In 1994, the KoB was a creditor to approximately 4000 firms in the Czech Republic - the vast majority of all medium and large enterprises (Desai, 1995:34). In 1998, the KoB was the second biggest Czech bank in terms of its own equity capital and the fifth in terms of assets (Mertlík, 1998:113).



Source: Annual Reports of the Consolidation Bank/Czech Consolidation Agency

The Bank began to provide services as a supporter of the government's economic policy (however, unofficial and unproclaimed). As the then CEO of the KoB Vladimír Šulc noted: *"Support of the government's economic policy should be the basic framework of our activities."*²⁴ The KoB ran revitalisation and restructuralization programmes of large Czech industrial enterprises which also included the growth of its own ownership participation in numerous such enterprises, as was shown in the cases above. The institution was commonly believed to be an effective government channel for the granting of soft loans and through them for de facto invisible subsidising of Czech industrial enterprises (Mertlík, 1998:113).

²⁴ Lidové noviny, Příloha Koruna, January 21, 1995, Pozice Konsolidační banky se vyjasňuje, p. I.

1.4 Supporting Role of the FNM

Although the KoB was no doubt the main instrument for the state assistance to selected enterprises, it was not the only one of this kind. The National Property Fund (NPF, Fond národního majetku - FNM) was created as a quasi-autonomous state agency on the basis of a 1991 law on the administration of privatizing properties²⁵ and it was made sole "owner" of state assets. For the first two years, the FNM used most of the revenues raised from privatization to stabilize the credit-granting institutions of the financial system.

The Fund in 1991 offered to make Kčs 22.2 billion available to relieve the debt burdens of "viable" firms, and 7.8 billion to recapitalize banks. In 1992, the FNM issued 23.2 billion worth of bonds to strengthen the capital base of the main creditors to industry, KB (13 bil.) and IB (10.2 bil.).²⁶ Money raised from the sale of these bonds was redeposited in the two banks to increase their capital-asset ratios. By the end of 1992, 95% of all expenditures of the FNM since its beginning had gone to banks (Desai, 1995: 33).

Later, some debts were erased in a similar way, i.e. in line NPF – bank – enterprise, however, these cases were individual.²⁷ Such action had double benefit – the enterprises were made better off and the portfolio of banks was enhanced.

The massive debt write-offs should have been directed at firms which "*had a chance to be profitable*" and their debts were heritage of the old times. The banks themselves were to select "viable" firms, in cooperation with an advisory committee consisting of members from the FNM, central bank (SBČS), and ministries. The FNM-financed mass write-off did not accomplish its aim, as banks were unwilling to concentrate scarce resources on particular firms in order to give them the full force of the capital infusion. The money was spread too thinly to have a palpable effect on the growing problem of insolvency (Desai, 1995:18).

Throughout 1993 various other governmental authorities frequently turned to the FNM as a source of liquidity to cover a variety of expenses, mainly to provide assurances against the specter of bankruptcies. As the state budget was, by law, limited to providing no more than 10% of total revenue in the form of credit guarantees,²⁸ the government began using revenues from the FNM to provide cheap credit and "emergency" funds to large enterprises in distress – Škoda Plzeň, the transport engineering firm ČKD Praha, and to the three Moravian steel mills. In this way, industries could receive necessary funds, and the government could continue to boast of

²⁵ No. 171/1991. The FNM was solely responsible for the formal conversion of SOEs to joint-stock companies, and was to take over and administer the property, shares, or securities of the privatizing firm, participate in the management of the business unit, and exercise all rights involved with such ownership, including the right to sell shares or property, rent facilities, issue bonds, close contracts upon the sale on enterprise, and to be entitled to an equitable share of the value of a liquidated firm according to share of ownership.

²⁶ HN, February 9, 1995, Úkol: zrychlit privatizační tempo, Hospodářské noviny, p.5

²⁷ Ekonom, August 22, 1996, Daň z nechtěného dědictví (2), p.16

budget surpluses. As a distinct legal entity, the FNM was to maintain separate accounts, and its revenues were not to be included in the balance sheets of the regular state budget.

The funds from the FNM supported also the KoB. The government decided to strengthen the KoB's reserve fund by transfer of CZK 15.8 billion from the FNM in 1994 and by yield from 15.1 billion of FNM's bonds in 1995.²⁹

1.5 Essential Role of Banks

If we are analysing the non-defined but existing state interventions in the enterprise sphere, we cannot omit to discuss the critical role of banks in (financing) Czech transition.

Privatized enterprises were dependent on a favourable policy of the banks and their willingness to provide credits under advantageous conditions for risky projects. Many companies had survived a few years more than it would be possible without the existence of this phenomenon. Why didn't the banks leave non-viable enterprises to go bankrupt? The behavior of banks in the transition doesn't make sense from the point of view of a conservative banker. Nevertheless, it is necessary to take into account the contemporary climate. One of the major factors was no doubt the will of the state, i.e. the political representation, that was able to influence the decision making of the state-owned banks.

Banks were under political pressure since the beginning of the transition, they were pushed to support the transition process with a generous credit-awarding policy (Kábelová, 2000:24). It is likely that banks were under this pressure firstly to aid privatization by providing credits for companies' acquisitions during the privatization process. Then it was obviously necessary to provide the companies with working capital and the willingness of banks to finance enterprises was again supported by the government.³⁰ Three state-owned banks (KB, ČS, IPB) were most involved, especially in the process of privatization.

Such practice by the banks enabled companies to stay afloat and thus generated the unique low unemployment. Therefore, the state probably saved money that would otherwise have been lost in unemployment benefits. However, we must note that it was the state that sponsored companies via the state-owned banks. Čermák (2000:102) gives an example of the company ČKD Dopravní systémy that employed approximately three thousand workers, but it should have

²⁸ As Desai (1995: 33) notes, most of the guarantees for 1993 –1994 were taken up with two projects: the construction of the Ingolstadt pipeline from Germany, and the construction of a controversial nuclear power plant in Temelín on the Austrian border.

²⁹ Ekonom, August 24, 1995, Konsolidační banka mění strategii, p. 24

³⁰ If banks were serious about restoring capital adequacy and building credit analyses nad collateral appraisal skills before making new loans, total loans would likely have fallen in real terms as they did in Poland between 1992 and 1995 and in the US during the credit crunch from 1989 – 1992 (Stein, 2000:25).The fact that loan growth remained strong indicates that other factors such as political pressure, the desire to maintain employment levels and/or the maintenance of corrupt, mutually supportive relationships (clientelism) were present.

employed just one thousand according to experts. The company thus needlessly paid wages amounting to CZK 1.5 bil. during the first five years since privatization.

The ownership stakes of banks, or their subsidiary investment companies, in some enterprises represent another factor important in the deformation of the bank-enterprise relationship (e.g. Dvořák, 1997:65). Due to the capital structure that had emerged, banks had powerful incentives not to enforce their debt contracts with many enterprises. Banks were in a position of a creditor as well as an owner of many enterprises due to the control over relevant investment companies. Banks became, through complicated chains of ownership participation intermediated by Investment Companies (ICs) and Investment Funds (IFs), core investors in a huge part of the Czech industry. Most of the largest banks' loan portfolios were tied up in the largest privatizing firms, and thus banks threatened their own existence by foreclosing. A bank therefore had another reason not to initiate bankruptcy proceedings but keep the company afloat through generous credits or, on the other hand, to stripping resources from other prospering companies.³¹ Therefore, banks naturally did not evaluate investment projects and credit demands of companies fully and independently (Mertlík, 1998:48). In addition, although banks had sufficient ownership shares in many companies, they did not have sufficient technical capacity to force enterprises into restructuring.

Until 1996 there were no "Chinese walls" in banking regulation that could prevent banks from taking advantage of the outlined situation. The privatization of the banks was assigned a very low priority in the government's reform agenda. As the World Bank (2000:4) noted, these banks therefore remained subject to political influence and poor governance, and did not exert any significant pressure on their delinquent debtors.

We must also note that bankruptcy law at the time was another important factor as it did not provide the incentives for banks to initiate proceedings against the loss-making firms, since the costs of liquidation were much higher than any benefit any creditor could expect to receive.

The table below demonstrates deformation of credit allocation in the early transition. From the data, covering 1325 enterprises, it is clear that the most profitable industrial sectors were not receiving the most credit in 1994. There is a negative relationship between profitability and new borrowing: in other words bank credit flowed to loss-making industries.

³¹ Such practices carried out by one of the banks were extensively described in the study „Rise and Fall of Investiční and Poštovní banka“ (2002)

Table 3: Rankings for Lending to, and Performance of Selected Industries, 1992

	Credit/equity	Bad debt/equity	Profit/equity
Iron and Steel	4	2	3
Chemicals and Rubber	5	4	1
Electrical Material	1	1	6
Paper and Pulp	3	4	5
Glass and Ceramics	6	5	2
Textiles	2	3	4

Source: Desaj, 1995:28.

Allocation of "soft loans" was of course problematic as the banks themselves realized during the course of time. Especially as the central bank's regulation was becoming stricter. Many of the banks therefore took to rolling over loans and other means of avoiding foreclosure on their clients, which would have been detrimental for the bank itself. A vicious circle was thus initialised.

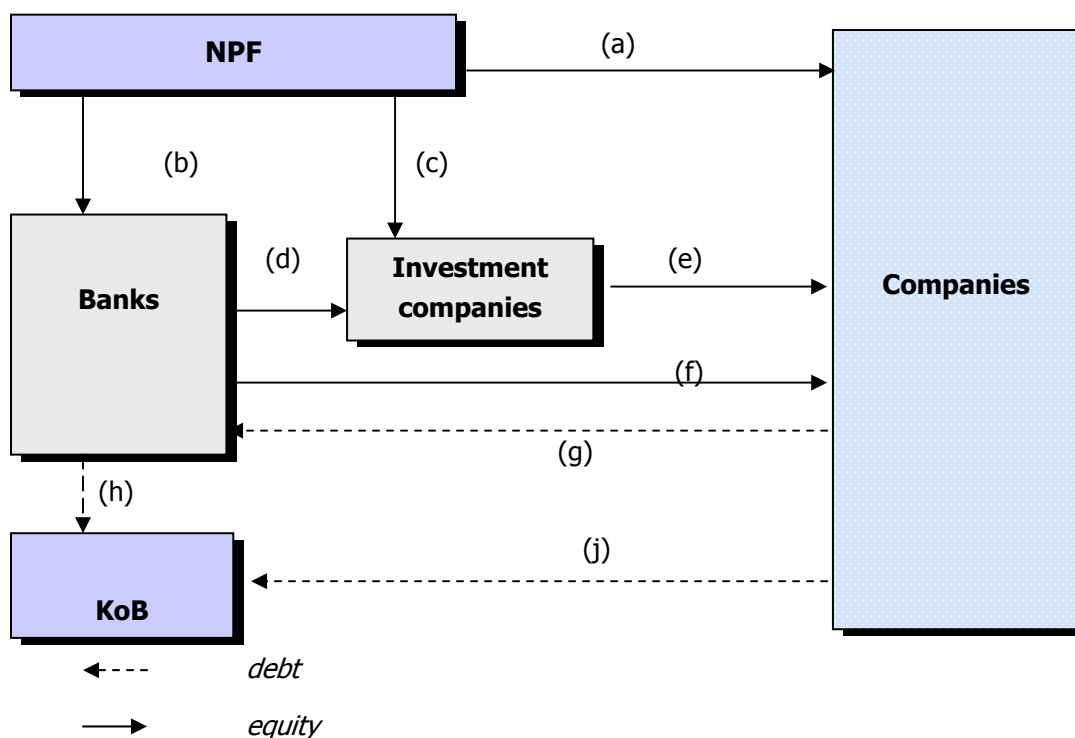
1.6 Links of Banks, Companies and Transformation Institutions

It is also interesting to demonstrate a sketch of possible connections among banks, companies and transformation institution which shows that state's involvement had a variety of forms.

A basic capital structure involving the National Property Fund, the KoB, and the relationship between a bank and a firm is presented in Scheme 4. Such structures were typical around the mid 1990s. To simplify, individual investors are not included.

The NPF maintained an equity stake in (a) privatized firms, (b) banks, and sometimes (c) Investment companies (ICs) set up as joint-stock companies. ICs, in turn, were (d) subsidiaries of banks which, via Investment funds, owned up to 20% of a joint-stock corporation (e). The bank itself might hold direct equity stakes in a firm (f). Banks had also transferred portions of loans to the KoB, but could owe debt to the KoB stemming from KoB's new loan activities to large commercial banks (h). Firms, finally, could be indebted to both banks (g) and the KoB (j).

Scheme 4: Possible Links among Banks, Companies and Transformation Institutions (1994)



Source: Desai (1995:22)

1.7 Accumulation of Hidden Public Debt in Transformation Institutions

Our issue of invisible state interventions is closely related with creation of hidden public deficit. Generally, it is argued that, when the government seeks to maintain a balanced conventional deficit, it often responds by increasing hidden or off-budget liabilities giving the "illusion" of a fiscal adjustment. The Czech transition provides an illustrative example of this statement and it is also worth a brief analysis in our context.

In many countries governments have used financial institutions to "hide" their fiscal deficits often by asking them to extend subsidized loans to public entities. As Poláčková (1999:3) stresses, transition and emerging market economies face particularly large fiscal risks. Their dependence on private foreign financing, weak regulatory and legal enforcement systems, often distorted incentive structures, opaque ownership structures and low information disclosure, elevate failures in the financial and corporate sectors. Such failures, in turn, often generate political pressures on governments to intervene through bailouts.

The Czech Republic was known for balanced government budgets in the first half of the 1990s. However, fiscal performance in the Czech Republic encompassed a significant amount of government activities financed outside the budgetary system. The Czech case provides an example of the deliberate use of guarantees and other support provided through off-budget institutions, which have reduced the (traditionally) measured fiscal deficit and public debt. These

activities led to a rapid accumulation of government liabilities. In the latter half of the 1990s, these off-budget fiscal risks became more visible, as state guarantees and agencies that were either explicitly or implicitly guaranteed by the government generated significant claims on the budget. Excluding quasi-fiscal activities of the central bank, the "hidden" part of the fiscal deficit comprised of two main components: a) net spending on programs of a fiscal nature by special, off-budget institutions (the Consolidation Bank, Česká finanční, Česká inkasní and the National Property Fund) and b) implied subsidies extended through state guarantees.

The table below shows a more detailed overview of rapidly increasing approximate levels of hidden public liabilities.

Table 4: Hidden Public Liabilities (bil. CZK)

	1993	1994	1995	1996	1997	1998
KoB (net of provisions and reserves)	79	81	79	70	86	98
Česká inkasní (net of provisions and reserves)	20	27	25	17	8	7
FNM	29	33	40	22	17	15
State guarantees (risk adjusted guarantees outstanding)	3	3	6	28	74	107
Hidden public liabilities (net of provisions and reserves)	131	144	150	137	185	226
Hidden public liabilities (% of GDP (net of provisions and reserves)	13.1	12.5	11.1	8.9	11.2	12.7
Provisions and reserves of KoB and CI	19	24	42	59	71	84
Gross hidden public liabilities (not adjusted for provisions and reserves)	150	168	192	196	256	310
Reported gross government debt	159	162	154	155	173	194
Reported gross government debt (% of GDP)	15.8	14.1	11.5	10.1	10.5	10.9

Source: Poláčková, 1999

Note: Activities of KoB include financing of the Stabilization Program of Česká finanční. Therefore, the table does not include Česká finanční as a separate entity

For years, the government of Mr. Václav Klaus boasted of balanced deficits. When his government had to resign in autumn 1997 and when the new government of Mr. Tošovský started to rule, the existence of a budget deficit was finally admitted and the news about the accumulated hidden deficit of transformation institutions started to appear in the daily press.

In January 1998, the cabinet decided to pay 5 billions of KoB's loss from the year 1996 from the state budget. The illusion of balanced budgets was finally shattered. In March 1998, the Ministry of Finance published the official result of the transformation institutions' audit. The debt which was hidden in the KoB, Česká finanční, Česká inkasní and the NPF was assessed at more than

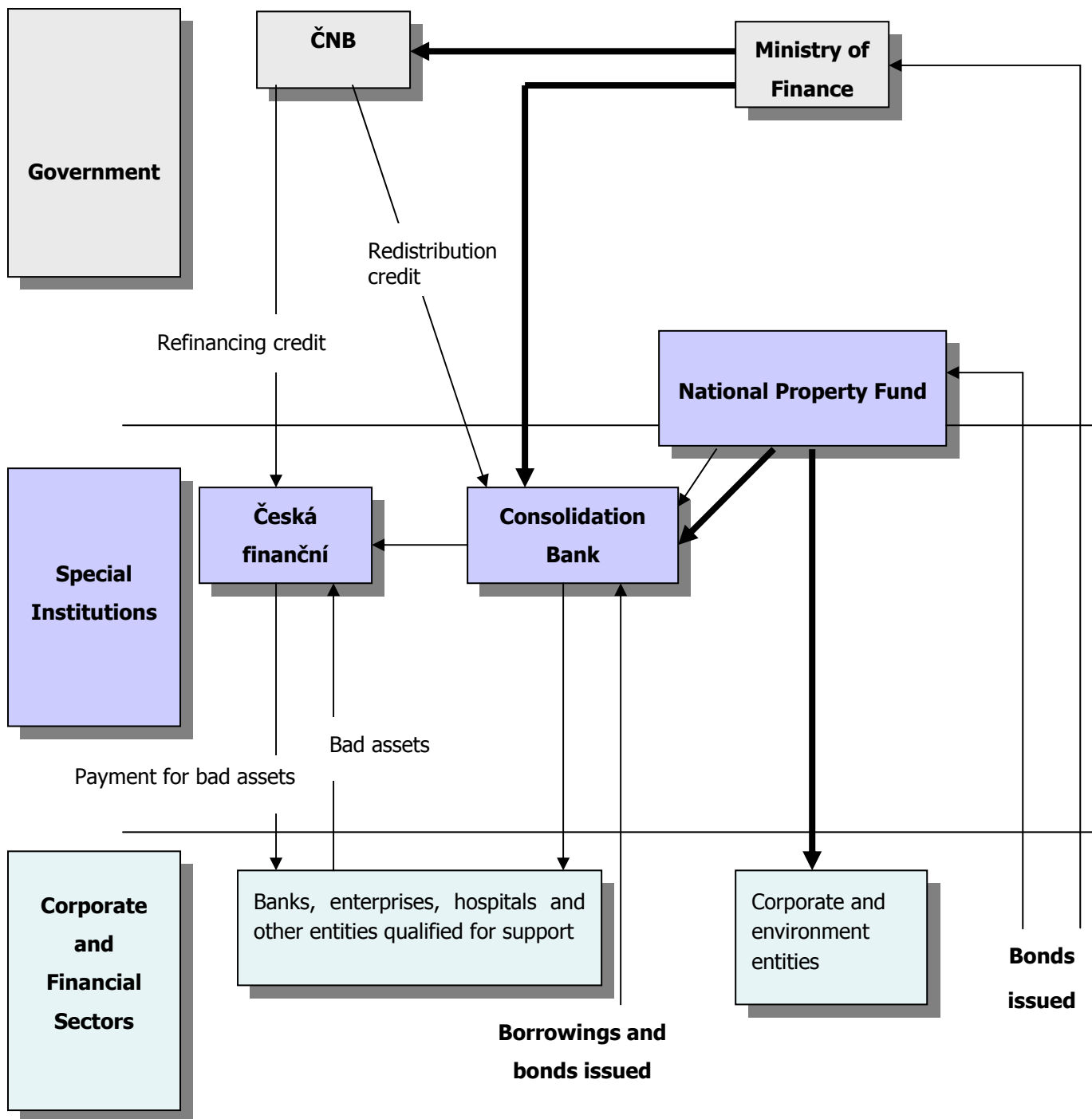
170 billion CZK in 1998.³² This number doubled the debt of the Czech Republic (at that time) – from 10% GDP it suddenly jumped to 20%.

At the time of Tošovský's government, experts also began to draw attention to assessing the situation and searching for solutions. The non-lucid and non-transparent financial relationships between the off-budget institutions were regarded as a major problem. Some experts even came to the opinion that the complicated relationships (see Scheme 5) were made purposely to make the public accounts even less transparent.³³

³² MFD, March 27, 1998, Skryté dluhy státu přesahují 170 miliard, p.14

³³ MFD, January 29, 1998, Stát má více dluhů, než přiznával, p.1

Scheme 5: Financial Relationships of Off-budget Transformation Institutions



→ Financial flows
 → Guarantees

Source: Poláčková (1999)

1.8 Forces behind Invisible Industrial Policy

Methods were outlined of state support to industry as well as some cases of companies that were getting the fruits of this helping hand. However, the government's rhetorical presentations were most of the time inconsistent with reality. The specific industrial policy has never been defined the way it actually functioned.

Moreover, the major representatives of the government, especially the then Finance and later Prime Minister Václav Klaus insisted at every opportunity that the government would be the worst-possible agent for restructuring, and that the duty of the government in industrial affairs was to lower the obstacles to free entry and exit, and to let the market do the rest. Therefore, rapid privatization was the solution; so was the prevailing opinion in the first years of the transition.

Although these liberal opinions of low governmental engagement in industry were rhetorically insisted on by the same politicians in much later years, the reality was not so black-and-white as we have seen. In silence, a few institutions were getting involved in an unproclaimed industrial policy which can be generally defined as support of selected enterprises, as was shown in previous part of this thesis. So far we have been investigating the methods of the policy but what were the reasons and motivations for its evolution? What were its aims? We will now search for the reasons why this policy developed and the factors which influenced its creation.

Holding the Unemployment Down

At the beginning of the transition as well as during its later stages, reformers were determined to hold the unemployment down and thus to prevent social conflict. It was thus necessary to prevent mass bankruptcies. The industrial giants were especially important, from a political point of view, those companies were simply "too big to fail" for their size and importance, i.e. not only the importance of the company as an employer of thousands of people but also as a bread-winner for usual bunch of suppliers. Sometimes, a fall of such a company would mean a disaster for the region where the enterprise was settled. In addition, the crediting banks would be badly affected. On the top, as such companies would also have very strong unions, the government was threatened with the possibility of strikes. It would be a very difficult political decision to leave such companies without resources.

Inclusion of such thoughts into the concept of the transition opened space for providing supports to big industrial companies in distress. The government began to act as a fire-extinguisher, it provided subsidies in the worst cases where even the politically-manipulated banks refused to allocate their credits. The already mentioned cases of Zetor, Chemické závody Sokolov or Aero provide examples of such ad hoc subsidies.

To summarize the research, there were several possibilities how the government helped an important company that was endangered from bankruptcy proceedings, e.g. from the side of a bank:

- The government could press on the bank to extend the credit or relax the conditions for repayment.
- The KoB could take over the liabilities of the company.
- The government could through the transformation institutions purchase share in the company and involve the company into a revitalisation scheme under patronage of the KoB. It de facto meant re-nationalisation of the company.
- The KoB could simply award credit to such a company, or the company could have received guarantees from the NPF for the credits.

Strategic Interests

The case of the state's extensive help to Aero Vodochody provides an example of a company where not only the imperatives of holding the unemployment down played its role. This company, as was already mentioned, was the biggest Czech producer of air crafts and therefore important for the state from a strategic point of view. The whole Aero Holding was merging one of the core structure of country's armament industry.

When the government started solving the indebted company's troubles, there was the intention behind the help that a Czech strategic partner should purchase the company in the end. This idea was in line with the prevailing spirit of the time that stressed the importance of "keeping Czech silver in Czech hands", i.e. not to sell Czech strategic companies to foreign investors if possible. We have already seen that in the case of Aero Vodochody the government had to step back after much troubles and pouring money into that bottomless vessel and sold the company to consortium of Boeing and České Aerolinie. Generally, however, state representatives' reluctance towards foreign investors might show itself as one of the supporting factors explaining why the government had proneness to subsidise industry.

It can be argued that the sale of 27 per cent share of SPT Telecom represents another case of state intervention in the economy although the mechanism of this intervention rather differed from methods we have been discussing so far. The aforementioned share of SPT Telecom was sold to foreign consortium TelSource for USD 1.32 bil. However, the resources obtained from the sale of the share were invested back in SPT Telecom.³⁴ We can thus argue that this transaction was destined to support the telecommunication monopolist in a roundabout way.

³⁴ MFD, June 29, 1995, Vláda schválila prodej velké části Telecomu, s.1

Breathing Space for Chosen Enterprises

There might have been a general economic reason why the government wanted to intervene in industrial companies. Privatized companies bore a burden of extensive debts in many cases. Enterprises' debts were not cleaned up before their privatization. In addition, the new owner was usually indebted from purchasing the company (Kábelová, 2000:15) and the privatization itself might have been problematic, e.g. it did not bring sufficient capital to restructure the company. Therefore, one motivation for subsidising the important enterprises could be to give the chosen enterprises "breathing space" for surviving the uneasy starting conditions of the transition and for orientation in the new situation. As Mertlík (1998:111) notes, some of the important enterprises were in heavy financial troubles, they lost their Eastern and third world markets and their re-orientation to Western markets and restructuralization was a difficult, long-lasting and very costly process, and it may be questioned if there was any chance at all of success without massive governmental intervention. It was believed that the provided "breathing space" would promote prosperity of the enterprises in future.

The relaxation of conditions for TOZ repayment or allocating new credits to some companies, as was mentioned above, provide examples of such policy. The number of firms whose privatization projects did not work, and have later successfully sought some sort of government assistance was not small, and most of them tended to be the largest value-added industries.

The weak side of this argument is obviously its selectivity. The mentioned "breathing space" was allowed only to some exquisite enterprises.

Industrial Path Dependency: Deep Roots of Socialism

As was mentioned in the previous section, the enterprises tried to gain some breathing space to recover from the transition from a centrally planned to market economy. However, such behavior also meant that the habits from socialist times were announcing their survival. The practice of soft budget constraints³⁵ should have been abandoned but the path dependency or inertiae of the socialist system could not have been disposed of so easily.

Generally, the phenomenon of soft budget constraints survived long after the beginning of transition in all countries (e.g. Schwarz, 2000). The burden of the socialist time is represented by the inability of enterprises to keep within their budget constraints. In developing economies, however, capital is scarce, long-term capital markets are thin, and thus the manufacturing sector demands cheap credit pure and simple. Instead of solving its problems of insufficient profitability through restructuring and productivity rise, the enterprise seeks state support. During transition, government can hardly refuse help to an enterprise who's troubles stem from socialism. It is necessary to help the company with loans or subsidies. Industry naturally begins to rely on this

practice, even softens its budget constraint and the vicious circle continues. We can, of course, expect that manufacturing firms will attempt to sustain these methods of subsidization.

The described proneness to path dependency probably was one of the causes of the evolution of the invisible industrial policy in the Czech Republic. However, we must also note the fact, that the policy itself caused the tendency of the companies to soft budget constraint practices and therefore, also to the development of certain forms of moral hazard.

The Role of Industrial Interest Groups

As we have already mentioned, there was no proclaimed conception of the described policy, however, it began to evolve in an unrestrained manner. Once the government opened the Pandora's box of ad hoc subsidies, the relevant industrial companies started to take such behavior into account. It was clear enough that the state was anxious about such companies falling down and therefore the pressures for state help intensified from industrial spheres. Financial preference has been extended to some firms and restricted to others. A relevant example may be provided by the mentioned case of Škoda Plzeň and its debt-alleviation.

If the government helped to one important company, why would they not repeat it? It was just a matter of time when the companies began to rely to the state invisible helping hand. The original idea of low involvement in the economy was therefore eroded by the insufficient government resistance to enterprises' urges. The imperatives of holding unemployment down and preventing massive bankruptcies opened the door to both rent-seeking by industry and government intervention in support of favored, badly performing, companies.

The Crucial Role of Ministry for Industrial Affairs

If we are searching for the forces behind evolution of invisible industrial policy, we cannot omit the involvement of state institution. One of possible (but obviously just particular) explanation for development of invisible state interventions is given by Rai M. Desai (1995). He argues that a mild opposition to the major opinion stream (no state interferences) existed. This opposition argued that, given the legacies of Czech industrialization, the economy would not reform successfully without some form of selective government assistance, for example, in searching aggressively for foreign partners or promoting investment in export-oriented industries. Vouchers, then, would merely privatize firms while leaving them dangerously cash-starved. Without extra, initial help, Czech industry could not be competitive. The Minister for Industry, an ODA member, had supported the idea of promoting exports and providing assistance to industries in purchasing higher-end technologies, in public statements. *"In the halls of the Ministry of Industry and Trade (MPO), there was a talk of the need for industrial 'policy'. At*

³⁵ Soft budget constraint was defined by J. Kornai in 1980s in a following way: "Soft budget constraint appears when the strict relationship between costs and profits is relaxed because costs exceeding profits can be payed by some other institution, typically by the state (Kornai, *The Soft Budget Constraint*, 1986, p. 4).

cabinet meetings, however, the loud talk quickly turns to whispers, since industrial policy is something to which Klaus and the ODS members are firmly opposed (Desai, 1995:32). Nevertheless, an instrument of a de facto industrial policy was established in the end that involved primarily selective industrial guidance and credit arrangements for industries in distress, as was described.

The Consolidation Bank Itself as a Stimulator of Interventions

The KoB was established as debt-alleviation vehicle for TOZ credits, i.e. a specialized institution that was pre-destined to be abolished in relatively short time. However, as was described above, it developed into a stable phenomenon in Czech banking system. Later, the KoB itself worked out a new strategy for future orientation of this institution that was turned to active participation on the industrial restructuring and revitalisation (as was described above). In some declarations by KoB's representatives, for media, we can detect the tendency of the Consolidation Bank to promote its business, e.g. some revitalisation projects.³⁶

The KoB's motivation for such efforts might be similar to theoretical explanations of bureaucracy's behavior as was described in Niskanen's theory of bureaucracy.³⁷ The bank's behavior provides an example of "portfolio sucking" – the KoB's interest was to extend its business since it could prevent the institution from becoming unimportant or even from being abolished.

Therefore, and also due to possible strong interdependencies between such bureaucratic units and industries, the KoB itself, the governmental instrument for interventions, can be considered as a promoter of the invisible industrial policy.

Political Factors versus Economic (In)effectivity

As is obvious from the arguments given above, allocation of direct or indirect subsidies to enterprises can be explained more truthfully by political aspects rather than by searching for advantages of economic efficiency by the state.

The imperatives of holding unemployment down and preventing bankruptcies became a justification for government intervention in preferred non-viable enterprises. Looking at the situation from the point of view of the year 2003, it seems that main result of the policy was conservation of old industrial structures which have been replaced or restructured costly in the end (as is described in following parts of the thesis) and the process is not finished yet.

The KoB, NPF, a few other transformation institutions, as well as state banks, became the main instruments against insolvency, instruments which enabled allocation of cheap credits or debt-alleviation. This way, the government kept essential control over credit allocation or even subsidies to privileged companies at interest cost less than market rate.

³⁶ HN, July 25, 1997, *Některé ozdravné projekty firem vláda zatím nechce moc slyšet*, p.5

The described methods, enabled by the transformation institutions, were indeed convenient from a political point of view. Political representatives could keep their liberal vision of low state involvement in industrial affairs while on the other hand, they could provide the industry with subsidies and other help behind the scenes without even the experts noticing, because the whole picture was fragmented and it was hard, if not impossible, for persons not involved to see through such clouded structures as those created from the transformation institutions.

Promoting or keeping the state's influence (political sphere) in the Czech economy can be considered as one of the reasons for the rise and expansion of the invisible industrial policy. For the political establishment this policy had another by-product, i.e. the government saving enterprises and therefore preventing unemployment gained due to their involvement significant political capital, without actually leaving its liberal approach that gained them political points on the other side of electorate scale.

³⁷ Summarized in: Hampl (2001).

2 State Interventions in Distressed Companies since 1998

2.1 Introduction

In the first half of the 1990s, the Czech Republic was presented as a prime example of a successful transition country. The economy was growing, inflation was under control and unemployment was at a surprisingly low rate. However, little attention was paid to microeconomic foundations of the economy. Essential inadequacies in microeconomic restructuring and adaptation of large segments of the corporate sector were not sufficiently revealed until the Czech Republic started to suffer from an economic downturn in the second half of the 1990s. The weak microeconomic underpinnings of the Czech economy were ultimately reflected in a poor growth performance during the second half of the decade – in the 1996 – 1999 period, GDP grew by less than 0.6 percent per annum (World Bank, 2000:vii).

The Czech Central Bank increased interest rates in 1997/1998 as a reaction to the threat of deepening macroeconomic imbalance. Practically at the same moment, the Central Bank strengthened banking regulation. Consequently, under new circumstances, it turned out that the condition of many companies was worse than expected, as was indicated by an inability to pay off their debts; many companies were actually in a bankruptcy state. Enterprises suffered from low work productivity, low competitiveness, over-employment and a critical lack of capital. Ultimately, it became apparent that the restructuring process in Czech industrial sphere was still far from being completed in the second half of the 1990s.³⁸

Why was the assumed restructuring process during all the transition years insufficient? That is a fundamental question and therefore, in the following section, we will try to outline some of the major causes for why Czech enterprise sphere was performing so unsatisfactory.

The next part of the thesis will then address the issue of dealing with ailing enterprises, i.e. methods used to solve the problems of industrial companies that were applied in late 1990s.

2.2 Major Causes of Insufficient Restructuring Process

As we have seen, state influence in the economy was more significant than was officially admitted. Many companies stayed afloat thanks only to government assistance and due to the soft loans policy of state-owned banks. The government decisions and interventions, as well as other factors like institutional framework, briefly outlined below, should be emphasized in our context. Some of those factors directly or indirectly enabled the survival of ineffective colossal enterprises which would otherwise have been removed in the early stage of transition period.

"First Privatize Then Restructure" Philosophy

It is important to discuss the government's role regarding the privatization process. It was decided that state property should be transferred to private hands as quickly as possible. The government essentially influenced the whole privatization process by choosing the following sequence of reforming steps.

1. The companies were privatized
2. The new owner was supposed carry out necessary restructuring.

Privatized companies were expected to be more efficient than state-owned ones and hence bring more growth for the economy.

Financing of the Transition Process

There was also another important role of the government as a majority owner of banks. We addressed the issue above but it is worth emphasizing again. State banks provided financing for the privatization to Czech entities. As a result, those entities were, in the majority of cases, indebted when they entered a company as owners (Kábelová, 2000:12). In addition, the company itself could be bearing a burden of former debts that the new owner was buying with the company.

The situation when little was done in restructuring of Czech companies was allowed to continue for so long, due to state banks handed out soft loans, not only to buy the companies but to keep them running with working capital. Consequently, they were utterly dependent on these loans by the state-owned banks.

Legal and Institutional Framework

Potential problems connected with initial debts and the primary absence of restructuring were addressed by adopting a specific bankruptcy law. This law effectively sheltered enterprises against the threat of bankruptcy proceedings.³⁹ Obviously, the economy was thus given "breathing space" to accommodate to the new situation. In addition, it was mentioned that bankruptcy laws did not provide the incentives for banks to initiate proceedings against loss-making firms.

Moreover, as for institutional framework, a "rescue rope" was created for big and important enterprises in the form of revitalisation programs and subvention as were described in the previous chapter.

³⁸ It must be noted that we are now speaking of large companies especially. Small and medium sized enterprises passed through quite substantial restructuring, as noted e.g. in Mejstřík (1997).

³⁹ Law no. 328/1991. The law included an article effectively blocking anyone from initiating bankruptcy. Bankruptcy proceedings could only be brought against firms facing primary insolvency, that is, the inability to sell goods. The rationale behind these requirements was that secondary insolvency, caused by customers' failure to pay bill, should not be cause for liquidation, since the firm might still be profitable. The law, under pressure from firms and banks, was postponed twice, revised, and finally enacted in April, 1993 (Desai, 1995:19).

Main Privatization Method and Its Consequences

Dispersed Ownership Structures

Reasons for unsatisfactory economic performance, in the Czech Republic, during the second half of the 1990s can also be attributed, to an extent, to the weak internal and external mechanisms of corporate governance. The issue of corporate governance is crucial to understanding the degree of restructuring that the various privatization methods entailed (Frydman & Rapaczynski, 1994, *Privatization in Eastern Europe: Is the State Withering Away*; quoted in Schwarz, 2000). The extent of control of companies depends on how property rights are defined and if they are concentrated. The more clearly defined and the more concentrated property rights are, the better owners will be able to control managers. The voucher privatization in the Czech Republic was problematic from this point of view as it led to dispersed ownership structure and consequently to inefficient corporate governance.

Lack of Effective Enterprise Control

Nevertheless, the problem of dispersed ownership was supposed to be solved by creating investment funds and investment companies (ICs) that held the shares that were distributed to the public. Single IC often founded several funds. The largest ICs were subsidiaries of the largest commercial banks. In the end, the funds of the 13 largest ICs collected 77.6% of all investment points allocated to funds, the six largest ICs took 65% of these points, and the largest alone took 16 % (Laštovička, Marcinčin, Mejstřík, 1994:15).

These numbers would suggest that ICs would be well situated to take on the burden of adjustment. Nonetheless, ICs did not take the initiative to restructure companies. As Desai (1995:16) notes, ICs elected their own representatives to supervisory boards of the firms they controlled, but these members were usually forced to defer to the judgement of managers, limiting themselves to encouraging current managers to improve operations, rather than firing them.

Therefore, investment funds and companies were not efficient enough to be able to accomplish a necessary role in corporate governance. It resulted in a situation where companies have remained unstructured and uncompetitive because domestic shareholders did not exercise sufficient control over managers.

The ownership structure which came out of privatization was to a great extent a result of requirement for speed in privatization. This speed was however obtained at the expense of effective enterprise control and consequently it resulted in the lack of restructuring measures.

Also, as Mertlík (1998:39) stresses, after the privatization processes of the first five privatization years, a typical Czech privatized industrial enterprise was controlled in the end, by the state, through a complicated chain of capital shares.

Summary of Anti-restructuring Incentives

We can summarize the anti-restructuring incentives of all participating subjects – enterprises, their owners, banks and the government:

- Corporate governance arrangements stemming from the voucher privatization and following dispersed ownership structures did not establish efficient control over enterprises.
- Banks enabled the running of an enterprise without any requirement for restructuring. The delays in privatizing the major state banks contributed significantly to this problem.
- Enterprises (especially their unions and employees) were not interested in restructuring process as it would obviously mean decreasing the number of employees. The owner could have used their employees as “hostages” when negotiating with the government for additional support.
- There were deficiencies in legal framework (especially bankruptcy law and banking regulation) that hindered restructuring.
- Government usually came with help in the end with no conditions or requirements for necessary restructuring.

2.3 Revitalisation of Czech Enterprises – an Attempt at a Systemic Approach

2.3.1 STRATEGIES ADDRESSING PROBLEMS OF INDUSTRIAL SECTOR

The Social Democratic government, which came to power in June 1998, decided to deal with the outlined problems along two basic lines. Firstly, the government agreed on the necessity to privatize the banks. Secondly, there were a few different strategies how to address the issue of ailing enterprises. The next part of the thesis will describe these strategies. Then we will return to the crucial issue of bank privatization and dealing with bad debts (although both mentioned parts and other addressed issues are interconnected).

As the problems of Czech enterprises became apparent, the Social Democratic government began to consider measures to help the industrial sphere. In fact, the Social Democrats declared completing the industrial restructuring as one of their priorities in economic policy and therefore different plans to help the industry were prepared even before the party won the elections in 1998.⁴⁰

There were two versions of a plan called “Revitalisation of Czech Enterprises”. The first version was promoted by the Minister of Industry and Trade Miroslav Grégr, however, it was significantly modified and restricted. The latter strategy of revitalisation was obviously planned to change the government’s “invisible policy” into a systemic approach, corresponding more with market rules. However, this effort gradually gravitated to being smothered, as will be described. Moreover,

although the government promoted revitalisation as its fundamental industrial policy, they were still performing "invisible industrial policy" – they were, to a large extent, providing subsidies and soft loans to ailing enterprises.

2.3.2 PRIMARY REVITALISATION PLAN

After the Social Democratic government was elected it was obvious that the official industrial policy would undergo a turn over. The then Minister of Trade and Industry started to visit the Czech enterprises he considered as Czech industrial flagships and promised government support – subsidies, debt-equity swaps and even special transactions with Russia.⁴¹ The anticipated industrial policy of the government thus became *visible*. It apparently should have concentrated at attempts to rescue industrial giants like Škoda or Tatra with subsidies, selective tax and duty relief and soft loans. The Minister's plans should probably culminate in his comprehensive revitalisation plan.

The original version of revitalisation plan was presented for the first time in October 1998 as a massive support to a large number of enterprises. The Minister of Industry and Trade wanted to exempt the enterprises of their debts and provide guarantees for new loans. All this was conditioned by a transfer of ownership rights from the current shareholders to the state.

The original plans were such that revitalisation would concern large enterprises with more than 250 employees that encountered temporary cash-flow difficulties, high debt and worthless claims on other companies, and had contracts with customers for further production. According to Grégr's presumptions the firm would be returned to former owners after the stabilisation was accomplished. It is obvious that the criteria for state help were pretty vague and unjustifiably extensive.

The plan was evidently aimed not only to support the ailing enterprise sector, it was linked with cleaning up asset portfolios of banks. The government wanted to sell the two state banks – Komerční banka and Česká spořitelna – to a strategic partner, while enhancing their non-performing loans portfolio was a necessary step for achieving a better price. However, Grégr's plan would also essentially help to a completely private Investiční and Poštovní banka (IPB). The programme was to be applied to a number of companies which included many prominent debtors of IPB (such as ZPS, Škoda, ČKD, Chemapol etc.) so if it was really undertaken, IPB could potentially scrap many of its meagre stakes but at the same time would be able to get rid of a huge bulk of bad credit, which would be guaranteed by the state. The revitalisation conducted under the original plans would help IPB's management a lot, for the bank would be cleansed but the management would maintain its control over it, which would be a very unlikely result if the state was trying to cleanse the bank itself (The Rise and Fall of Investiční a Poštovní

⁴⁰ Interview with Mr. Pavel Mertlík, March 21, 2003

⁴¹ Lidové noviny, August 11, 1998, Zarytý "znalec" průmyslu, p. 10

banka, 2002:28). Media noticed that Grégr's plan was worked out by people close to IPB⁴² and criticized the program and Minister Grégr who was "less concerned with the fundamental restructuring of troubled industrial concerns than with simply keeping them afloat – and their managers ensconced – through generous state loans and loan guarantees".⁴³

In February 1999, Industry and Trade Minister submitted the plan to the Economic Council of the government. The concept, however, encountered with strong opposition from the quarters of the then-Deputy Prime Minister for Economic Policy, Pavel Mertlík, and also the Ministry of Finance. The resulting compromise reduced revitalisation significantly and attempted to give the industrial policy a new systematic direction.

2.3.3 SECOND REVITALISATION PLAN

The government agreed on the final revitalisation concept on April 14, 1999.⁴⁴ The scheme was limited to a small number of significant companies and it was based on an essential presumption that failed managers and shareholders should not be rewarded. Therefore, it strongly contradicted to Grégr's notions that the companies should be returned to the owners after state intervention. On the contrary, revitalisation was aimed on finding a strategic investor for the selected companies that would be restructured and unburdened from the weight of their debts and previous mismanagements due to state aid.

Although it was considered necessary to clean state banks' portfolios, revitalisation program was not destined for this purpose. Revitalisation was a solution to deal with large and complex cases but these cases amounted to only 2 - 3 per cent of the total value of bad assets in the Consolidation Bank.⁴⁵ It was originally assumed that the Revitalisation Agency, a subject established to execute the revitalisation program, should acquire shares and debts of the companies from the state banks for market value that was considerably low. Banks should have been enhanced with capital injection. In the end, other ways were chosen to recapitalize those banks, as will be described later, which resulted in essential modification of the revitalisation program.

2.3.4 THE REVITALISATION AGENCY

The Revitalisation Agency (RA) was established in May 1999 as a special subsidiary of Consolidation Bank and became a founding stone of revitalisation program.

Mandate of the Agency

The agency's mandate included selecting companies for its portfolio, purchasing their debt and/or equity at fair market value, managing and restructuring these assets to minimize fiscal

⁴² Euro, February 22, 1999, Grégr od volantu, Dolečková, M., Páral, P., p. 24

⁴³ Prague Business Journal, March 5, 1999, A change of plans

⁴⁴ Government's resolution no. 354/1999

⁴⁵ ČTK, November 18, 1999, Ziegler: RA je jen prvním stupněm řešení špatných aktiv KoB

costs, and maximizing revenues from asset sales. The goal of the Revitalisation Agency was to act as a catalyst using state exposures in revitalising companies to bring about a comprehensive restructuring.

Institutional Aspects

World Bank (2000:7) positively acknowledged efforts that had been made to insulate decision-making of the agency from political pressure. The following concept was adopted by the government in order to ensure the RA's independence in making primarily market-based decisions, to minimize political interference in the restructuring process, and to reduce the level of state-bailouts.

- *Outsourced management.* A big step in this regard meant that although the agency was 100% state-owned, the management of RA was out-sourced to a reputable international investment firm. In June 1999, a public tender for RA's manager was launched and in October the consortium Lazard Frères & Co. LLC and Latona Associates of Europe LLC. became Revitalisation Agency's manager. Manager's reward should have been based on success fees. This should ensure that the entity was managed by a company which 1) had the requisite skills and experience and 2) was motivated based on successful restructuring of companies with minimum state expenditures.
- *An Independent Investment Committee* was also created consisting of the board members plus independent workout or financial specialist. The supervisory board, which consisted of government appointees, was responsible for monitoring RA's activities. However, the supervisory board was barred from involvement in specific portfolio companies and transactions.

Criteria for Participation in the Program

Only companies that were considered to be viable in the future were eligible to participate in the programme of the Revitalisation agency. The precise criteria for eligibility were as follows (Schwarz, 2000:15):

1. *Criterion of national (regional) economic and social significance:* the debtor entity (including subsidiaries of which it is the majority owner) employs over 2000 people
2. *Criterion of a multiplier effect in the Czech economy:* the volume of materials, work and services purchased from domestic suppliers in the past accounting period exceeded CZK 1 billion.
3. *Criterion of improving banks' balance sheets:* the combined size of the non-standard loans from the Consolidation Bank, Česká spořitelna and Komerční banka exceeds CZK 3 billion.
4. *Criterion of conditional viability:* in the last accounting period the debtor made positive earnings before income tax and dividends (EBITDA). Alternatively, positive cash flow could be used as the criterion.

Potential candidates could be debtors that fulfilled at least three of the four criteria. The company's management of course had to be willing to cooperate with the agency and existing shareholders had to agree with substantial dilution of their equity position. State help was thus conditioned with restructuring, limiting of the management and shareholders' authority and final privatization. The strategy therefore led to temporary (and often complete) re-nationalization of the selected companies.

2.3.5 IMPLEMENTATION OF THE REVITALISATION PROGRAM

Based on the above mentioned criteria, eight companies were included in the RA's portfolio, as indicated in Table 5.

Table 5: Companies Included in the Revitalisation Program (Financial data in CZK mil.)

Company	Staff	KoB NPLs	Total Debt	EBITDA	Largest Shareholder	%	Second Shareholder	%
Aliachem	9 000	2 365	4 971	n.a.	Chemapol	23	Aliachem	17
ČKD Praha	12 200	> 3 000	n.a.	n.a.	Inpro	39	Deutsche Bourse	26
Spolana	3 275	1 430	3 566	670	FNM	37	Chemapol Group	29
Škoda Plzeň	14 042	> 3 000	n.a.	n.a.	NERO, s.r.o.	23	Deutsche Bourse	19
Tatra	3 800	3 600	n.a.	n.a.	Škoda	43		
Vítkovice	3 131	n.a.	5 297	2 098	FNM	67		
Zetor	2 241	2 120	2 590	95	KOB	50	Motokov	48
ZPS Zlín	3 400	n.a.	n.a.	n.a.	SIS Fund	21	Česká pojišťovna	19

NPLs – non-performing loans

*Note: Later the company **Hutní montáže** was also included in the program.*

Source: World Bank (2000:8)

2.3.5.1 General Methodology of Revitalisation

The implementation of the revitalisation program took a different shape than it was originally assumed. Reasons of the shifts are discussed in the next section. However, before we come to the issue of a certain failure of the original revitalisation concept and its causes, we will briefly try to detect common methods used in the approach to the companies that were selected to take part in the government revitalisation scheme.

The following model is based mainly on cases of four companies (Zetor, Škoda, Vítkovice, Tatra) where the Revitalisation Agency was able to influence the restructuring procedures. Scheme 6 outlines a simplified version of state intervention in the mentioned companies. The Revitalisation Agency was seemingly a catalyst of the described processes.

a) Obtaining control over the company

Firstly, the company was stabilised through a state-owned entity (a special purpose vehicle - SPV) that either:

- Started to control the company's financial flows and production due to hiring (in fact, ring-fencing) production means. Osinek in Vítkovice and RA Traktor in Zetor represent cases of such special purpose vehicles.
- Or, ownership control was gained in the company due to debt-equity swaps as was the case of Tatra or Škoda. In the most complex case of Škoda, not only the state was enabled to participate in gaining share in the special purpose vehicle (Škoda Holding) but also the main creditors were invited to capitalize their claims.

The result of these operations was many-sided. Primarily, management of company's operation was gained by a transparent entity under complete state control. Secondly, the company was in fact completely re-nationalized, previous particular owners were thus stripped of their influence and the Revitalisation Agency could effectively manage a turnaround of the company which allowed a preparation for sale to a strategic investor according to a restructuring plan generated by the Revitalisation Agency. If the company was not nationalized through the established special purpose vehicle, the effective ownership control was obtained by the KoB (b) itself due to debt-equity swap (Vítkovice, Zetor) while control over the operation of the company was acquired by the mentioned special purpose vehicle.

Last but not least, the use of a SPV for hiring production means (the so called "*tolling*") resulted in strengthened position of the owner (state) in negotiations with company's creditors.⁴⁶ The company was effectively shielded from the threat of bankruptcy as the production would be preserved even if the company went under bankruptcy administration (as happened in the case of Škoda). Shielded with tolling, the state (RA) could have to a large extent dictated conditions of financial restructuring (standstill agreements, compositions). Implementation of this concept represents an original contribution of the Revitalisation Agency and is regarded as one of the most useful ideas applied in Czech environment to recover large industrial enterprises.⁴⁷

b) Debt-equity swap

The described measures were accompanied in each case by debt for equity swaps of the claims from the KoB or Česká finanční. Such intervention had several advantages. Firstly, it was a non-cash solution and recycled previous cash infusions rather than to create new cash inflows into the capital structure creating less of a burden to the state. Secondly, the debt-equity swaps immediately bolstered the company. Due to this operation, solvency and stability could come to the passive side of the balance sheet. Thereafter, working capital financing was derived from

⁴⁶ Otherwise, creditors can blackmail the government with the threat of bankruptcy proceedings.

⁴⁷ Interview with Mr. Miroslav Zámečník (former deputy manager of the Revitalisation Agency), April 2, 2003

improved payments terms from suppliers and customers due to the more solvent status of the company.

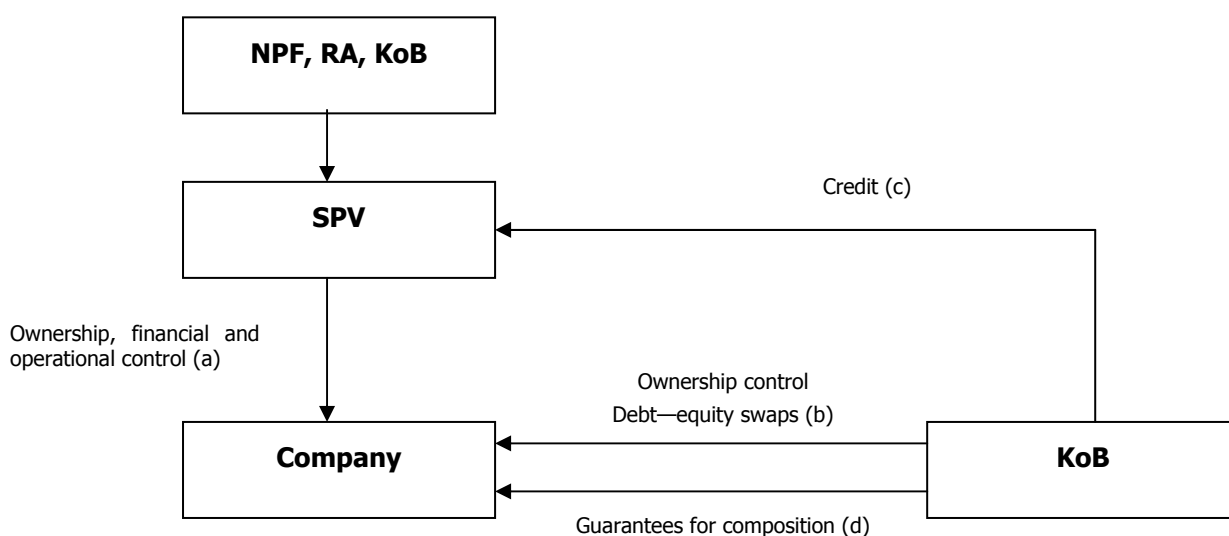
c) Inserting finances

Usually, KoB provided financing for the company due to operational credits (c). In Vítkovice's case, Česká inkasní was used for injection of money as well.

d) Composition

Debt-equity swap usually did not suffice to dispose the company of its debts entirely. There was still an essential amount of remaining creditors and thus the company might have been threatened with bankruptcy proceedings. Therefore, composition was realized and conducted by the Revitalisation Agency in the cases of Vítkovice and Zetor. However, in these two cases, the composition process had been preceded by a buyout of small creditors by the state, the objective being primarily to aggregate the debt position of the state so as to prevent rejection of the composition process during the creditors meeting. The KoB again helped the process with guaranteeing repayment of the claims in composition up to the agreed value (d).

Scheme 6: General Model of State Intervention in Revitalisation Companies



Operational restructuring

The Revitalisation Agency also usually prepared a restructuring plan and new management was inserted to realize it in cooperation with the agency's experts. In some cases, however, a restructuring plan was the only contribution of the Revitalisation Agency (e.g. Spolana).

We can summarize that the RA's overall restructuring strategy was typically in three phases:

1. Financial restructuring (passive side of balance sheet)
2. Working capital restructuring (current assets and current liabilities)
3. Operational restructuring (long-term assets)

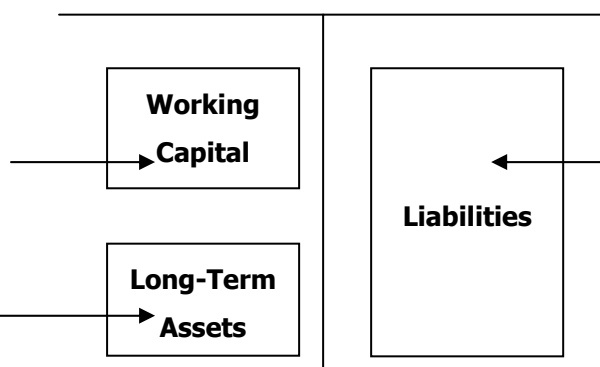
Scheme 7: Overall Restructuring Strategy

Working Capital Restructuring:

- Lengthening of Supplier Terms
- Shorter Terms on Distributors
- Improved Cash Management

Operational Restructuring:

- Sale to Strategic Investor
- Crisis Management
- Operation Expert Engagement



Financial Restructuring:

- Composition
- Debt-equity Swaps
- Out of Court Debt Restructuring
- Exchange Offerings
- Bank Guarantees

2.3.5.2 Obstacles to Revitalisation

This part addresses the causes why the resulting role of the revitalisation program and the Revitalisation Agency was marginalised. We are going to search for the major reasons why revitalisation's reality differed from the proposed concept and why it fell somewhat flat in the end, never quite living up to expectation.

From the above described methods used in restructuring of selected enterprises, it is obvious that the original concept of revitalisation was altered significantly. In addition, the plan was essentially suppressed: only projects of two companies were finished within the program and the involvement of the Revitalisation Agency was confined to an advisory role – the Agency did neither own the companies nor manage their restructuring as was originally presumed. The next part therefore concerns influences that acted as deformations of the revitalisation process.

“Natural” Development

Before the Revitalisation Agency managed to start operating effectively, two of the candidates for revitalisation – ZPS Zlín and ČKD Dopravní systémy – went bankrupt. This way the companies withdrew from the influence of the KoB and the Revitalisation Agency while the cooperation with the mentioned state institution depended on potential willingness of the administrator of the bankruptcy estate.

In the case of *ZPS Zlín*, bankruptcy was pronounced already in October 1999. The administrator of bankruptcy estate, the KoB (the most important creditor – approx. 2.7 bil.) and other creditors reached an agreement about keeping the company operating. Moreover, the Revitalisation Agency was cooperating with the administrator of the bankruptcy estate in searching for a strategic partner.

The recovery process of the company represents a positive case of restructuring through bankruptcy proceedings. The cooperation between the Revitalisation Agency and the administrator was successfully completed with selling the company to an Italian company Tajmac in eight months. Therefore, this case can be considered as a revitalisation “success story”

although the original conditions of the revitalisation program were significantly altered due to the new circumstances that had risen from the bankruptcy process. For a long time, ZPS Zlín represented the only completed project within the revitalisation scheme.

The cooperation of the Revitalisation Agency and the administrator of the bankruptcy estate was much less successful in the case of **ČKD Dopravní systémy**. The Agency offered its advisory services to the administrator, however, it was not chosen and therefore it did not have any chance to participate in the restructuring of the company.

Consequently, the processes in the two described companies must be considered as "*natural*" deviations from the revitalisation process; since the developments were spontaneous, having arisen from law procedures that were justified by the critical state of the companies. However, we must not assume that the revitalisation process was hampered only by such natural processes.

Intentional Interferences with the Revitalisation Program

Processes that depended on decisions of state institutions (or politicians) are considered here as "*intentional*" (of course, as a contradiction to the above described "*natural*") obstructions. Such decisions interfered with the concept of revitalisation and thus hindered realization of its original intentions, i.e. in particular prevention of ad hoc governmental subsidies and an attempt of a systemic approach to industrial policy.

The Fall of Revitalisation's Fundamentals

According to the original plan, the Revitalisation Agency should have acquired stakes in the companies selected to participate in the program. Nevertheless, the direction of the program fundamentally deviated from the primary intention as it was decided that the state-owned banks would be cleansed in a way that differed from the above mentioned assumption. Banks' capitalization was achieved due to a transfer of a significant amount of its non-performing loans portfolio to the KoB for prices close to their nominal value. The fundamental assumption of revitalisation, however, counted with a possibility to purchase companies' shares and debts from the banks for market values that were essentially lower. Consequently, the Revitalisation Agency could not get efficient control over the companies.

The agency should have been also equipped with sufficient capital to enable obtaining shares in companies included in revitalisation. The original idea that commercial entities will inject capital in the agency proved impossible – there were no entities interested in such a transaction. Also, the original capital of the agency amounting to 100 mil. should have been increased by the state but it did not happen.

Agency's managers Latona and Lazard were allegedly interested in investing in the companies that were revitalised.⁴⁸ Nevertheless, there was an obvious conflict of interests meaning a serious obstacle – the consulting firm would be purchasing a company that would be partly evaluated by themselves.

These facts represent important causes why the Revitalisation Agency's activities were constrained to advisory role and therefore significantly marginalized in comparison with the original concept.

Softening of Financial Conditions

The Revitalisation Agency was not yet in full operation when the two already mentioned candidates for the revitalisation program went bankrupt and two other companies included in revitalisation – Vítkovice and Zetor, came under the same threat.

In September 1999 the government therefore approved state aid for **Vítkovice** in total 2.8 bil. CZK. Although the company's inclusion in the revitalisation program was already known, the help was not conditioned according to the revitalisation's principles. Not surprisingly, the help had no positive impact and the company was again cash-starved in a few months. Even the other plan of the government, approved in February 2000, was probably too extensive for revitalisation's standards. Proper restructuring plan by the Revitalisation Agency was not ready until April 2000. Meanwhile, there was probably a significant inflow of government's finances.

Extraordinary subsidy were also allocated to **ČKD Dopravní systémy** in autumn 1999 before the company went bankrupt in January 2000. The KoB having obtained shares in the company, was commissioned to negotiate with potential strategic partner. These events were obviously not integrated with the revitalisation program that was just being prepared. (For details of both cases see the description below.)

Seeing these two examples, one must admit that the financial conditions for state aid to companies in distress were softened by these ad hoc interferences, further undermining the RA. Government involvement thus introduced asystemic incentives that were obviously not in compliance with stricter revitalisation rules or criteria. It is likely that the reputation of the revitalisation program could have been undermined which provided a signal for both the industrial companies, as well as other interest groups, that capacity for rent-seeking had not been reduced. This is apparently contrary to what should have been the message of the new systemic approach.

Antagonistic Decisions of State Institutions

Sometimes, decisions of state institutions went directly against the intentions of the revitalisation program or the representatives of the program themselves.

⁴⁸ Lidové noviny, August 27, 2001, Revitalizace neproběhla, tak jak původně měla, Interview with Michael Saran

Aliachem, a significant chemical company, represents an interesting case where the KoB wanted to buy share in the company in compliance with the Revitalisation Agency's restructuring plan, however, the solution according to the revitalisation program was not enabled by the government as Aliachem was sold to another interested entity (that was also partly state-owned – see details below).

Spolana was another significant chemical company that was selected to participate in the revitalisation program. However, even though, the Revitalisation Agency had just managed to generate a restructuring study, the company's problems were solved with no regard to the existence of the revitalisation concept.

Another example of state obstruction to revitalisation is provided by the NPF's behaviour in **Vítkovice**. The NPF, as a majority shareholder, surprisingly did not agree on measures required for the process of debt-equity swap of KoB's claims. Consequently, the crisis management, that had been found in cooperation with the Revitalisation Agency, resigned. However, even more surprisingly, no more than four months afterwards the original plan was smoothly adopted... Was it a coincidence that the coup caused by the NPF happened in June 2001 – just two months after Minister of Finance Pavel Mertlík, one of the main defenders of the revitalisation program resigned? Nevertheless, this leads to perhaps the most fundamental obstacles that can be attributed the failure of revitalisation.

Revitalisation – the Political Outsider

Why did the government (and other state institutions) complicate realization of the revitalisation plan even though it was apparently a program approved and promoted by themselves? Some of the government's acts were obviously not meant to harm the revitalisation. This especially pertains to the solution of banks' capitalization. If the government had decided for direct injection of capital in the banks, it would have required immediate financial support. With transferring part of the debts to the KoB, the problem for public finance was postponed. The concept of revitalisation was thus seriously hampered which was, however, seen as a minor problem in comparison with the issue of banks.

Nevertheless, there were obviously forces that obstructed the revitalisation deliberately. The Ministry for Trade and Industry was continuously assailing the plan. Minister Grégr often made an effort to extend the program as for the volume of resources as well as the number of companies involved. On the other hand, the government did not want to financially support the activities of the Revitalisation Agency. Obviously, the government was not unified in support of the revitalisation process, which had the most serious consequences regarding the failure of the original revitalisation concept.

There was a sudden change when Minister Mertlík resigned in April 2001. It was a milestone in the revitalisation's history. Relations between the state and Odiem Restructuring Services

(successor of the Revitalisation Agency) suddenly deteriorated.⁴⁹ The company and the revitalisation process itself was criticized by representants of the government and the KoB.⁵⁰ Odien, on the other hand complained about the lack of cooperation from the state.⁵¹ There were also disputes as Odien did not get paid in accordance with their agreements. In the end, two mandate agreements (for Škoda and Hutní montáže) were recalled in August 2001. It seems from this context as well as from the campaign in the daily press that the dissatisfaction with Odien (and revitalisation, respectively) was artificial. It was being undermined by opponents of revitalisation from within the political sphere. However, it might still have been stimulated by the industrial sphere and relevant lobbyist groups.

The Revitalisation Agency could have been a thorn in the eye of all interest groups that were accustomed to benevolent and nontransparent system of state aid as it was described in the first part of this thesis. The agency was to a large extent insulated from the political influence (World Bank, 2000:8) and thus it represented an element endangering the activities of interest groups with influence in political circles. Therefore, the successful protection of the Agency from the mentioned influences might have been a particular cause of its fall. Was it not then a Pyrrhic victory?

2.3.6 CASE STUDIES OF REVITALISATION COMPANIES

The following case studies outline the development of four companies (Zetor, Vítkovice, Tatra and Škoda Plzeň) that were included in the revitalisation program. The companies can be considered as cases where the influence of the Revitalisation Agency was considerable even though the Agency was constrained to an advisory role. The examples are confined, to a large extent, to the revitalisation period, however, some additional or historical information are also provided to give an insight into the background of the case.

2.3.6.1 Zetor

The historical beginning of state interventions in the company Zetor was described in the first part of the thesis. The KoB twice erased its debts through recapitalizations by 1996. In July 1998, 34% of the company was sold to Motokov International, a Czech business company. Motokov gained further 13.74% in 1999. The KoB still owned 49.9 % but Motokov controlled and managed the company.

However, this partial privatization did not solve Zetor's problems at all. The new owner was dependent on Zetor's survival and it did not have sufficient resources to restructure the company. The economic and financial situation of Zetor was acutely deteriorating in 1999. The

⁴⁹ Official (formal) relations between the managers of the Revitalisation Agency and the state changed already at the beginning of 2001. Four mandate agreement were signed by Odien Restructuring Services and the KoB. The agreements were concerned with completion of the restructuring projects for companies Tatra, Zetor, Hutní montáže and Škoda Holding and their sale to strategic partners.

⁵⁰ ČTK, May 14, 2001, Respekt: Rusnok označil Odien, nástupkyni RA, za podivnou firmu

⁵¹ Ekonom, June 19, 2001, Poradíme si bez poradců

company was deeply indebted again, it was not able to finance its production and consequently, production was stopped.

It is doubtful if the company was worth rescuing after the previous considerable state aid proved to be entirely ineffectual. The state the whole time controlled majority share in the company. Was it thus useful to try to resuscitate the company again under state's conduct? Nevertheless, the government once again decided to intervene, probably under the threat of thousands of jobs that would be allegedly lost if the company went bankrupt.

Zetor was included in the revitalisation program and the government in March 2000 approved a plan prepared by the Revitalisation Agency to revive the company's tractor production. The RA established the subsidiary company, RA Traktor, s.r.o., to ring-fence fresh working capital for temporary financing of Zetor in tolling agreement. The KoB provided credit 700 mil. CZK for this project.

Motokov sold its share in the company to the state (for 31 mil.) and the company was thus completely re-nationalized. The KoB gained control over the company and the restructuring process under the supervision of the Revitalisation could restart. However, there was still the issue of Zetor's enormous debts that put the company under constant threat of bankruptcy. To erase some of the debts capital was decreased by 2.656 bil. Since it still did not solve the problem entirely, composition process was started so that the remaining debts of 6.48 bil. CZK would be settled. The company proposed to pay off 30% of the majority of claims. The KoB had to intervene in this case again, the bank issued guarantees up to 800 mil. that the debts will be repaid. However, such state intervention had to be approved by the newly established Office for the Protection of Competition (ÚOHS). The approval was attained in December 2000 and the process of composition could go through - debtors approved the proposed solution in May 2001. The success with composition meant that the company could continue in the restructuring process and search for a strategic investor conducted by the Revitalisation Agency.

Zetor seemingly enhanced its performance as it finally got out of losses in December 2000. It looked like the search for strategic partner could be achieved soon. However, this final solution was prolonged due to disagreements between Odien Restructuring Services, a company that had the mandate to sell Zetor (a successor of Revitalisation Agency and consortium Latona and Lazard), and the Czech Consolidation Agency (ČKA, a successor of the KoB). In fact, ČKA was unable to specify the conditions for the sale of the company and without this crucial decision Odien could not fulfill its commitments. The process was therefore prolonged which obviously had negative consequences – it put off inflow of necessary capital into the company. Minister Grégr also criticized Odien for prolonging the process.⁵² Disputes resulted in Odien's resignation from the mandate agreement and the sale of the company had to be finished by the Czech

⁵² ČTK, November 30, 2001, ČKA zvýšila podíl v Zetoru z 50 procent na 97,7 procenta

Consolidation Agency. In March 2002 the supervisory board of ČKA finally approved the sale of the company to Slovak HTC Holding for 310 mil. CZK.

Table 6: State Interventions in Zetor (mil.CZK)⁵³

Date	Amount	Note
November 1994	1 370	Debt-equity swap
End of 1996	3 700	Capital decrease
End of 1996	3 686	Shares bought by the KoB
June 2000	2 656	Capital decrease to pay off the accumulated debt
June 2000	31	Purchase of Motokov's share by the state.
August 2000	700	KoB's credit
December 2000	800	KoB's guarantees in compensation

Source: Daily Press

2.3.6.2 Vítkovice

The company Vítkovice, a huge metallurgical and machinery complex, employed 14 thousand people in 1999. However, in the same year the company suffered from deep financial crisis, debts of the firm reached 9.5 bil. CZK, and banks refused to provide Vítkovice with further credits necessary for operation of the company.

The company was partly state-owned – the NPF held 67.31% share. Nevertheless, there were additional reasons for state aid to be considered and that was the importance of the company in the North Moravian region where unemployment reached 14.4% at that time (i.e. approx. 23 thousand people). According to government's analysis, the bankruptcy of the company would lead to a loss of 26 thousands job places.⁵⁴

In September 1999 the government therefore approved state aid for Vítkovice in total 2.8 bil. CZK. The help included credit 500 mil. to keep the company operating. Česká finanční also took over claims of the company for 600 mil. and KoB should swap 1.7 bil. TOZ credits for equity.

However, a few months after the KoB provided the mentioned extraordinary credit, the company was again cash-starved. At the beginning of 2000, the company announced that it will not pay wages on time and had to restrict production significantly.

The government reacted with approving another emergency rescue plan that was this time concealed since it was undesirable to publish the measures the government intended to be taken. The beginning of the scenario was, however, revealed a few weeks later when a newly-

⁵³ All tables of state interventions in companies below are approximate and their purpose is to provide gross orientation in the extent of state involvement.

⁵⁴ ČTK, June 25, 2001, Restrukturalizace Vítkovic má zachránit 26.000 pracovních míst

established subsidiary of the NPF Osinek started to manage operation of Vítkovice. Osinek in fact hired property of Vítkovice and started to finance production in the company with credit 2.8 bil. CZK provided by the KoB. The immediate lack of resources was also partly solved with paying off the debt of 400 mil. to Vítkovice through Česká inkasní.

The Revitalisation Agency contributed to Vítkovice's business plan, helped to search for crisis managers and in cooperation with Deloitte and Touche prepared a plan for financial and operational restructuring which was completed in April 2000. The company should be transformed to holding structure and particular parts of the holding should have been sold. It was assumed that creditors would be compensated with composition. The composition process had been preceded by a buyout of small creditors by the state; the objective being primarily to aggregate the debt position of the state so as to prevent rejection of the composition process during the creditors meeting. Česká finanční had approximately 1 billion at its disposal for this settlement of Vítkovice's creditors.

Creditors agreed with composition that was conducted by the Revitalisation Agency in November 2000 and the company therefore escaped direct threat of bankruptcy proceedings. The KoB guaranteed repayment of the creditors taking part on the composition up to total amount of 3 bil. CZK (30% of the claims value should be repaid). The composition was unprecedented and most complex in the country.

Although composition of Vítkovice was successfully completed, it demonstrated a number of weaknesses in the current framework. For instance, Social Security Office could not vote for composition due to conflicting legislation (it could not compromise claims), minimum payout in cash (more than 30% in 2 years) was prohibitively expensive and legal disputes were considerably lengthy. Dual voting quorum also increased costs (more than 50% creditors representing 75% claims) as some creditors had to be bought out at high cost to reduce hold-out and abuse.⁵⁵

Although the company still did not dispose of losses in 2000, it was going through a deep restructuring process under the new management and in cooperation with consultants from the Revitalisation Agency. The state's company Osinek was profitable and in addition, the Vítkovice itself announced profit in May 2001 for the first time after the crisis had begun, which meant a significant turning point. Up to that date the company had dismissed 5274 employees.

⁵⁵ Interview with Mr. Zámečník, April 2, 2003

Table 7: State Interventions in Vítkovice (mil. CZK)

Date	Amount	Note
September 1999	2 800 consisting of:	Approved by the government
Autumn 1999	500	Credit to bridge over a difficult period, perhaps component of the above mentioned 2.8 bil, - wages and necessary payments
Autumn 1999	600	Česká finanční took over company's claims for 1.7 and discharged them for 600 mil.
	1 700	Debt-equity swap of KoB's TOZ claims
2000	1 000	Česká inkasní's resources of settlement of Vítkovice's creditors
February 2000	400	Debt in Česká inkasní paid off to Vítkovice
March 2000	2 800	KoB's credit to Osinek
October 2000	700	Claims of Vítkovice's creditors purchased by Česká finanční
October 2000	3 000	KoB guarantees repayment of claims included in composition.

Source: Daily Press

Debt-equity Swap

Still there was one step missing that was necessary for restructuring the company and disposing of its debts, this was a debt-equity swap of KoB's claims (approx. 3 bil.). As was already mentioned above, it was surprising that the NPF did not agree on measures required for this process at a shareholder's meeting in June 2001 and consequently the crisis management resigned.⁵⁶

However, not later than in October 2001 the shareholder's meeting approved the original plan – the equity was significantly decreased and KoB should gain 95% share due to swap of its claims for shares.⁵⁷

The importance of Osinek was significant thereafter, moreover it has even grown since because Osinek (still owned by the NPF) obtained majority share in Vítkovice Steel, the metallurgical division of the company, for CZK 3.3 bil. in March 2002. Even though there was another foreign partner interested in buying the company – LNM Holdings based in the Netherlands. The ownership of the company thus just traveled from one state institution to another. Reason of this

⁵⁶ As the media noted, these events might have been connected to resignation of Minister Mertlík who supported this way of restructuring process. Minister Grégr, an opponent of Mertlík's ideas, started to take advantage of the new situation and tried to interfere with the process.

⁵⁷ It is also worth noting that this plan was less advantageous for the NPF than the original one that counted with greater participation of NPF on company's shares.

operation probably was to avoid realization of KoB's guarantees. For the state it would be more expensive to sell the company than to leave it under state control at that moment.⁵⁸

2.3.6.3 Tatra – a Journey from SDC to SDC

Tatra, a truck producer, suffered from financial difficulties and its losses were deepening since 1994. When Škoda Plzeň purchased 43.5% share in the company in February 1996, Škoda's general director Soudek started to persuade the government to help Tatra out of its debts. Soudek required the KoB to buy Tatra's debts in Komerční banka and capitalize them. He referred to the case of Aero Vodochody, where the state aid was provided in a similar way.⁵⁹ This proposal was supported by the then Minister for Industry and Trade Vladimír Dlouhý.⁶⁰ However, he resigned in June 1997 and the government refused to approve Škoda's plan.

Tatra's situation was deteriorating and therefore, its owner had to search for solutions – there was a significant capital decrease in August 1997, Škoda had to finance production of the company and most importantly a prospective foreign investor (SDC International) was found in 1998 that expressed interest in purchasing the company.

However, in 1998 the government changed and the Ministry of Trade and Industry Grégr showed willingness to help Tatra out of its financial troubles. Thus the old plan was disposed of dust and Soudek obviously hoped in state aid that would enable the company to survive while staying under his control. The state representatives, on the other hand, considered the possibility of restructuring the company that would raise attractiveness of the company for investors and thus made the transaction more profitable. SDC's offer was thus in fact given up even though the company kept on expressing its interest. The delayed payment of SDC was an excuse.

However, the state of Tatra was critical. Production was practically stopped at the beginning of 1999 and the employees' wages were paid just up to 60%. Thus a radical solution was needed. Tatra was included in the revitalisation program. In June 1999, the government approved a secret stabilization plan for Tatra. Although precise conditions of the plan were not known, the aim was once and again to find a strategic partner for the company, debt of which reached 4 billion CZK at that time.

Financial Restructuring

To get space to restructure the company, Tatra was renationalized. The KoB bought 43.5 % share from Škoda Plzeň for 140 mil. and Česká finanční purchased 14.97% from investment funds for 55 mil. The state thus gained majority in the company. As a supporting measure the KoB also purchased claims of Komerční banka in nominal value of more than 3 billion for 1.8 bil CZK. The KoB provided Tatra with operational credit amounting to 400 mil. as well.

⁵⁸ Interview with Mr. Zámečník, April 2, 2003

⁵⁹ HN, October 17, 1996, Část dluhů Tatry možná vyřeší stát

⁶⁰ Moravskoslezský den, June 4, 1997, Tatře pomůže s dluhy Konsolidační banka

Next step was capitalization of the mentioned claims now accumulated in the KoB amounting to CZK 4.1 billion. (It was the largest ever debt-equity swap in the country.) A daughter company of the NPF – Kras Brno – was established for this transaction and the company capitalized the claims thus increasing Tatra's own equity. Kras gained 78.65% share in Tatra. The KoB after purchasing shares in Tatra from Česká finanční owned 12.96%.

Table 8: State Interventions in Tatra (mil. CZK)

Date	Amount	Note
1999	140	KoB's purchase of Škoda's 43.5% share
1999	55	Česká finanční's purchase of 14.97% share from investment funds.
1999	400	KoB's credit
2000	4 100	Debt-equity swap of KoB's claims

Source: Daily Press

RA's Involvement

The Revitalisation Agency started to advise with the restructuring process in November 1999. A plan for restructuring and an information memorandum for negotiations with potential investors was prepared. The tender for the sale of Tatra to a strategic partner was thus announced and managed by Latona and Lazard.

In 2000 the company dismissed 400 employees and for the first time exhibited profits and sales increased by 70% in comparison with the previous year.

Table 9: Losses and Profits of Tatra (mil. CZK)

Year	1995	1996	1997	1998	1999	2000
Losses/Profits	- 775	- 1.048	n.a.	- 395	- 700	148

Source: Daily Press

In 2001, the sales process was taken over by the successor of the Revitalisation Agency – Odien Restructuring Services. In May 2001, the new Minister of Finance Jiří Rusnok criticized the company for delays in the process of search for a strategic partner.⁶¹ However, this time Odien finished the sale of the company – it recommended SDC International to become a strategic partner for Tatra. American SDC International offered CZK 1.25 bil. for 91.61 % share in Tatra.

2.3.6.4 Škoda Plzeň

Škoda Plzeň, the Czech Republic's biggest machinery producer, got into serious financial troubles in 1996-1997. In the latter year its losses reached more than 4.2 billion. The state was involved

⁶¹ Respekt, May 21, 2001, Mlha nad Tatrou, Respekt, 21.5.2001, Němeček, T.

in Škoda’s financial relationships through the KoB which belonged to Škoda’s main creditors. The KoB thus took an active part on primary financial stabilisation of the company that was concluded with standstill agreement among creditor banks in 1999. The agreement opened possibility of Škoda’s actual inclusion into the revitalisation program and thus the restructuring of the company could be initiated.

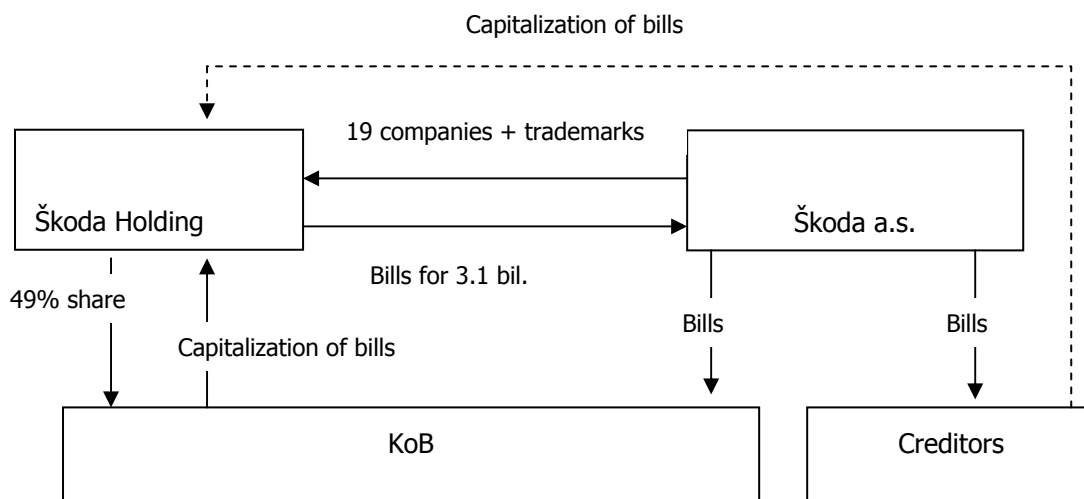
In autumn 1999 shareholders decided to substantially decrease capital by 75% (from 9.479 to 2.369 bil.) to pay off losses from previous years. In March 2000, a new company – Škoda Holding, a.s. was founded, by Škoda Plzeň and its creditors in cooperation with the Revitalisation Agency, to restructure the company.

Original Scenario and Its Failure

Škoda Holding acquired 19 profitable daughter companies of Škoda, a.s. and also purchased their debts. The core Škoda operation companies were thus ring-fenced and prevented from potential uncontrolled liquidation. The Holding company paid for the assets with bills of exchange amounting to 3.1 billions (Neprašová, 2000:120). Škoda Plzeň offered to exchange the bills for claims of its creditors who could swap them for shares of Škoda Holding. Except of this, Škoda Plzeň put in Škoda Holding trade marks worth 1.783 billion.

Although quite complicated, the plan had a certain logic, it aimed at ensuring the survival of perspective parts of the company even if bankruptcy proceedings were announced (as actually happened in the end).

Scheme 8: Scenario of Škoda’s Revitalisation (Phase 1)



The process was only completed by the KoB. The bank capitalized its bills amounting to 2.1 billion thus getting 49% share in Škoda Holding. However, the second most important creditor – IPB – did not want to take part on the project which was a serious obstacle.

As a result, Škoda a.s. held majority in the company which meant that the state did not control the company and naturally did not want to agree with proceeding of the original plan without

getting majority stake. Therefore, the Revitalisation Agency came with modified scenario. Škoda Plzeň was required to borrow 18% of the company's shares to the KoB. This way, the state would get the majority in the Holding company. Then, the KoB would swap its claims (1 bil.) for equity thus erasing debts of the company. Škoda's immovables should have been transferred to Škoda Holding as a last step.

However, in August 2000, Škoda Plzeň and its management refused to obey the plan since it was according to their opinion "*not favourable for the company*".⁶² Therefore, the plan had to be altered again. The government approved in December 2000 that the KoB would acquire the mentioned share for transferring its claims (now expanded by assets of IPB that were transferred to KoB) to Škoda Holding which would then capitalize them.

There were again disputes between the KoB and Škoda's management at the beginning of 2001 that prolonged completing the described plan. In addition, Odien Restructuring Services withdrew from the agreement closed for restructuring the company, obviously because of criticisms and troublesome cooperation with the state.

When all of the involved subjects finally reached an agreement, bankruptcy was initiated and Škoda Plzeň came under bankruptcy administration in September 2001. Although the original transfer of Škoda's main parts to the Holding enabled the company to survive and produce under such critical conditions, the Holding company was still destabilised, mainly because the immovables were not transferred to Škoda Holding on time and in the new situation it had to operate and produce in property managed by the administrator.

It was necessary to search for another solution that aimed at selling the company or its parts. However, two of the daughter companies Škoda Těžké strojírenství (ŠTS) and Škoda Steel were in financial troubles. ČKA therefore capitalized its claims (140 mil.) after ŠTS. Claims after Škoda Steel were capitalized by a consortium of banks and ČKA. The loss of ČKA from the transaction with Škoda Steel should amount to 900 mil. These interventions were not complying with the previous restructuring plan. Such measures signalled that state intervention again slipped into asystemic ad hoc solutions.

Table 10: State Interventions in Škoda (mil.CZK)

Date	Amount	Note
1992	1 888	Old debts of the company erased.
April 2000	2100	Capitalization of bills acquired by KoB for its claims
March 2002	140	Capitalization of KoB's (ČKA's) claims in Škoda Těžké strojírenství
March 2002	900	Loss of ČKA from transaction in Škoda Steel (debt-equity swap)

Source: Daily Press

⁶² MFD, August 11, 2000, Škoda Holding má znovu velké potíže

Škoda Holding (48% share of the state) was sold to Appian Group for CZK 350 mil. in December 2002. The investor bought assets in nominal value amounting to CZK 4.5 bil. The revenue thus reached 8-9% which is a level similar to revenue reached in case of bankruptcy.

2.3.7 RESULTS OF REVITALISATION

Basically, two major motivations behind the revitalisation program can be recognised according to the author's opinion. The principal and official aim of revitalisation was to keep the companies afloat during the difficult period of economic recession. However, there was also a secondary incentive that was not officially admitted for obvious reasons and that was the attempt to construct the revitalisation concept as a hedging against the uncoordinated ad hoc interventions of the state.

Was the revitalisation successful as for the noted intentions? Were there also other consequences of these activities of the state? To answer these questions, this part will try to resume the results of the revitalisation program.

2.3.7.1 Primary Aim: Keeping the Companies Afloat

The creation of the revitalisation program has to be seen in a specific context. As was stressed at the beginning of this chapter, the economy was afflicted with recession, as well as a number of other accompanying problems, like the deteriorating conditions of a large part of the production sphere and increasing unemployment. In this troublesome period the government decided that some ailing companies would be supported and protected against their likely collapse.

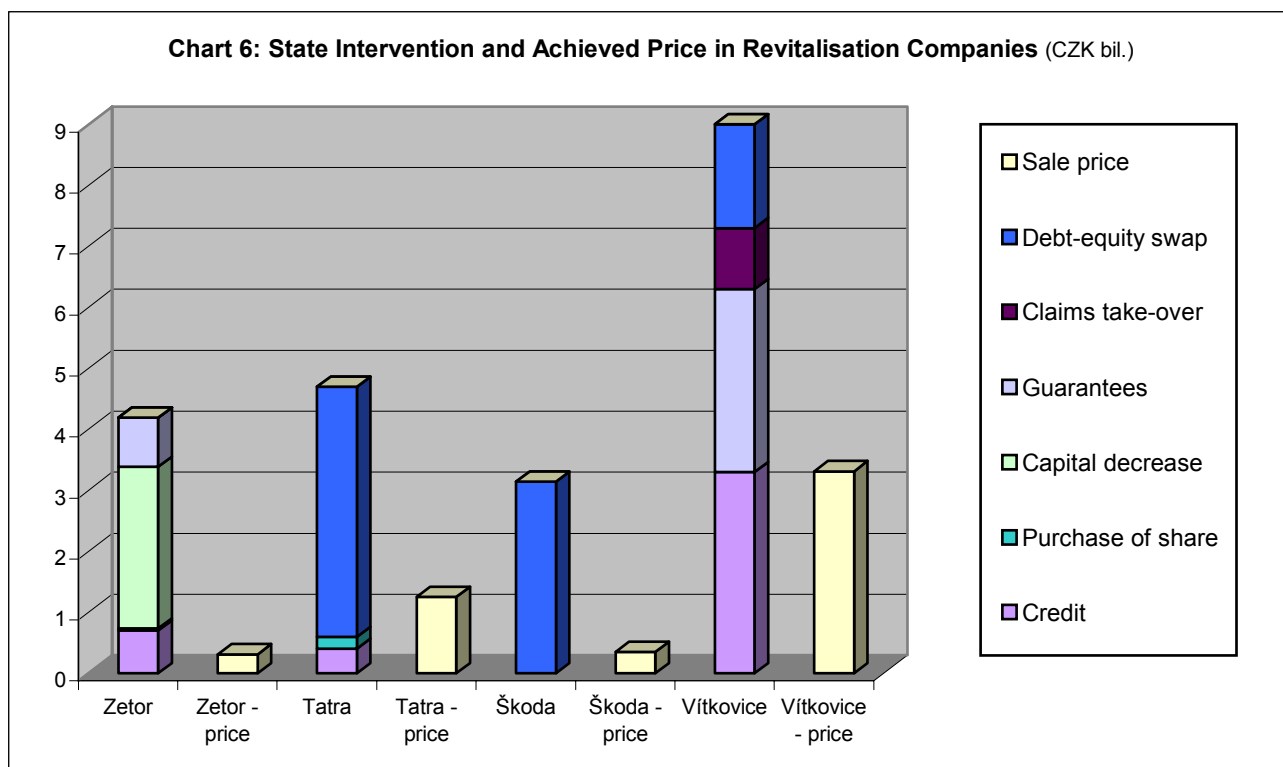
The companies selected for the program had at least one aspect in common, i.e. they were too big to fail due to their importance to the region they were based in. The government obviously hoped to rescue a relatively huge number of jobs (see Table 5) and hence to prevent further stimulation of social unrests that usually accompany economic downturns.

It must be stressed that the mentioned primary aim was achieved. None of the companies collapsed and even in the case of ZPS Zlín that went bankrupt, the company did not stop its operation due to quick and effective selection of a strategic investor.

But what was the price of achieving this goal? And was it a long-lasting solution? Wasn't the revitalisation program just another instrument to prolong the life of companies that were wasting away anyway?

2.3.7.2 Costs and Benefits of Revitalisation

Primarily, in an attempt to answer the questions outlined above, we will look at the approximate value of state intervention in comparison with the price achieved when relevant company was sold.



Source: Daily Press

Note 1: Graphs in of state interventions in companies are approximate and their purpose is to provide gross orientation in the extent of state involvement.

Note 2: Vítkovice 's price (3.310 bil. CZK) should actually be counted as cost for the state as it was payed by Osinek owned by the NPF.

We can see that state aid to the companies was several times higher in comparison with the sale price. Therefore, for the KoB (resp. tax payers) revitalisation business was suffering a loss at first sight.

However, such a superficial analysis will obviously not suffice to give a more comprehensive assessment. We also have to mention other aspects, respectively benefits of revitalisation that would be hard to count, i.e.:

- **Not only negative impact on public finance:** Income and VAT taxes that would be lost in case the company would collapse and social expenditures that would have to be expended for the potentially unemployed.
- **Revitalisation vs. bankruptcy proceedings:** It was also referred to the advantages of revitalisation in comparison with otherwise more than likely bankruptcy or liquidation. Bankruptcy proceedings have been seen as ineffective and excessively protracted and the company usually lost its value before conclusion of the process. Many creditors have viewed the bankruptcy process practically as a complete write-off of claims against the company. To avoid bankruptcy proceedings, composition process was usually initiated in companies participating on the revitalisation program and creditors thus got a chance to receive 30% of

their claims. For instance, Vítkovice went through the most extensive court settlement (composition) in the history of the Czech Republic until then.

- **Enhancement of banks' balance sheets:** Impacts on banks represents another positive effect of the revitalisation program that can hardly be computed but has to be taken into account. When the KoB took over non-performing assets related to revitalisation companies, it enhanced the banks' balance sheets and was obviously reflected during their privatization.

2.3.7.3 The Approach to Revitalisation Companies and Its Impact

During the revitalisation period, state aid for revitalisation companies was conditioned on the start of a restructuring process. Advantages of this approach were proved as the companies became stabilised, their performance level significantly improved and the controlling special purpose vehicles (Osinek, Škoda Holding, RA Traktor) were even profitable. One comparison might illustrate the difference between state aid provided on the basis of revitalisation and bailouts granted outside the program. Whereas Vítkovice were essentially restructured and its productivity improved, Nová Huť – a company previously in better condition than Vítkovice, was still cash-starving not long after bailout.

This case of Nová Huť is actually interesting also for other reason. If we compare results of the sale of Nová Huť, it is obvious that the transaction was even less advantageous for the state than in cases of revitalisation companies. Nová Huť – 67% share and 4.8 bil. of KoB's claims - was sold for CZK 660 mil. to LNM Holdings in 2002. The state therefore received approximately 10% of the claims – such ratio was lower than in case of some revitalisation companies.

Considerably sophisticated methods were introduced by experts from the Revitalisation Agency to protect the companies (quite successfully) from the threat of bankruptcy, e.g. as Škoda Holding case represents. That was the main aim of the described SPVs – to shield the company against bankruptcy. Also, this method helped to enhance negotiation position of the state (as a main owner) with company's creditors who lost the threat of bankruptcy to enforce repayments of their debts by the state. Standstill agreements and compositions were successfully reached due to this arrangement.⁶³

Another positive achievement must be stressed and that is substantial fragmentation and reduction of the former colosses. It was attempted to separate the non-performing parts of the companies from the perspective ones. Vítkovice represent a successful case of such fragmentation. State involvement in the process of restructuring also helped to overcome possible resistance by company insiders against restructuring.

The attraction of the company for strategic investors was enhanced because it was recapitalized and the state obtained full control over the company. However, the interest of strategic investors was probably lower than was originally expected. The sale of Tatra demonstrates such

a disappointment. According to general presumption, it would have been adequate to sell the company, that had always been recognised as a Czech industrial jewel, to a famous and significant player like Volvo⁶⁴ and not to an unknown SDC.

We can conclude that although the companies in revitalisation may not be viable or perspective in a long-term view as they represent, to a great extent, the declining heavy industry, the revitalisation program approached those companies in a considerably reasonable way. If the companies were to be supported, state interventions were for once designed in a way that complied with market forces, i.e. deep restructuring, fragmentation, decreasing employment etc.

2.3.7.4 Comparison with Treuhandanstalt

It has to be noted that the activities of the Revitalisation Agency resemble those of the German Treuhandanstalt to some extent. Like the Treuhandanstalt (today: Bundesanstalt fuer vereinigungsbedingte Sonderaufgaben (BvS)) the Revitalisation Agency had a screening process in which it was decided which companies should be saved and privatized. Companies received state funding for several purposes: to stay alive until a new investor was found or to enable restructuring (Schwarz, 2000:16). Of course, there are important differences: whereas the Treuhandanstalt/BvS carried out its tasks at the beginning of the transition process, the Revitalisation Agency was founded at a rather late stage of transition. In Eastern Germany companies also had access to finance and the institutional environment of a mature market economy right at the start of transition. In contrast, these institutions had to be developed in the Czech Republic. Another difference between the Treuhandanstalt and the Revitalisation Agency is that only a limited number (particularly large firms) could participate in the program, whereas the Treuhandanstalt included principally all East German companies. Furthermore, it was unlikely that the Revitalisation Agency would spend a comparable amount of money on the companies participating in the program.

2.3.7.5 Overall Impact

We have seen that the revitalisation program had some substantial benefits. However, was the overall impact on the economy worth the costs of revitalisation? A significant impact on the Czech economy could not have been expected as the number of participating companies was very small. There certainly was a multiplier effect on suppliers and in the relevant region. Nevertheless, if we look at the costs of revitalisation, the profits associated with the program are more than doubtful. It probably helped a few thousands of people not to lose their jobs and consequently to the government to gain some short-term political capital. Furthermore, the future of the companies is still uncertain at present and the costs to keep them afloat could have

⁶³ Interview with Mr. Zámečník, April 2, 2003

⁶⁴ Interest of such well-known investors allegedly existed in early 1990s when Tatra produced 15 thousand cars a year (Právo, June 5, 2001)

been used in another way, e.g. cover the costs of reorientation of the economy to more up to date production and technologies or, to support small and medium-sized enterprises. That is to support the economy via performing standard industrial policy as it is carried out in the EU and other developed countries.

However, we cannot see the problem only from the perspective of standard economic approach because of the complexity of the issue. To assess the revitalisation in a fair way, it must be emphasized that one of its major aims was not only to provide companies with bailouts but also to **prevent bailouts**.

2.3.7.6 Revitalisation – a Systematic Approach

The revitalisation program apparently should have introduced a fundamental change of the benevolent approach to state aid pertaining industrial companies. Revitalisation was designed to put an end to ineffective and asystemic practice of ad hoc bailouts. The program was created to make state's industrial policy more lucid, transparent and standardized. Therefore, clear criteria were declared for state's involvement and limits were defined how far state aid can go and under which conditions. In this sense, we can consider the revitalisation as an attempt to switch to methods of industrial policy more conform with market forces.

Revitalisation should have served as a hedging against further expansion of state aid as such strong tendencies were present in the government. As the vice-Prime Minister for Economy Pavel Mertlík stated: "*Revitalisation is a better solution than individual help to enterprises through government's interventions, which would be unavoidable in some cases.*"⁶⁵ It was even argued that the Revitalisation Agency saved money for the state due to its pure existence and the resistance of its representatives to some proposals to help enterprises. As Miroslav Zámečník from the Revitalisation Agency declared: "*The agency has already payed off abundantly to tax payers when it said no to many ideas.*"⁶⁶

Revitalisation strategy can be evaluated as a unique approach in Czech context due to its opposition to the described form of invisible industrial policy and tendency to systematic solutions.

However, this attempt remained isolated and required turn over in governmental policy was not achieved. As we have seen, state interventions returned to ad hoc solutions (e.g. bailout of Škoda's subsidiaries). Revitalisation developed too slowly, before the strategy could unfold substantially, favourable political climate expired (or was getting less and less opportune) and the program met with strong opposition. Concealing of concrete information about state help within the program did not help the aim to make the policy more transparent either.⁶⁷ Come

⁶⁵ ČTK, November 18, 1999, Činnost RA neoslabuje činnost věřitelských výborů

⁶⁶ Respekt, February 7, 2000, Už teď jsme se bohatě vyplatili, Němeček, T., p. 8

⁶⁷ In the case of Vítkovice, the government was attacked by opposition party (US) for keeping government decision about concrete conditions of help to Vítkovice in secret.

back to obscure ways of privatization has to be pointed out in case of Vítkovice as well. The company Vítkovice Steel (the profitable part of Vítkovice) was sold to the state-owned Osinek in a tender in which also a company from the Netherlands (LNM Holding) competed.

We can conclude that after the revitalisation episode there were strong tendencies to expand ad hoc and, to a large extent, unconditioned bailouts. Upcoming accession to the EU represents significant factor that prevented possible expansion of the policy. (EU's influence will be addressed below) However, even during the revitalisation period, parallel invisible industrial policy still existed.

2.4 Parallel Invisible Industrial Policy

The revitalisation program and its defenders apparently attempted to introduce certain rules into the practices that were described in the first part of this thesis, based on ad hoc and non transparent intervention of state institutions into the industrial sphere. These interventions are referred to as "invisible" industrial policy here. Although metaphorical, this expression describes reality in a considerably accurate way.

Although the revitalisation concept obviously attempted to wipe out such practices by introducing strict conditions for government's help to a company, the invisible industrial policy did not diminish. Government intervention outside the revitalisation program still existed in a considerable volume. State support was aimed especially at giant metallurgical companies – as was the case with Královopolská, Nová Huť and Válcovny plechu. However, the government also intervened in companies that were originally included in revitalisation but later disentangled from the plan and influence of the Revitalisation Agency. The government subsidized ČKD DS that went bankrupt as well as its mother company ČKD Holding that was endangered with the same threat. Also with Aliachem, although the company was in fact prevented from entering the revitalisation program, state influence still played an important role.

The role of the KoB did not diminish during the revitalisation period either, in fact, the opposite happened, the role of the state institution was even strengthened due to the transfers of significant parts of asset portfolios from the state banks, as well as from the IPB. The KoB also undertook its own actions that were out of government's reach. This was the case of a company called Korado, where the bank capitalized part of its claims after the firm thus becoming the controlling shareholder.

Invisible industrial policy therefore still existed simultaneously with the revitalisation program, carried out by both the government as well as the KoB. This parallel policy sometimes copied procedures used within the revitalisation plan, e.g. in the case of Královopolská, where a NPF's subsidiary, a special purpose vehicle, gained control over the company and the composition process was also used to satisfy creditors. Nevertheless, such interventions obviously undermined the objectives of the revitalisation strategy. The plan probably should have signalled

the end of such ad hoc activities due to selection of a limited number of companies eligible for the state's help, however, under strict conditions.

The following sections discuss case studies of four companies to demonstrate how the above mentioned interventions were realized. Three of the companies (ČKD, Aliachem and Spolana) were originally included in the revitalisation program. The last case – Královopolská – represents a company that was never considered as a participant in the revitalisation. Finally, the closing table contains also other companies and summarizes examples of state intervention that were found by the author.

2.4.1 ČKD

ČKD, one of the major machinery companies in the country, represents a typical showcase of negative consequences of the privatization of "Czech silver" into Czech hands (Čermák, 2000:80). Control over ČKD was gained by a company that obtained credit from IPB for purchasing its share. Consequently, a holding company was created consisting of a complicated structure of subsidiaries.

The company was in fact, only kept afloat due to the favourable approach of banks that were recklessly crediting the company. Čermák (2000:93) gives an example of investment credit (519 mil.) that was allocated by the KoB for construction of aluminium technology. Collateral of the credit was absolutely inadequate and clearly not enforceable. Similar was the situation regarding the credits provided to ČKD by other banks, mainly ČS and IPB. The KoB was one of the most important creditors of ČKD during the 1990s and it also purchased ČKD's bonds amounting to 890 mil.

In 1999, the situation in ČKD was getting serious. ČKD Dopravní strojírenství (DS), probably the most important part of the holding, was especially endangered with bankruptcy. The company fought an unbearable burden of debts and could not even pay wages.

The losses of the entire holding eventually reached 1.89 bil. in 1998. This burden of debts born by the company obviously motivated the consideration of ways to dispose of them. The then general director Maroušek declared that if the state does not help the company out of its debts, they "*will have to proceed according to law*".⁶⁸ Probably inspired by the government's revitalisation scheme, Maroušek even came with his own revitalisation program.

Seemingly under the mentioned pressure, the government took advantage of its influence to ensure financing for the company and its specific demands, as was the case of metro wagon's production for Prague's subway.⁶⁹

⁶⁸ Euro, 18 January 1999, Resuscitace nebo smrt, Dolečková, M., Šperkerová, M.

ČKD DS

The KoB helped with closing a standstill agreement in both ČKD DS and ČKD holding in autumn 1999. The bank obtained 49% share in the company amounting to 462.1 mil. and was also commissioned by the government to negotiate with potential strategic partners. Siemens expressed serious interest to buy ČKD DS, however, it did not want to take over the company with its debts.

Nevertheless, before some agreement could have been closed, complicated situation in ČKD DS lead into pronouncing bankruptcy in January 2000. Since the company had some considerable orders and the government still did not give up the idea of keeping the company operating; the KoB thus again intervened, e.g. it approved a loan for the company amounting to CZK 500 mil. in May 2000. The role of the Revitalisation Agency was marginalized in this case – the agency offered its advisory services to the administrator of bankruptcy but it was not selected. In autumn 2001, 60% of the company's assets were then sold to Siemens for CZK 750 mil.

ČKD Holding

The mother company was also in danger of bankruptcy proceedings in 2000. Composition was proposed to financially stabilize the company. Most significant creditors were the KoB and the NPF, claims of these transformation institutions reached more than CZK 7 billion. The government agreed on following plan in February 2001.

The KoB with its claims amounting to 5.2 bil. should capitalize claims up to 4.7 bil. The NPF should capitalize its claims up to 2.6 bil. This way, the state would acquire 90 % share in the company. Losses from this operation were estimated to 1.2 bil. for the KoB and 2.04 for the NPF, in 2002. The composition and consequently the related operations were approved by court in October 2001.

Table 11: State Interventions in ČKD (mil.CZK)

Date	Amount	Note
Until 1999	?	Credits from KoB
1999	462.1	KoB's purchase of share in ČKD DS
May 2000	500	KoB's loan for ČKD DS
2002	7300	Debt-equity swap of transformation institutions' claims after ČKD

Source: Daily Press

2.4.2 ALIACHEM

Aliachem came from the production core of former chemical giant Chemapol Group that had gone bankrupt. The company was indebted and, in addition, there were some unfavourable agreements closed by Chemapol that endangered the very existence of the company. The firm's future was thus uncertain. On the other hand, the company was considered as profitable in a

⁶⁹ ČTK, July 26, 1999, ČKD Dopravní systémy by měly plnou výrobu obnovit do půlky srpna

long term perspective, and therefore it was decided about its inclusion in the revitalisation scheme. At the beginning of 2000, the Revitalisation Agency submitted a proposal to creditor banks for securing the financing of the company and stabilizing its relations. The agency also made an offer for purchasing Aliachem's shares, which belonged to Chemapol's bankruptcy estate. The Revitalisation Agency then withdrew from the tender as well as from any consulting activity, being replaced by the KoB that made the final offer to purchase the 49.25% share for 805 mil. However, the company was sold to another interested entity – Agrobohemie, which was owned by state company Unipetrol and private firm Agrofert.

Nevertheless, KoB's involvement in revitalising the company was obviously still not finished as the bank agreed on the restructuring of credits provided to Aliachem. Media also came with information about another credit allocated by the KoB to Aliachem amounting to 300 – 400 mil.⁷⁰ The approximate value of KoB's claims was estimated to CZK 2506 mil.⁷¹

Aliachem represents a case where a company originally included in the revitalisation program had disentangled itself from the program and the influences of entities managing the program. Still, state help to the company in recovering from its debts can be detected from KoB's involvement. Therefore, the case represents partial revitalisation without the Revitalisation Agency, which supports the statement about the government's parallel invisible industrial policy – parallel to its revitalisation program.

2.4.3 SPOLANA

Spolana belongs among three of the most significant Czech chemical companies and is the biggest Czech producer of PVC. The company had experienced high losses since 1995, although the losses were gradually decreasing. However, Spolana's debts were the most serious problem of the company – yearly installments amounted to CZK 500 mil.

Table 12: Losses of Spolana (mil. CZK)

1995	1996	1997	1998	1999	2000
- 1200	- 569	- 492	- 431	- 353	- 180

Source: ČTK

In 1999, the ownership structure of Spolana was the following: the NPF (36%), Chemapol Group (28%) and C.H. Chem (20%). Spolana's privatization was problematic and the company obviously bore the burden of old decision to privatize the state share to Chemapol Group because this company went bankrupt. The decision was cancelled in July 1999 and the government also decided that the restructuring process of the company should start as soon as possible.

⁷⁰ ČTK, November 23, 2000, MfD: Kabinet tají, jak pomohl Vítkovicím a AliaChemu

⁷¹ ČTK, June 20, 2001, AliaChem uhradí snížením kapitálu na 4,3 mld. Kč předchozí ztráty

In December 2000, the government decided to forgive Spolana's debts, amounting to more than CZK 2.5 billion, and then convert them into company shares. This involved receivables that the KoB acquired from Komerční banka and IPB due to transfers of their classified assets to the KoB. This way, the state received a majority stake in the company. After transfer of the shares and capitalization of the share to Spolana's registered capital, Česká finanční had 28.82 %, Sanakon 16.10%, and Konsolidační banka 47.23%.

In November 2001, the government decided to sell the state's share (81.6%) in the company for CZK 569 mil. to Unipetrol Holding – a company controlled by the state.

However, even after the sale, the favourable approach of the KoB did not cease. The bank allegedly allowed Spolana to postpone repayment of loans amounting to 300 mil. by 2 years.⁷² It seems that it was an advantageous position for Spolana that the company in fact stayed state owned.

2.4.4 KRÁLOVOPOLSKÁ

Královopolská, a significant machinery company based in South Moravia, was purchased by a company called Kenap in 1994 but the new owner did not pay for its share and therefore Královopolská ownership reverted to the state in 1998.

The company had deep losses, its debts amounted to three times more debt than own capital.⁷³ The company employing more than 2000 people was thus endangered by the immediate threat of bankruptcy.

In 1998, Královopolská's management obviously wanted to take advantage of changes in the Ministry of Trade and Industry and turned to this ministry with request for help. According to the company's proposal, Královopolská's debt at the KoB should have been "solved" so that the NPF would purchase claims of the KoB amounting to 2.012 bil. for 1 mil. and capitalize them.

The government approved a plan for financial restructuring of the company in the end of 1999. Královopolská's capital was decreased from CZK 1.209 bil. to 1.21 mil. to compensate part of its losses amounting to 4.25 bil. Capital increase by a subsidiary of the NPF called Kras followed. This company capitalized claims of the KoB amounting to 2.253 bil.

Since a settlement with other creditors was necessary, composition was proposed. The government provided guarantees amounting to 550 mil. Moreover, capitalization of another approx. 350 mil. of KoB's claims should be realized. These additional measures were approved by the government in November 2000 and the composition was allowed in May 2001. Also, sanctions for not paying social transfers were forgiven to the company.

⁷² ČTK, May 26, 2002, Euro: ČKA vytáhla Spolanu z krize, povolila odklad splacení úvěru

⁷³ Euro, February 1, 1999, Bitva na Králově poli, Dolečková, M., p. 26

Table 13: State Interventions in Královopolská (mil. CZK)

Date	Amount	Note
1999	1209	Capital decrease
1999	2253	Capitalization of KoB 's claims
2000	550	Government 's guarantees for composition process
2000	350	Second capitalization of KoB 's claims
2000	45	Sanctions from Ministry of Labour and Social Affairs forgiven
2000	706	Sanctions from health insurances forgiven

Sources: ČTK

Table 14: Summary - Other Cases of State Interventions in Industrial Companies

Company	KoB's involvement	Amount (mil. CZK)	Date	Based on	Ownership	Note
Korado	KoB increased equity through capitalization of its claim	287.7	November 2000	Decision of KoB	KoB 34% EBRD – 29% (after KoB's involvement)	
ZVVZ	KoB allocated credit (without any interest) for realization of an order	25	March 2000		Česká průmyslová (owned by Ges Holding)	Compensations for order of nuclear power station in Iran that was not realized due to ban of Czech authorities.
	Preferential credit from KoB	200	April 2000	Government's resolution		
	Capital increase due to capitalization of KoB's claim (TOZ credits)	94.237 (acquired share: 13.8 %)	May 2000	Agreement between the government and owners of ZVVZ		
Nová huť	KoB's credit	Up to 750	June 2000	Government's resolution (7 June 2000)	NPF - 49 %	Czech biggest metallurgical company, employed 12.700 people in 2001 In contradiction with rules of Office for the Protection of Competition (ÚOHS)
	Another credit (conditioned with standstill agreement of creditors)	750	Approved by govt. in June 2000			
	Third credit (conditioned with endurance of standstill agreement)	800	Approved by govt. in June 2000			
ČKD Vagónka Studénka	Capitalization of KoB's claims	873.9	Approved by govt. in 2000	Government resolution		
Třinecké železářny	KoB guaranteed credit provided to the company by Komerční banka	300	2001			
Válcovny plechu Frýdek-Místek	Capitalization of KoB's claims, KoB acquired 34% share	290	2001		Nová Huť – 55%, KoB – 34%	Rejected by ÚOHS
Walter	KoB capitalized its claims and the acquired share was transferred to a company Novus Holding for 1 CZK that should increase capital by 165 mil.	1450	July 2001			

3 Results and Consequences of Invisible Industrial Policy

3.1 Different Methods of Structural Policy

In a traditional view, industrial (or more accurately in our context structural) policy was aimed at allowing an industry suffering structural difficulties to gradually adapt and convert production factors to new, more productive uses, by dampening market pressures. The structural adaptation was to be spread across a longer time period and thereby even retarded (Urban, 1997:172, in Mejstřík, 1997). This way state intervention was justified especially in European heavy industrial companies in 1960s – 1970s. There is also other structural policy approach which is more market-based and which has come into favor since the 1980s. This modern approach is based on building competitiveness of the economy and removing barriers to competition, e.g. breaking down obstacles to international trade, removing of measures protecting industries, professions and enterprises etc.

It is obvious that the approach to large industrial enterprises in the Czech Republic complies more with the traditional approach to structural policy. (It is important to emphasize that now we are discussing the whole period since the beginning of the 1990s.) Mertlík (1998:134) notes that according to its economic nature, the policy is basically an old-fashioned "Keynesian" policy of the 1950s and 1960s, consisting in the protection of the "old" enterprises and industries jeopardised with the changes on the demand side of the economy. This policy is costly as it is based in conservation of old industrial structures which never can be – by definition – eventually successful.

The Czech Republic is not exceptional from this point of view since in almost all market economies one can find elements of the first, traditional approach (Urban,1997:173, in Mejstřík, 1997). However, a standard traditional approach usually addresses problems of whole industries in a way that allows gradual adaptation and conversion, i.e. a basic plan for such an adaptation exist. Therefore, even if we take the traditional approach as a benchmark, Czech invisible industrial policy exhibits significant deviations that cannot be justified even according to benevolent traditional criteria.

3.2 Deviations of Czech Policy from the Standard Approach

The policy was lacking a clear and regular plan that would immediately determine which industries were eligible for government help, under what conditions and for what reasons. For example, in the case of the metalurgical industry such a plan would perhaps outline gradual decline of some non-perspective parts of this industry and support the restructuring measures aimed at reorientation to products with higher added value. Such restructuring was successfully accomplished in Belgian Charleroi or in the 1960s – 1970s in Pittsburgh (in the USA) where the

production was substantially modernised and the volume of produced steel actually didn't decrease but the product was of better quality and thus competitive.

No such concept existed in the Czech Republic that would resemble a similar strategic plan from which some criteria for company support could be derived.⁷⁴ As a result, the state did not support industries but rather intervened in selected enterprises with little regard to their future perspective. The interventions were uncoordinated and there were no explicitly formulated principles.

The Czech policy pertaining to large industrial enterprises has not been aimed at the acceleration of economic reconstruction during the 1990s, consequently, the one and only reason justifying government aid can be detected and that is to keep the companies afloat. With the exception of revitalisation, state representatives did not care if there are sufficient restructuring processes in progress in the subsidized companies or industries. It is a bit paradoxical because, as we have seen, the state in fact created a great power to influence the reconstruction of enterprises via the transformation institutions and state-controlled banks. However, such power was not harnessed in a positive way, i.e. to influence and catalyze restructuring processes. It seems that the system was most likely empowered by various political and interest groups and in fact functioned in an entirely opposite way.

Are there any motives to which the government's actions could be justified? As was already mentioned the threat of unemployment obviously played a crucial role that was aggravated due to economic recession in second half of the 1990s. At the time of economic downturn it was even more important for the government not to leave the giant industrial companies to collapse.

The majority of the companies receiving state aid also represent the cases suffering from mistakes arising from privatization – responsible owners for the companies were not found and negative consequences of this state just came to light in the mentioned period. Some companies thus bore a burden of past decisions of state institutions and hence the state was, to a certain extent, possibly obliged to help. However, the support was also provided to companies that were still controlled by the previous detrimental owner or management. Although the revitalisation program tried to introduce requirements of removing original controlling entities, the government still parallelly supported companies where nothing had changed.

To summarize our arguments. The specific transition and post-transition conditions might seem to justify government's interventions to some extent and the motivations for industrial policy seem to be rather similar to reasons that are usually mentioned in definitions of traditional approaches to structural policy. However, it must be argued that lack of coordination and

⁷⁴ It must be noted that there are also several explicit official industrial policies towards a few particular industries. This is the whole sector of electricity, gas and water supply, the major part of the sector of mining and quarrying with coal mining as the most important example, oil refining. Some of these industrial policies had been formulated explicitly as official industry policy programmes (as the energy policy)(Mertlík, 1999:134).

strategic planning activities that constitute regular structural policy suggest that governments were performing a policy for which no support from the side of economic theory can be found. This impression is aggravated due to actual practical performance of state's interferences in the economy as pointed out in the following part.

3.3 Practical Performance of the State as an Agent of Restructuring

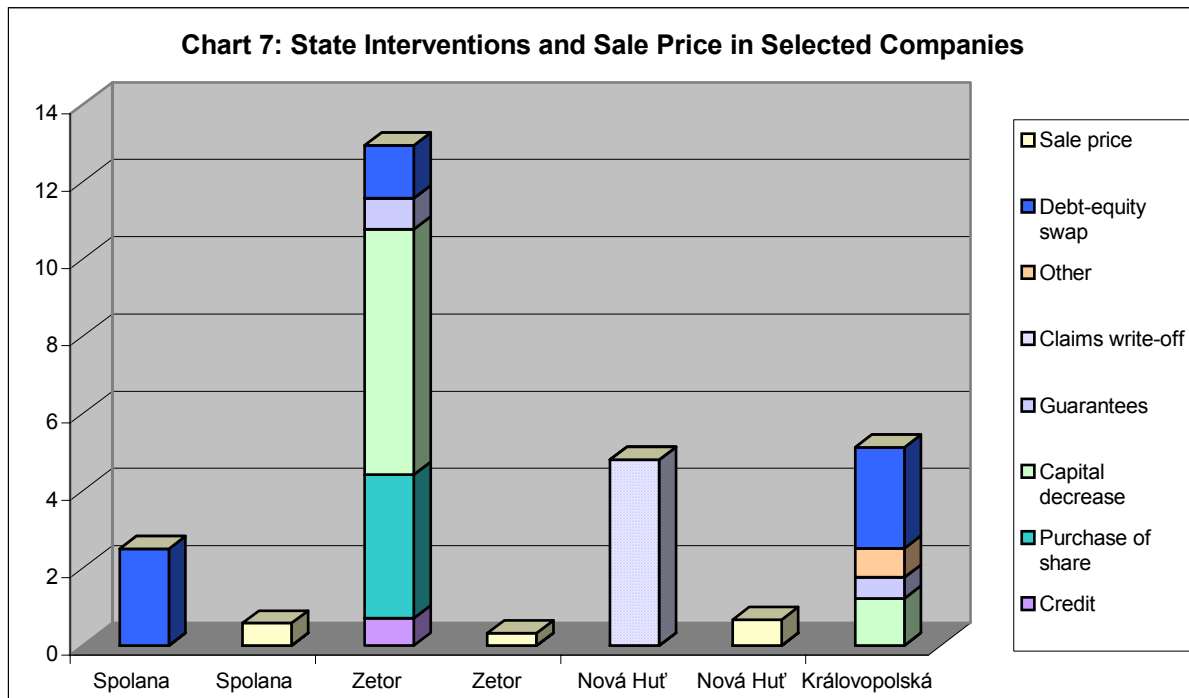
The process of restructuring is often launched by banks in developed economies. Banks frequently hire special firms to task them with restructuring a company. Confidence was placed in Czech banks that they will function as catalysts of such curative processes especially because of their ownership shares gained through their subsidiary Investment Companies and Funds. However, as has already been mentioned above, banks failed considerably. And when the state-owned banks as well as private ones (IPB) started to tumble down, there was hardly any subject who would participate on restructuring except for state institutions. The inclusion of the government and transformation institutions therefore seemed to be unavoidable if the political decision was made to keep the ailing companies afloat.

However, we must again stress that government decisions (with the exception of revitalised companies) were usually not bound to restructuring measures. The help was after all provided by state bureaucracies, e.g. from the KoB and NPF. How could we expect such administration-based entities to restructure industrial giants like Nová Huť or ČKD?

On the other hand, we can see that complex system of revitalisation and particularly the involvement of experts from commercial sphere were shown in enhanced results in participating companies where restructuring was completed.

State institutions have indeed proved themselves many times as an ineffective owner. Generally, it is assumed that the state-owned companies hardly restructure and only take reactive measures and these results have been empirically confirmed (Schwarz, 2000:4). The Czech Republic does not represent an exception in this sense. We can recall the cases of Aero or Zetor where the state possessed a majority stake for years and the worsening situation was repeatedly solved with allocation of credits that were not repayed or debt-equity swaps, i.e. subvences. Nearly 11 bil. CZK flew into Zetor in 1994 – 2000 with no impact. After the Revitalisation Agency came in the company, they had to declare that attempts to recover the company with relatively immense amount of public resources were entirely ineffective as the interventions were both amateurish as well as had just one aspect, i.e. pouring of money.

Following chart demonstrates the costs of interventions in some companies in comparison with price achieved when the company was sold.



Source: Daily Press

Government's activities sometimes seem senseless from our ex-post point of view. Such was not only the described case of Aero (see the first part) but also government behaviour in the case of Tatra where the first attempt to sell it to a strategic investor (SDC International) in 1999 was ruined due to interference by the Minister of Industry and Trade. Then, government took over the enterprise, restructured that, using a few billions CZK, and sold the company again to SDC whereas the price did not cover even half of the costs of restructuring. We can also recap the case of Spolana where the state disposed the company of its debts amounting to 2.5 bil. so that the company would be sold again, in fact, to the state for 569 mil.

The more the process of restructuring and sale of a company was delayed the higher the costs of state involvement increased. The longer were the large companies kept ineffectively afloat, sometimes in state hands, the worse was their situation when the real state was revealed. It is obvious that the policy also helped to keep giant companies with all their subsidiaries together whereas the later development showed that much better strategy would have been to allow fragmentation of these former colosses (ČKD, Škoda, Vítkovice). However, the later fragmentation was achieved at the expense of public resources. Consequently, the burden stemming from the roots of the policy in early 1990s has grown and the overall costs of preparing the company for final sale to a strategic investor were uncomparable with the price achieved.

The short term goal of the government was achieved in many cases, i.e. the relevant company was kept afloat and jobs saved. Nevertheless, we can rightfully ask if the costs of the interventions are justifiable. It is obvious that sometimes an excessive level of emphasis was put on the number of jobs rescued while it would be better to close the company right away or sell it

even for some negligible price (Zetor or some steel mills might represent such cases.). A person doesn't need to be an economist or perform deep analyses to conceive that if resources spent on subvention to such unviable companies were invested in technologies for instance, the whole society might now be better off.

However, to answer the question of pros and cons of the relevant policy in a broader view, it is necessary to look also at other consequences or impacts the policy had on the overall economic environment.

3.4 Distortion of Market Relationships

It is argued that if the state implements traditional structural policy in support of specific industries or enterprises instead of letting the market decide which would prosper and which would not, such state's decisions might distort market environment and effective allocation of resources significantly. Opponents of state intervention argue that the state cannot pick out industries that are potential catalysts for a given country's economic growth, or those products in which the country has a comparative advantage, because it could never have enough information to do so effectively (Urban, 1997, in Mejstřík, 199).

In Czech practice, state institutions were continuously allocating direct or indirect supports to companies that could not have been considered as catalysts for economic growth. Moreover, in the majority of cases, no consideration was made for the future prospects or perspectives of the companies.

However, supported companies gained a special advantage that was not accessible for the rest of the industrial sphere. The state de facto awarded enterprises that were unable to survive in the market by themselves. The result being that not only the effectiveness of the allocation was distorted, due to keeping ailing businesses unviable in long-term view,⁷⁵ but also healthy companies were thus handicapped. Fair market competition was obviously harmed which has actually been a long-lasting phenomenon within the Czech economy. We can recall from the first chapter that the debt alleviation pertained only to selected companies. For instance, Škoda Plzeň was disposed of an essential part of its old debts whereas other companies had to fight with the burden of debts by themselves. Some companies received credits from the KoB even though commercial banks rejected to provide further financing. Later on, during the economic recession, the state supported large firms to prevent their collapse whereas small and medium-sized enterprises were left at the mercy of the market. All this quite substantially changed the economic environment in the country and it could even be argued that such heterogeneous conditions of business environment became a systemic syndrome in our economy.⁷⁶

⁷⁵ See for example the table in the first part of the thesis where it is shown that many companies that received credits from the KoB went bankrupt.

⁷⁶ We will get back to this argument in later chapters as this syndrome has survived until present.

Effects of this syndrome are generally twofold. Firstly, it introduces moral hazard in decisions of businesses. Secondly, it stimulates rent-seeking activities of entrepreneurs and various interest groups.

3.5 Moral Hazard

Moral hazard pertains to the behaviour of companies as well as representatives of the state. The above described involvements of state institutions provided a signal to relevant companies that they did not have to resort to difficult restructuring measures or even the sale of some parts of their companies. Instead, they could have repeatedly counted on state help in future. The already mentioned Tatra or ČKD represent some of the more visible cases. Consequently, an additional selection mechanism was present on the market which reduced risk for some enterprises. Increased protection of such enterprises and especially of their managers resulted in decreased incentives for strengthening productivity and competitiveness. Motivation for difficult and painful restructuring was already eroded due to the relaxed credit policies of banks and further involvement of the state only reinforced the lack of enthusiasm by companies, that were "too big to fail", to promote restructuring measures.

On the side of the state, the phenomenon of moral hazard has existed as the comparison of pure economic costs and benefits of state intervention were apparently not given primary importance. Instead, political consequences were considered as the priority. Moreover, instruments used to carry out the policy did not enable direct and easy (public) recognition of the costs of any intervention. State guarantees, KoB's credits and debt-equity swaps were used and therefore real costs were veiled and did not show up at the moment of the sole action. Awareness of this "loop hole" in public accountability probably stimulated government tendency towards bailouts. It must also be noted that even in cases where the government took advantage of their influence in state-owned banks and arranged an allocation of credit to an ailing company (e.g. the case of ČKD, see above), the non-performing loan had returned to direct state care during assets transfers before the bank privatization process.

3.6 Rent-seeking and Influence of Interest Groups

The government has never signalled that the interventions would come to an end. In addition, once possibilities of receiving state support were opened, companies began to consider such contingencies as a factor relevant for their decisions and actively started to seek it.

Mentioned forms of government assistance represent typical examples of creation of a space for rent-seeking. The concept of rent-seeking was introduced to the economic theory by G. Tullock (1967). Rent-seeking consist of an action that is aimed at a change in laws or redistribution of

social welfare that a person or a group obtains at the expense of other group or person.⁷⁷ In our context, we focus on redistributive rent-seeking. Selected companies obtain state's support at the expense of other companies, respectively the whole society (resources used to support ailing companies could have been used in another productive way).

Loss of effectivity is inevitable if the possibility of rent-seeking is created. Tollison (1995:XI) stresses that if there is any hope to obtain a "rent", entities will have motivation to invest in seeking for it. And, as Urban (1997:199, in Mejstřík, 1997) points out, industrial policy will always manifest the danger that, instead of preferring industries with potential, the state will support those groups best at rent-seeking. It is also emphasized that for this reason governments should avoid a selective approach and that industrial policy should be based on the principle of uniform rules for all industries and manufacturers.

Some examples of rent-seeking behaviour

Indeed, we cannot omit the possibility that in many cases the government or the KoB might have been pushed by various interest groups. What were practical means of rent-seeking? And could they be somehow detected?

Examples of behaviour aimed at obtaining a rent comprise various methods that serve to lobby the government or subsidiary bureaucratic structures (KoB) for preferential treatment. Some manifestations of rent-seeking were even visible. A significant company of course did not encounter many difficulties if its representatives wanted to ventilate the case in media. This way the case became a political affair and the threat of social conflict addressed by media then forced the government to react. Negotiations about debt-alleviation in Tatra demonstrate such a conspicuous conflict. Behaviour of the then general director of Škoda Plzeň Mr. Soudek and his statements for media can be qualified as strong pressure (or even blackmailing) of the government. Soudek among others referred to selective support of other companies: if the government supported other large enterprises, it was allegedly obliged to help Tatra as well. It is also interesting to recall in this context that Škoda were already recipients of massive government's support.

It is therefore obvious that if the government helped once, such precedents brought a possibility that other subject will take advantage of this argument. It was not only the case of Škoda but for instance of ČKD and its general director Maroušek who came with his own revitalisation program and demanded government's support. Generally, all companies that were aware of the fact that they are too big to fail could and probably did exhibit pressure to get preferential treatment. The investors interested in purchasing such a company also began to count on government's help, e.g. in Aero Vodochody (Boeing), ČKD (Siemens) or Chemické závody Sokolov (Eastman).

⁷⁷ J. Patrick Gunning, *Understanding Democracy*, Chapter 16, p.1,
<http://www.fortunecity.com/meltingpot/barclay/212/votehtm/vm-16.htm>

The first plan of revitalisation (made by minister Grégr) represents a grand example of how far rent-seeking could go. As was already mentioned above, the plan was associated with the commercial bank IPB, which would significantly enhance its bad debt portfolio if the plan would have been accomplished. Candidates for revitalisation were simultaneously substantial debtors of IPB and the bank probably relied on the program to help it to survive.⁷⁸ The program's draft was even worked out by persons from a close circle of the bank. The extreme lobbyist power of IPB was well-known,⁷⁹ this time, however, the bank did not succeed in pushing its interests through and the plan was significantly altered to avoid the possibility of fulfilling IPB's intentions. The second version of the revitalisation plan therefore represents a successful case of resistance to rent-seeking activities. Nevertheless, the case of IPB demonstrates that the arrangements of state and political institutions lead to a potential of rent-seeking that was quite considerable.

3.7 Extreme Vulnerability of the System

We can argue that the system that developed for the support of industrial companies was extremely vulnerable to pressures of interest groups. What can be seen as major causes of this vulnerability?

3.7.1 OPACITY

Potential for rent-seeking multiplies the less transparent are the structures that have the power to decide about allocation of state aid. From this point of view, the environment that was created in the Czech Republic represents a most "favourable" milieu for rent-seeking activities and games of interest groups due to its non-transparency and opacity. It is given by a tangle of relationships among transformation institutions, banks and companies that does not provide an easy survey and therefore the financial flows among those entities are impossible to be controlled or publicly examined (for demonstration see Schemes 4 and 5 in the first part). Speculation even appeared in media that such confusing arrangement was in fact created intentionally. The intention might have been to distort the real state of public finances.⁸⁰ However, rent-seeking activities were therefore considerably untied as well.

3.7.2 ABSENCE OF CLEARLY FORMULATED CRITERIA

Absence of clearly formulated criteria can lead to rent-seeking and even corruption because it enables decisions at state institutions' discretion. If it is not strictly stipulated who is eligible for help and under which conditions, space is widened for discretionary decisions in favour of an entity that is not the most eligible one but is best in rent-seeking. Such circumstances developed in the Czech Republic because no system for state intervention existed. It also lacked coordination and control as many institutions were combined in provision of help (see e.g. the

⁷⁸ After its fall in 2000, IPB's value was estimated at approx. negative value of CZK 68 bil.

⁷⁹ For more information see the study *The Rise and Fall of IPB* (2002)

⁸⁰ MFD, January 29, 1998, *Stát má více dluhů, než přiznával*

case of Vítkovice). Lack of coherent strategy and explicitly formulated principles in government industrial strategy stimulated ineffective solutions and probably resulted in successful actions by various pressure groups.

3.8 Structural Policy Preventing Structural Change?

State interventions and the environment encompassing them lead to a paradoxical situation where the state was performing an industrial (or structural) policy which actually prevented structural change due to keeping large companies afloat and unstructured. The uncoordinated state aid had such an impact although there were exceptions – the companies complying with revitalisation. However, the revitalisation program was of insufficient extent to change the course of a policy that had deep roots since the early transition years.

Why did the government not attempt to produce some general strategy for government focus in industrial policy? Such a strategy would after all mean a first step to changing the notoriously ineffective system.⁸¹ One reason might be that the system answered the purpose of many powerful interest groups. However, it must also be recalled that the government was until 1997 continuously declaring aversion to any intervention by the state in the industrial sphere. It was believed that only the market should determine winners and losers. Such proclamations were inconsistent with the reality; nevertheless they also prevented creation of a standard structural policy that was obviously necessary for a country exposed to turbulences of the transition process.

⁸¹ To be fair, the system was not entirely ineffective, its effectivity consisted in gaining political capital.

4 Influence of EU State Aid Policy on the Czech Practice

The influence of the EU represents one of the important and interesting aspects considering the invisible state interventions. The EU influence considerably contributed (and still does) to cultivation of the Czech environment regarding our issue of invisible state help in significant enterprises because such involvement is perceived in the EU as state aid – a phenomenon that is under control of strict rules.

4.1 EU State Aid Policy

State aid control is one of the key elements of European Union's competition policy. It was defined under Article 87 of Amsterdam Treaty and it is examined by the Commission (EC).

How is the notion of state aid specified? It is important to note that not only direct bailouts or subsidies are regarded as state aid. One of the contributions of the EU rules is the recognition that state aid may be granted from state resources of any form. As the Community State Aid Survey (2001) emphasizes: *"The notion of state resources is very wide and covers not only the central budget of a state but all the resources including those foregone by way of state aid."* In addition, state resources comprise the different administrative entities of the state, agencies that act on behalf of the state etc. Specifically, types of state aid instruments can be: grants, tax exemptions, equity participations, soft loans, tax deferrals or guarantees.

Although state aid is usually perceived as harmful, the EU in some cases recognizes that government interventions can be justified. Therefore, state aid may be provided to resolve market failures in various economic sectors, to support national, regional or Community policy objectives (e.g. SMEs, training, R&D) or reduce the potential social cost of structural changes that are occurring throughout the EU.

However, there are strict rules for granting state aid. If state help is considered as being the most appropriate instrument, then its objectives should be sufficiently well defined so that it is possible to monitor its effectiveness and compare its success with other types of intervention in order to assess its efficiency. State aid can also be provided just once. Monitoring of such expenditures and resulting requirement for transparency of granting state aid are therefore an essential component of EU control policy.

What are the results of the policy in the EU? The above mentioned Survey shows that overall levels of state aid in the EU have continued to fall: the overall level of national state aid has dropped from an annual average of Eur 102 billion during 1995 – 1997, to Eur 90 billion during 1997 – 1999. The level of state aid had decreased in every member state except in Denmark, Ireland, Luxembourg, and the Netherlands. The increase in Ireland is largely caused by the inclusion of figures for Irish Corporation Tax. It shows how strict the policy is in consideration made about what state aid actually comprises.

We are mainly concerned with ad hoc state aid to industrial sector. This type of state aid is generally considered as the worst form of state interventions. This type of aid is usually granted for rescue and restructuring of companies outside any of EU's programs (which can be for example the economic and social cohesion policy). The European Commission considers this aid as most prone to distort competition. However, a relatively large volume of aid is granted on such an ad hoc basis to individual enterprises in the EU and limited number of such large individual aids (in manufacturing, financial services and transport sectors) account for a disproportionate part of the total aid granted. In the manufacturing sector, it increased in volume to 11% of total aid to this sector in 1994 before dropping back to 1.7% in 1999. If aid granted to the new German Bundeslander via the Treuhandstalt Agency is added – such aid can be considered similar to ad hoc aid – the share in overall aid to manufacturing increased to 37% in 1994 and had subsequently fallen back to 4.7% in 1999 (European Commission, 2001:16).

4.2 EU Rules and the Czech Environment

The EU's influence significantly changed the Czech environment regarding state aid. For the first time there were rules curbing Czech practice of relaxed state aid allocation. Agreements closed with candidates for EU membership contain a clear obligation for them to abide by *acquis communautaire* on state aid. Compliance with these rules will be required after our country's accession. During the pre-accession period, the Commission has followed closely the developments in state aid in the applicant countries and provided a benchmark according to which the countries could compare their measures and assess their compliance with EU rules.

The European Agreement with the Czech Republic, which came into force on 1 February 1995, determined a competition regime to be applied, based on the above mentioned Article of EC Treaty (87) concerning state aid. Implementing rules were to be adopted within three years of the Agreement's entry into force.

The European Commission criticized the Czech Republic for the state aid practices in the country, especially towards the end of the 1990s. The 1998 Regular Report concluded that no significant progress had been made either as regards restrictive agreements or as regards state aid. The 1999 Report stressed that progress in state aid control was inadequate. Nevertheless, according to the 2000 Report, alignment in respect of state aid had progressed significantly following the entry into force of the new law. The 2001 Report notes that steady progress had been made with regard to state aid.

General implementation rules in compliance with EU principles were adopted in 1998. The law about state aid came into force in 2000. Office for the Protection of Competition (Úřad pro ochranu hospodářské soutěže - ÚOHS) was established to review all possible cases of state aid.

These developments indeed had a positive impact on the Czech environment. During the negotiations, the Czech Republic had to demonstrate that the Czech practice is able to comply

with EU state aid rules. In addition, the EU's strict rules were one of the major arguments for implementation of the second version of the revitalisation program in 1999. Therefore, the EU's influence was a major catalyst for partial cultivation of the described nontransparent environment.

The EU and Czech Metallurgical Industry

The EU has always criticized that restructuring of the steel industry has made little progress. The European Commission could agree with support of steel industry if it was defined as exceptional measure motivated by social reasons. EC required in 1998 so that the mentioned restructuring plan would be generated. However, the plan was remaining overdue for a long time. It was a main obstruction, which hampered conclusion of the chapter on competition policy during the negotiations about Czech entry to the EU. In the end, the EU rules forced the Czech Republic to make the state aid in steel industry more transparent although attempts at avoiding the rules still existed.⁸² The EU agreed on the support of Czech steel industry in December 2002 prolonging the exception until 2005. (It has to be noted that the exception originally expired at the end of 1996 according to the European Agreement. All state aid allocated during 1997 – 2001 was therefore in conflict with the Agreement and was legitimised only ex-post.)

At the beginning of April (2003), the government again wanted to allocate state aid to private steel company Třinecké železárny due to purchasing its credits and bonds amounting to CZK 2 billion.⁸³ However, such bailout would mean serious violation of agreements with the EU and therefore it is probable that this time the intervention wont be realized.

4.3 Insufficiency of EU's Influence

Although the EU's influence obviously helped to support the revitalisation program (its second version), the attempt remained isolated and required turn over in governmental policy was not achieved. Government intervention outside the revitalisation program still existed in a considerable volume circumventing the EU rules⁸⁴ and pertained not only to metallurgical companies, as was described above. It is interesting that the European Commissions Regular Reports did not take note of these cases although the Report referred to revitalisation program quite extensively. It is also surprising that the current practices of Czech Consolidation Agency in asset disposal process (analysed in the next chapter) do not attract the attention and critique of the European Commission although these interferences might harm EU state aid rules.

⁸² Obscure ways of privatization has to be also pointed out in this context. In 2002, the company Vítkovice Steel (the profitable part of Vítkovice) was sold to the state-owned Osinek in a tender in which also a company from the Netherlands (LNM Holding) competed. One possible reason of this transaction could be the necessity to avoid enforcement of KoB's guarantee in case LNM Holding would acquire the company as the European Commission would definitely question this measure. Such transactions can be perceived as a game with the EU.

⁸³ ČTK, April 4, 2003, O pomoci Třineckým železárnám se rozhodne do měsíce

⁸⁴ For example, a fundamental EU rule determining that the state aid can be provided just once, was systematically violated.

There can be generally two reasons of this lenient approach. Firstly, asset disposal is taken as an unavoidable process – similar problem had to be solved for example in Sweden by its Agency called Securum. (However, there are possible ways how to enhance the Czech system, which is extremely opaque and vulnerable to influences of various rent-seeking practices.)

Secondly, and more importantly, opacity of system of the transformation institutions constrains even ability of Czech experts to understand it. There is no comprehensive information about state aid provided through above mentioned channels, the only information can be obtained from fragments in the press. Therefore, we can argue that the European Commission can hardly assess harmful consequences of the system. In addition, it must be noted that the Commission is obviously too much concentrated on the metallurgical sector. Nevertheless, neglecting such an important distortion of market environment in the country might undermine reputation of the Commission as for promoting the aim of competitive environment in accession countries.

4.4 European Commission 's Double Standards

The approach of the EU appears even more questionable if we take into account potential implications of the Accession Treaty for Czech banking sector. According to the Treaty, the European Commission can review state aid provided to banks prior to entry (since 1994) and can impose measures against a bank that received state aid considered by EC as inappropriate. This problem concerns all big Czech banks and supports amounting to hundreds of billions CZK. On the other hand, no such retroactive measures are likely to happen in case of billions CZK allocated to industrial companies in the mentioned period. The Commission proceeds strictly in case of banks and their previous support, and is expected to be even stricter, whereas it does not pay attention to supports provided to companies either due to described hidden subsidies in the past or due to actions of Czech Consolidation Agency (ČKA) at present.

This approach is fundamentally controversial as subsidies allocated to enterprises represent bailouts, which had no positive long-term impact and were mostly aimed at keeping the company afloat. However, the aid to banking sector was a necessary step for cleansing the banks before their privatization and was directly connected to transition of the Czech economy. Therefore, it can be argued that the EU approach is fairly paradoxical and can be perceived as certain double standards introduced by the EU, with reasons of this development unclear

4.5 The EU as a Catalyst for Cultivation of Czech State Aid

However, if we get back to the policy that was described as "invisible" interventions in the manufacturing sector, it is most necessary to emphasize that the upcoming accession to the EU represents significant factor that has been preventing possible expansion of this policy. Office for the Protection of Competition has hindered many attempts at allocation of subsidies to ailing companies (e.g. in Válcovny plechu - capitalization of KoB's claims was rejected by ÚOHS). The EU influence functioned as a catalyst for cultivation of Czech environment regarding state aid and

it is obvious that presence of this element (EU state aid rules) has prevented governments from many asystemic ad hoc interventions. Although state aid phenomenon still survives in the EU, the policy promoted by the European Commission is forward thinking, i.e. it proceeds against conservation of ailing companies that have no chance to survive the competitive market environment. This feature has been extremely important as it shifts the non-transparent Czech environment, regarding state interventions, in a healthier direction.

5 Dealing with Assets Accumulated in the Consolidation Bank

As we have seen in previous sections, overall economic downturn contributed to disclosure of troublesome situation in many enterprises. These conditions naturally had an impact not only on the enterprise sphere itself but also on the banking sector which was badly afflicted. As has already been mentioned, considerable percentage of enterprises were not able to pay off their loans. Moreover, the Czech Central Bank strengthened banking regulation and the approach to classified loans thus became much stricter aiming at preventing banks from practices like rolling over of loans or inadequate collaterals. The change in external conditions therefore aggravated the problem of persistent accumulation of non-performing loans; a result of soft lending practices.

The accumulation of bad loans was not just a Czech speciality, in all transition countries bad debts increased between 1991 and 1994. However, as Schwarz (2000:9) stresses there are important differences across countries. In Hungary, bad debts decreased at the end of the first half of 1990s. Poland had a rather low level of bad debts (with regard to GDP). The Czech Republic, however, witnessed a strong increase.

Table 15: Bad Debts in Poland, Hungary and the Czech Republic

	1991	1992	1993	1994
<i>As per cent of bank loans to enterprises and individuals</i>				
Hungary	9.4	20.7	42.6	30.2
Poland	16.5	26.8	27.4	29.0
Czech Republic	2.7	19.3	22.1	38.8
<i>As per cent of GDP</i>				
Hungary	3.5	5.4	11.9	7.9
Poland	2.2	3.3	2.7	3.2
Czech Republic	1.9	14.2	16.9	30.4

Source: Anderson, R.W., Bergloef, E., Mizsei, K. (1996), Banking Sector Development in Central and Eastern Europe, Centre of Economic Policy Research (CEPR) and Institute for East West Studies, New York, p. 59 quoted in Schwarz (2000:9)

Note: The assumed numbers does not allow precise international comparisons because it is difficult to follow bad loan statistics over time due to frequent changes of definition and reclassification of the loans in different countries. The numbers thus cannot be considered as accurate. The table provides above all illustration of a trend.

In the last chapter it was also referred to the government's determination to privatize the state-owned banks. This crucial decision was a part of the strategy destined to enhance overall economic environment in the country. The state-owned banks played a fundamental role in

financing Czech privatization and enterprises; hence they were shaping the development of a considerable part of the industrial sector. If the government wanted to shift the economy in a healthier direction, i.e. to restructuring and recovering of ailing enterprises, the sale of state banks indeed ought to be the first and perhaps most important step.

This way we are again getting to the tight interaction among the two spheres – banking and enterprise sectors – and the state. Namely, the method chosen for required recapitalization of the banks lead to transfers of significant non-performing loans portfolios to the Consolidation Bank (KoB). This transformation institution thus again extended its influence and importance in the economy. How did the Consolidation Bank proceed in solving the issue of bad assets? We will address this question in the next section as well as the consequences of KoB's interferences. Finally, the approach of the Consolidation Bank/Czech Consolidation Agency is compared to experience of other countries that had to handle similar problem.

5.1 Progress in Bank Privatization

Bank privatization proceeded at a very slow pace until end-1997. By that date, the state still had effective control over three large banks. The group of large banks with state ownership included the Commercial Bank (Komerční banka - KB), the Savings Bank (Česká spořitelna – ČS), Investment and Postal Bank (Investiční a Poštovní banka – IPB), and the Foreign Trade Bank (Československá obchodní banka - ČSOB).

World Bank (2000:5) notes that the failure to restructure the state banks and sell them to strong strategic investors was probably driven by the initial reluctance of the government to accept explicitly the large fiscal costs of restructuring, its initial aversion to foreign strategic investors in the large banks, and also its reluctance to recognize the failure of voucher privatization to improve the governance of enterprises and banks. However, after the Social Democratic government was elected in mid-1998, the approach changed and privatization of banks progressed as follows.⁸⁵ In May 1999 ČSOB was sold to a Belgian bank (KBC). This was followed by the sale of ČS to an Austrian bank (Erste Bank) in February 2000 and later also by the sale of KB to a French bank (Société Generale) in summer 2001.

5.2 Method of Banks' Recapitalization – a Fundamental Milestone

It became obvious that the state would have to intervene in the state-controlled banks and somehow recapitalize them to dispose them of the accumulated loss although it would mean to break the Social Democrats' promise not to put a single crown into banks any more. Moreover, the level of the required financial support was increasing steadily as the real problem of the non-performing loans was step by step revealed.

⁸⁵ In March 1998, the first major bank privatization was concluded, with the sale of IPB to Nomura, but the bank had not been properly restructured, and the transaction proved to be controversial, especially for the absence of a strong strategic investor.

An exception was ČSOB. In 1998, ČSOB's balance sheet was already clean, due to the previous transfer of bad claims to Česká inkasní, and the bank did not require any additional restructuring for privatization. However, both ČS and KB were still loaded with classified assets, despite the transfer of many bad claims to the KoB in the early 1990s. One way of disposing the banks of their losses was a direct injection of capital. Consequently, the strategic investor would acquire the bank with all its assets and thus transfers of bad assets into state hands could be avoided. As was argued in the previous chapter, a favourable by-product would also be generated regarding to the realization of the revitalisation program - its original concept counted with the mentioned way of banks' capitalization.

Nevertheless, different way was chosen to solve the problem in the end. It was argued that minority shareholders would block capital increase by the state and consequent lengthy legal disputes would unbearably prolong the privatization process contributing to further destabilisation of the banks. On the other hand, it must be noted that a proposal of direct capital injection was prepared that dealt with the problem in a complex way and proposed changes in legal framework which would enable direct recapitalization of the banks to go through.⁸⁶

Also, the fact that costs of the operation would show up immediately probably played its role. The government would have to find resources to finance the operation which would mean significant deterioration of the budget deficit in the relevant year.

In addition, decisions about banks' privatization were to a large extent uncoordinated and evolved in an unrestrained manner.⁸⁷ As such, the process was vulnerable to be influenced from many sides and interest groups. We can even argue that it might have been a wish of many entities to transfer large volume of non-performing loans to a state institution. Firstly, banks as well as state representatives could have seen that as the easiest solution as it spread settlement of the operation's costs over time (resp. postponed detection of their real amount). Secondly, enterprises (particularly the large ones) naturally preferred their debts to be handled by the state because they possibly had an experience of dealing with the KoB and could have assumed that compromises might be rather achieved under state wings than in negotiations with foreign strategic investor who was likely to introduce standard methods of prudential banking and debt enforcement. Thirdly, the KoB had its existence ensured for many years ahead due to the transfers. All the mentioned entities were interested in realization of asset transfers and could have influenced the final decision to their favour.

5.3 Accumulation of Assets in the KoB

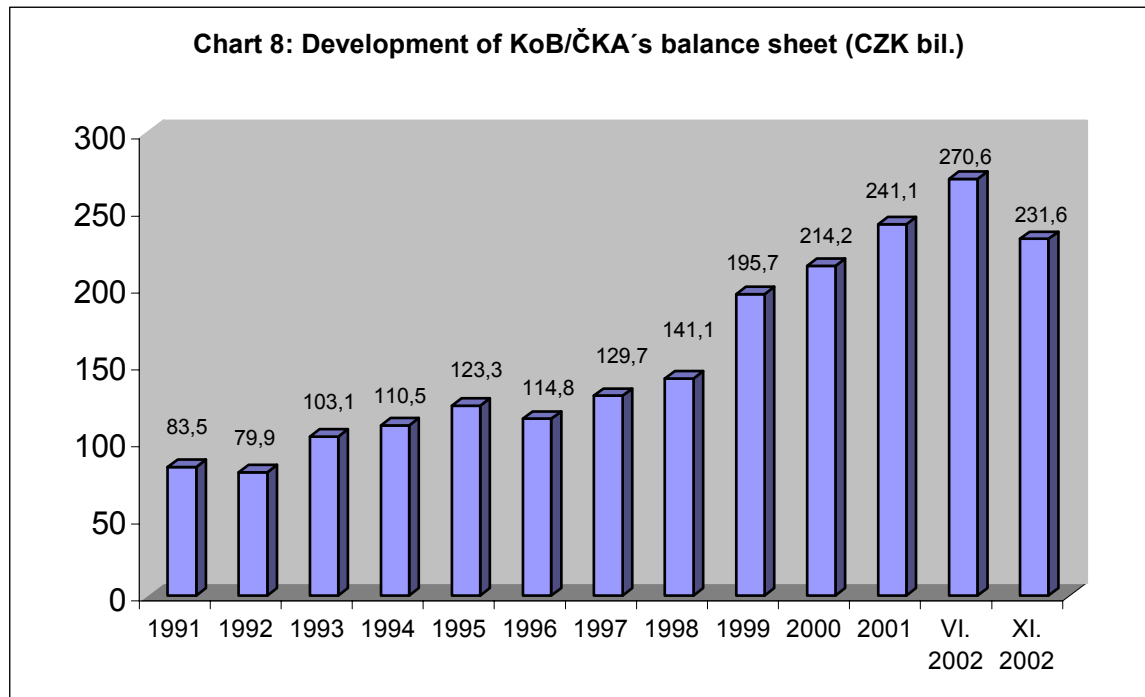
The proposals to recapitalize the banks through direct injection of capital were obviously in minority as the decision was made to cleanse the banks through transfers of non-performing

⁸⁶ Interview with Mr. Zámečník, April 2, 2003

⁸⁷ Interview with Mr. Mertlík, March 21, 2003

loans. As a consequence, the KoB continued to play a central role in financing the recapitalization of the state banks by carving out assets at above-market values. Moreover, participation of the state in solving the problems of bad debts was thus naturally ensured.

As a result of these assistance transactions, KoB's stock of classified assets grew as indicated in Chart 8 which shows the development of KoB/ČKA's balance sheet.

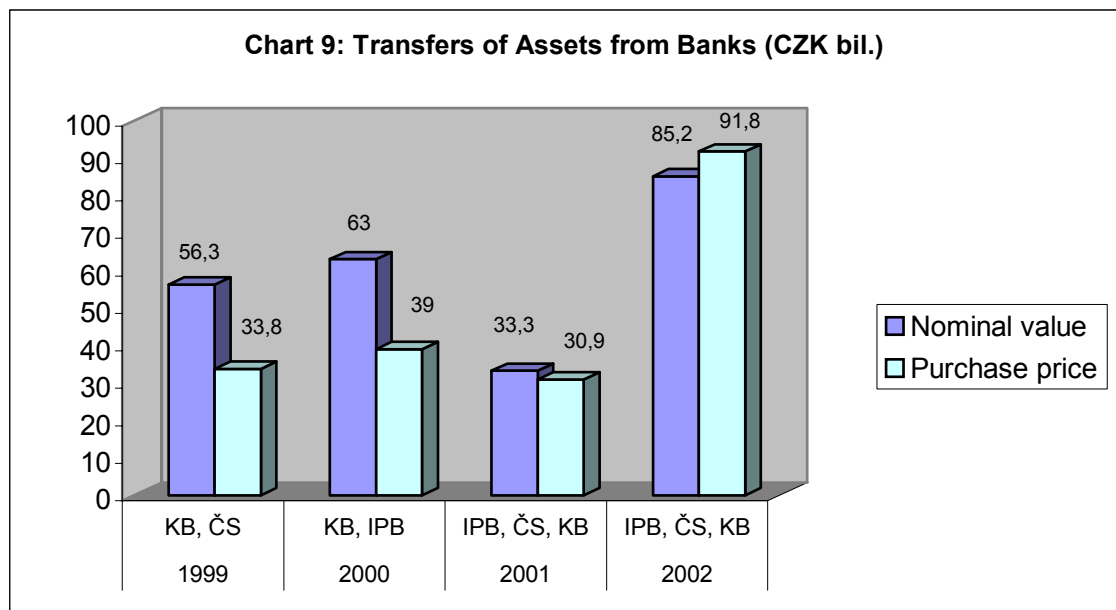


Source: ČKA

In 2000, when adding the balance sheets of the other members of the financial group (e.g. Konpo and Česká finanční), we arrived at a sum of more than CZK 300 billion. Following events contributed to the extension of KoB's debt portfolio.

- **Preparations of the state-owned banks KB and ČS for privatization** involved a few transfers of classified assets in 1999 – 2002 (see Chart 9).
- Increase in the assets held by the KoB was due to the **merger with Česká finanční (ČF)** in June 2000, which had been set up in 1997 to assist in the resolution of the small bank crisis through the ČNB-administered stabilization and consolidation programs, as was mentioned in the first part of the thesis. Before the merger, ČF's portfolio consisted of about CZK 50 billion of assets covering 1,400 debtors (World Bank, 2000:5).
- In 2000, **IPB** – the bank sold to Nomura in 1998, became insolvent due to long-term problems and was put under conservatorship. The bank was then sold to ČSOB while all IPB's assets were guaranteed by the state. Hidden loss of the IPB was revealed in later months. As an agreement on direct capitalization of the bank was apparently impossible to achieve, it was decided that a considerable part of IPB's debt portfolio would be transferred

to the KoB for book value. The asset transfers inflated KoB's (ČKA's) balance sheet in 2001 and 2002.



Source: ČKA

5.4 Assets Disposal Strategies

Whereas there has been more progress in privatizing the banks since 1998, it was only during 1999 that the authorities stepped up their efforts to deal with the bad loan problem. The Consolidation Bank and its successor Czech Consolidation Agency (Česká konsolidační agentura – ČKA) has applied following **asset disposal channels** since 1999:

- Bulk loan sales (pools)
- Individual loan sales
- Sales of restructured assets (debt plus equity)
- Other: Filing bankruptcy and out-of-court settlements, realization of collateral, auctions etc.

Pools

In 2000 the KoB announced that it would employ an approach relatively unknown in central and eastern Europe though quite common in other parts of the world. It was decided to sell an entire block of KoB's assets worth CZK 19.031 billion. The tender was won by Goldman Sachs in February 2001 and consequently the company Czech Debt Vehicle 1 (CDV 1), consisting of Goldman Sachs, Flow East and IFC, acquired the claims for price CZK 1.353 billion, which was about 11% of the package's book value and 7.1% of the nominal value.

It was positively regarded that the credit package was sold to an external manager having sufficient experience and resources for disposing of the assets quickly as the goal was to return the assets to the economy as soon as possible. Minimisation of costs connected to the

administration and management of the large volume of assets is another positive aspect of this method of debt disposal.

After successful completion of the pilot project, the KoB intended to announce another tender for selling additional asset packages in 2000. This should have involved a minimum of two cases exceeding in total CZK 10 billion.⁸⁸ The plan was to dispose of major part of the debts until the end of 2003 due to sales of large credit packages to private financial institutions that would accomplish debt enforcement themselves. The intention behind this strategy was to decrease high share of bad debts in the economy and simultaneously to dispose the economy of failed entities that were not repaying their debts.⁸⁹

Table 16: Summary of Pool Sales

	Year	Number of Clients	Accounting value	Nominal value	Yield (nom. value)	Yield (acc. value)
Pilot pool KoB	2001	300	11.9 bil.	19.1 bil	7.1%	11.4%
ČKA Pool	2002	479	23.3 bil.	37.8 bil.	9.0%	14.6%
Planned Pool (companies in bankruptcy)	2003	1634	42.0 bil.	62.0 bil.	?	?

Source: ČKA

However, when the management of the KoB was recalled in May 2001, the new general director Řežábek decided not to proceed according to the original plan and thus to slow down the process of asset disposal through pools. There were only a few small pool sales in the following year. Česká finanční and Konpo (ČKA's subsidiary) also sold part of its portfolio through pool sales in 2002.

After a year, the ČKA returned to the strategy of pool sales and a package in nominal value amounting to CZK 37.8 bil. was sold to Czech company EC Group for 3.4 bil. in September 2002.

Individual Loan Sales

Individual sales through tenders were conducted since 1999. In 1999, the KoB transferred CZK 3.267 billion in loss loans for a price of CZK 510.3 million.⁹⁰ In 2000, 27 claims in nominal value

⁸⁸ KoB's press release, February 9, 2000, Goldman Sachs buys first package of non-performing assets in the history of Central and Eastern Europe from Konsolidační banka, www.czka.cz

⁸⁹ MFD, June 12, 2000, Stát: rychle prodáme úvěry

⁹⁰ KoB's press release, April 20, 2000, KOB's performance affected by NPLs, www.czka.cz

1.9 bil were sold for CZK 259.5 mil.⁹¹ Recovery ratios are much better (around 13 – 15%) in comparison with pool sales. However, the process has been very slow.

Search for a Strategic Partner

There are a few companies that were selected for a special regime under governmental program called Exit that pertains companies in which the state has direct debt as well as equity participation. The regime is aimed at finding a strategic investor for the company due to selling claims after the companies with significant discount (i.e. for 20 – 40% of nominal value). The other governmental program (Rozvaha) should accomplish financial restructuring in a few companies under the supervision of the state.⁹²

5.5 Effects of KoB's Methods in the Czech Environment

It is obvious that the described processes have major significance for our investigation of state "invisible" interventions in the enterprise sphere. Considering the volume of debtors accumulated in the Czech Consolidation Agency, we must notice that the state again obtains substantial power due to capability to decide about the destiny of ČKA's assets. The selection of method for dealing with assets in KoB/ČKA indeed became a substantial moment of economic policy.

Now, however, we can argue that the state transformation institution is in an even more powerful position than it used to be as it decides about multiplied volume of assets in comparison with the period before banks' privatization. Therefore, the Agency's actions can considerably alter economic environment in the country. In following sections, we will examine consequences of ČKA's behaviour that can be perceived in the Czech economy.

5.5.1 HETEROGENEITY OF DEBTORS

As was described above, there are a few ways that the Agency uses to deal with its assets. The ČKA decides if assets will be sold in a pool or separately or if the company will be proposed for bankruptcy or out-of-court proceedings.

If we look at the process in more detail, we can argue that a result of such decisions (done by a state entity) may be that some debts are to a great extent forgiven whereas some entities bear consequences of their debts according to law, i.e. bankruptcy. Where can such debt remittances arise? The debt can get to the original debtor if it is sold in pools or separately through an intermediary. Although it is naturally possible that the new owner of the claim will enforce its repayment, swap them for equity or propose bankruptcy for relevant companies, it might be the easiest way to make profit on the claim, if it is sold to the original debtor. As the then Deputy

⁹¹ Právo, March 29, 2001, O špatné úvěry KoB je na internetu zájem

⁹² Program Rozvaha pertains companies Škoda JS and Mora whereas following companies were included in program Exit: Královopolská, Hutní montáže Ostrava, Praga Hostivař, TOS Čelákovice, Tuskulum, Cetos, Interma

General Director Řezníček noted: *"You can never prevent this completely. Debtors can also have a third party buy the debts for them..."*⁹³

This possibility seems to be even more likely if we take into account the still relatively cumbersome legal framework regarding bankruptcies. It is argued that for those who buy the claim it is the most profitable way to sell the debt to the original debtor as the legal environment does not support other ways of effective asset enforcement, i.e. bankruptcy proceedings or enforcement of collaterals. If a claim is sold from the Agency for, say, 10%, it means a 90% subsidy for the original debtor (of course it is less due to likely intermediary's profit).

Generally, we can argue that there might be two types of entities that may be interested in purchasing non-performing assets (if we omit intermediaries): the original debtors and "raiders". The first endeavour to wipe out the debt and thus to obtain a subsidy. It is thus an example of rent-seeking to the detriment of the state or a private subject – typically a bank or another large creditor. "Raiders", on the other hand, aim at hostile take-over of the debtor or the subject to which the debt is related.

The state also erases debts in particular selected companies due to mentioned governmental programs. Such was the case of the company Hutní montáže Ostrava. Claim after this company amounting to CZK 860 mil. was sold to a firm Jet Investment (ČKA refused to publish the price). It gives an interesting insight to note that Jet Investment purchased majority stake in Hutní montáže at the very moment when the government declared their intention to include the company in the program.⁹⁴ Jet Investment was also involved in another transaction that pertained the company Vinium. The debt of Vinium was sold in the first pool to Goldman Sachs that sold it further to Vinium – company previously acquired by Jet Investment in expectation of the transaction.⁹⁵

These cases demonstrate that the conditions created by the state in connection with asset disposal processes bring distortions into decisions of economic agents. Considerations are obviously made how to take advantage of the situation as we can see from the above mentioned cases.

These instances also demonstrate the heterogeneous conditions that pertain the debtors and their assets accumulated in ČKA. There are no rules for dealing with bad assets in the Agency that would be publicly known. We can only guess about certain guidelines that the ČKA uses for its decisions. Generally, it seems that preferential treatment (governmental programs) usually pertains large and important companies whereas smaller and medium-sized companies are more likely to go through bankruptcy proceedings, to be left unnoticed or to be sold in pools. This can be demonstrated on the case of Setuza – ČSOB proposed bankruptcy proceedings for this (rather

⁹³ ČKA's press release, December 15, 2000, Return on claims expected to be around 20%, www.czka.cz

⁹⁴ MFD, August 1, 2002, Stát začal prodávat dluhy předem vybraných firem

⁹⁵ Respekt, March 6, 2002, Loupež století u konce

significant) company as it was clearly overly indebted. However, the Czech Consolidation Agency refused the bankruptcy proceedings and claims after Setuza were transferred to the Agency.⁹⁶

5.5.2 BADWILL OF ČKA

The uncertainty about the whole process of asset disposal, its methods and schedule, negatively affects position of the debtors who are still trying to repay their assets. Connection with the ČKA brings a reputational risk and private entities are trying to avoid transfer of their debts to the Agency even if it means to repay their debt due to borrowing somewhere else for high price.⁹⁷

If the Agency has claims after an entity, other creditors regard it as a problematic debtor and its approach to financial resources is thus constrained. Entities that do not have the possibility of getting further financing cannot invest and tend to be surviving on the border of bankruptcy. However, the uncertain situation is apparently convenient for delinquent debtors.

This demonstrates another argument for necessity to act urgently to bring the claims back to the production sphere. The process was delayed when the sales of large packages were stopped in 2001. We can consider this decision as very unfortunate as the slower is the process the more the assets deteriorate and the less likely is the probability of debtors' recourse.

5.5.3 CZECH PRIVATIZATION CIRCLE

We have seen (e.g. the case of Hutní Montáže) that solution of bad debts in many cases results in another round of privatization. Due to transfers of assets to the KoB/ČKA, many companies were due to their debts naturally getting back under the control of the state and are again privatized. This time, however, conditions are different and, in some cases, state's disposal of a company is in fact heavily subsidized due to discounts provided on its assets.

A good part of the debts that have not been repayed originated in credits allocated for financing the privatization. As Mejstřík (1999:9) notes, inadequate debt burden is concentrated just in the companies that were acquired through leveraged buyouts (LBO). As was mentioned above, new owners were borrowing for companies' acquisitions and operation of their companies and therefore, as they were deeply indebted, they were not able to repay their loans. Collaterals for the credits were usually of much lower value and consequently the debts were transferred to the KoB/ČKA.

This way we are getting to an interesting phenomenon that could be named as „*Czech Privatization Circle*”.⁹⁸ The circle began with a credit for acquisition of a company (1), the loans were not repayed and therefore, it was transferred to the KoB/ČKA (2) due to privatization (ČS,

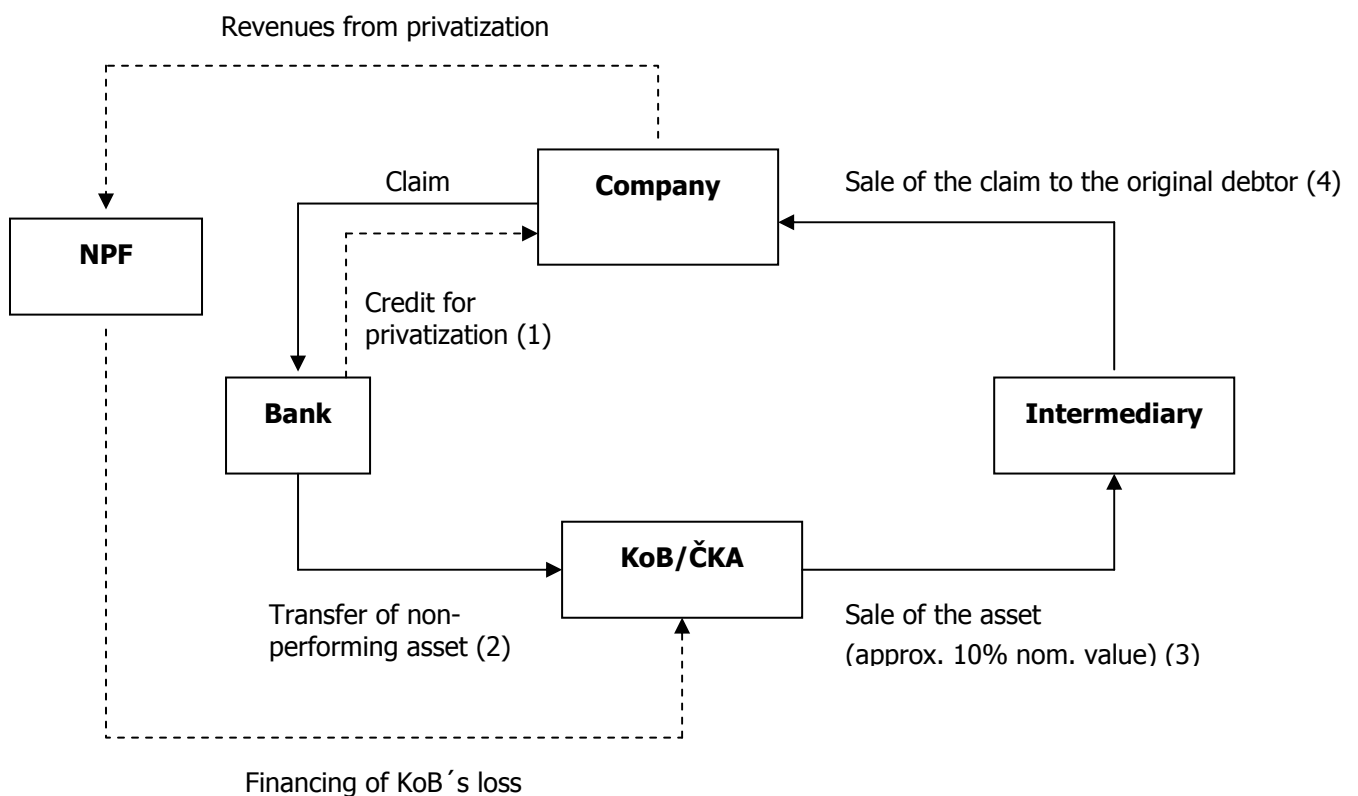
⁹⁶ ČTK, April 10, 2002, Konsolidační agentura nechce poslat Setuzu do konkursu

⁹⁷ Such was for instance the case of Česká produkční 2000 (servicing organization of TV Nova). The boss of this company – Jiří Šmejč protested against transfer of its debt to ČKA and was trying to remove the claim from the Agency as soon as possible. (ČTK, April 24, 2002, HN: Šmejčova firma proti tomu, aby její závazky spravovala ČKA)

KB) or failure of a bank (IPB, small banks). The KoB/ČKA sells the claim with a discount (see e.g. Table 15 above) either in pool or individually to an institution (3) that should realize final liquidation of the assets. The circle closes in case the original debtor purchases his own debt (4). If the full circle is realized, the owner in fact gets the company for a fragment of its nominal value.

The structure gets yet another dimension if we take into account that it was the National Property Fund (NPF) that received revenues from privatization process but this state transformation institution has also financed part of the KoB's loss.

Scheme 9: Czech Privatization Circle



The scheme is an output of a theoretical thinking and the hypothesis cannot be verified due to lack of information and nontransparency of the system. Although very little empirical evidence is accessible, we can at least be sure that the system of asset disposal discussed above is no doubt able to generate such results.

⁹⁸ This term was used by Mr. Vrba in an interview for Euro Magazine (Euro, April 29, 2002, Součástková velmoc)

5.5.4 RESURGENCE OF INVISIBLE INTERVENTIONS

We can summarize that the system enables selected private entities to gain a considerable rent to the detriment of the tax payers. The entities profiting from such a preferential treatment can hardly be detected as ČKA refuses to publish information about their debtors.

Due to the non-existence of any clear rules for asset disposal we again encounter with discretionary decisions of state institutions. Selective invisible interventions of the state in the economy therefore reemerge in a different form, however, with all problematic aspect that such decisions bring. We have mentioned bailouts of ineffective companies, the moral hazard and rent-seeking problems.

5.5.5 POLITICAL MANAGEMENT OF THE AGENCY

Another point is also interesting and that is the control over the decisions of ČKA. The Consolidation Bank transformed to Czech Consolidation Agency in September 2001. The new framework brought significant changes – the state asset management company is entitled to carry out transactions that a bank would not be allowed to accomplish, e.g. acquiring majority stake in a company, sale of a debt for less than market price, decreased constrains for information disclosure etc.

However, major attention should be devoted to the modification of corporate governance of the institution. The KoB's Board of Supervisors (BoS) was originally appointed by the Ministry of Finance. When the new law was passing through the Parliament, the Deputies took advantage of the situation and put through a proposal of parliamentary control over the Agency, i.e. the Board of Supervisors should consist of persons chosen by the Deputies in future.

Nevertheless, not only that the Deputies obtained the authority to control Agency's operation which is natural for a Board of Supervisors, they were also able to get the management of the Agency due to the change of ČKA's statute documents. According to the law, the Board of Supervisors should approve operations amounting to more than CZK 500 mil. After the change in statute, the BoS must approve all transaction that they require to oversee. If they disapprove, the transaction is rejected. This provision in fact means that the Deputies took over the executive power in the Agency; their power is rather unlimited and enables the approach to extensive portfolio of valuable confidential information. On the other hand, the *Board of Directors* still has the major responsibility for managing the company. We can thus argue that the ČKA's corporate governance model deviates from usual experience.⁹⁹ It is obviously legitimate that the Parliament, as a representative of people, should execute control over state agency as the ČKA. However, the present model also commingles executive and legislative competences as the Deputies now obtain significant executive power due to actually managing the Agency. It is an important difference which should not be neglected.

⁹⁹ However, it must be noted that similar issue concerns the NPF and also other state institutions.

Circumstances around adopting of the mentioned law also deserve our attention. Deputies elected to the Board of Supervisors in the first round consisted solely of the Opposition Agreement Parties – ODS and ČSSD. It is also worth noting that none of the Deputies in the Board of Supervisors is a banking or financial expert, however, they are managing a portfolio of assets corresponding to assets of big Czech banks (e.g. ČS or KB). It was pointed out that agreement about gaining control over ČKA comprised willingness of ODS to agree with repayment of KoB's loss due to issuing bonds amounting to CZK 36 bil.¹⁰⁰ From this event we can see that even before the ČKA actually started to exist, it became an object of intensified political wheeling and dealing. Therefore, we can argue that decision making in ČKA is likely to be liable to political pressures and the environment again stimulates invisible relations between political and business spheres.¹⁰¹

5.6 Comparison with Approaches in Other Countries

The next part addressed approaches that were adopted in other countries for dealing with bad assets and compares them with the Czech approach. From experiences of other countries it is obvious that some of the deficiencies in the Czech system can be overcome.

Many countries have recorded a rise in the volume of bad loans during the last two decades. This has involved even developed economies such as the USA and Sweden, and more recently, emerging markets in Southeast Asia and Latin America (South Korea, Thailand, Malaysia, Mexico).

Also the transition countries in Central and Eastern Europe had to deal with the problem and some of them – like Hungary, Poland and Estonia – have significantly reduced the share of bad debts. In Hungary, banks were privatized immediately to foreign investors after their recapitalization (Schwarz, 2000:10). This strategy has proved to be very successful and the problems of bad debts have been largely overcome in this country.

In contrast, the Czech Republic accumulated significant portfolio of bad debts mainly due to late privatization of banks. A benchmark for the solution of the problem represent the above mentioned countries, especially South Korea or Sweden. Most countries opted for a centralized approach by establishing a specialized institution which functions as an agent of the government in reducing the volume of bad assets. The two mentioned countries were rather successful in accomplishing the task of active work-out. Certain features of their approach are mentioned below and can help us to address the issue of enhancing the Czech system.

¹⁰⁰ HN, March 19, 2001, Česká konsolidační agentura podle představ ODS

¹⁰¹ It also is an interesting realization that politicians are now supervising management of debts which stem from the period of time when the banks were borrowing money under political pressures.

Speed of the Resolution Process

It is obvious that the problem gets worse and potential profits decrease with every day of inactivity. Indeed, time is money in dealing with problematic assets.

The Korean Asset Management Corporation (KAMCO) is a good example of how an aggressive approach to problematic assets can be successful. KAMCO accumulated assets amounting to USD 80 billion (nominal value) in 1997 – 2002 and sold USD 66 billion in bad assets until 2000 using a variety of instruments such as direct and pool sale, or the establishment of joint ventures with foreign investors. KAMCO's priority in the first phase was to create a market with claims and therefore significant volume of assets was sold to large, reputable investors. This process has been extremely successful. While at the beginning, investors offered only a fraction of the nominal value for the portfolio (10% to 15%), later for a comparable portfolio, many of the offers exceed 50% of the nominal value,¹⁰² which was attributed just to the creation of market with claims.

The Korean approach shows, how important it is to employ the fast asset disposal strategy. In Korea, the priority was not a maximum price but the speed of the process at the beginning. We have seen that it payed off in the end. The original pool sale in the Czech Republic should have started similar process. However, as was mentioned above, the process of asset disposal has been rather cumbersome - the method of pool sales was refused by the new management KoB/ČKA which caused significant delays.

Private Sector Participation

Private asset management companies are generally considered as more effective than centralized state institutions. It is another argument for transferring the assets to private sector as soon as possible. Effectivity of state institutions is among others hampered by system of rigid external and internal regulations which brings a serious obstruction to fast and effective solutions. State work out agencies have precautions to sell a claim to the original debtor and if it is done, the precautions are circumvented. Private entity does not have such precautions and which increases their effectivity.

Establishment of joint ventures with foreign investor proved to be a most efficient solution in Korea where different types of joint ventures exist, e.g.:

- **Asset Management Company** realizes sale of assets. Capital involvement as well as profits are divided half and half between state agency and private investor. The investor manages the portfolio himself.
- **Corporate Restructuring Company** involves cases of companies which are selected to be restructured. The investor inserts capital and know-how and profits are again distributed

¹⁰² Ziegler, K., October 18, 2000, Resolution of non-performing loans is similar in other countries, www.czka.cz

between himself and the state agency. This model is similar to the original concept of the Revitalisation Agency.

Similar experience using the private sector can be gained from Thailand. In 2000, the Thai Financial Restructuring Authority transferred USD 7.6 billion of assets from its balance sheet to eight private entities and later another large transaction of this type took place, when bad loans from the Krung Thai Bank worth USD 13 billion were bought by a private firm.¹⁰³

Also in Sweden, relatively low cost of banking sector's restructuring, in comparison with original estimates, are attributed to the results of Securum – state agency for dealing with bad debts. Already after five years, Securum managed to obtain 50% of bad assets. The reason of this success was seen in government decision to leave the management of Securum to representatives of private financial and banking sector who were motivated with success fees (Polouček, 1999:166).

In the Czech Republic, the concept of private sector involvement met with strong opposition as the case of the Revitalisation Agency demonstrated. There were considerations about greater participation of foreign experts and investors during the period of KoB's general directors Ziegler and Řezníček, however, after May 2001 when the new management came, such thoughts disappeared. Foreign investors were generally considered as expensive. However, experience of KAMCO and Securum demonstrate that such cost indeed pay off in the end. However, according to author's opinion, the major cause of antagonisms against foreign investors' participation stem from the unwillingness of Czech political sphere to give up the control over the asset disposal process.

Conditions of Asset Transfers

Although it is not apparent at first sight, a great importance is attached to conditions of original asset transfer to the centralized state institution. In Korea, assets were purchased for real market value (46% of book value on average). Korean Deposit Insurance Company ensured recapitalization of banks after asset transfer. This method makes the process of asset disposal more transparent as the results of dealing with bad assets by the Agency can be measured easily. The Agency can also make profits and is not criticized for performing loss operations. As the general director of KAMCO noted: *"This method was used in three countries – in Sweden by its agency Securum, in the USA (RTC) and in Korea. All these attempts were successful. Asset transfers for 100% book value were used in China, Japan, Mexico and also in the Czech Republic. Everywhere it represented an obstacle of effective solution of the transferred assets."*¹⁰⁴

¹⁰³ Ziegler, K., October 18, 2000, Resolution of non-performing loans is similar in other countries, www.czka.cz

¹⁰⁴ Euro, March 25, 2002, Proti politikům fungují cizinci, an interview with Cheon-Hong Kim, general director of KAMCO

It is argued that the method of recapitalization of the banks in the Czech Republic was chosen because of the threat that the minority shareholders would block direct recapitalization. However, other countries encountered with similar obstructions and in all cases the problem was solved with issuing a special law. In the Czech Republic, political strength and unity was obviously missing to create such "*Lex Hodina*".¹⁰⁵

5.7 Advisable Modifications of the Czech System

Generally two decisions can be seen as fundamental milestones in the development which lead to accumulation of bad debts in the Czech Consolidation Agency. Both were already mentioned, however, they are worth emphasizing: firstly, the decision about postponement of banks' privatization and secondly, the decision to recapitalize banks due to asset transfers to the KoB. As we have seen from comparisons with experience of other countries, not only that those decisions lead to the present state of huge volume of bad assets accumulated in ČKA but they also concealed some pitfalls with detrimental consequences for the asset disposal process. For example, the transfers for nominal value lead to impossibility to disclose real costs of the process thus stimulating further nontransparency (and possibly inefficiency).

However, we are more interested in present state than in attempting ex-post to outline enhancement of past decisions. The recommendations below are reflections of the above mentioned experiences of other countries. We can summarize the desirable modifications of the present conditions as follows:

1. Involvement of Private Sector

It is important to transfer management of majority of ČKA's portfolio to private sector. This should be the priority in medium-term. For the mentioned governmental programs for restructuring of selected enterprises, joint ventures similar to Korean can be established. It would be desirable to establish another joint venture for asset disposal itself. There have been such consideration by Mr. Ziegler and Mr. Mertlík, even about privatizing the whole Consolidation Bank,¹⁰⁶ however, these ideas were forsaken when the management of the KoB changed in May 2001.

In the above mentioned countries that we are taken as benchmark, attempts were made to insulate the state work-out agencies from possible political interferences. The role of politicians should be constrained to controlling power over the institution, political representatives should be cut off from decision-making in the Agency, which should be the very priority in reforming the system in the short-run.

¹⁰⁵ Mr. Hodina is a minority shareholder who is well-known for defending the rights of minority shareholders and thus making obstructions to banks' and companies' recapitalizations.

¹⁰⁶ ČTK, July 25, 2000, HN: Ministr Mertlík uvažuje do budoucna o privatizaci KoB

Management of ČKA itself ought to be entrusted to experienced and credible personalities from private financial sector who should be motivated with success fees as it was in the case of Swedish Securum.

We can see that none of the proposed ideas or none of the instructive features of foreign experience addresses the issue of original debtors purchasing their own debts with a discount.

It is morally controversial but cases when the debtor buys his own debt probably cannot be prevented entirely. In all discussed cases of foreign countries the bad debts have been bought particularly by the debtors themselves. However, in the countries where private sector was allowed to participate in the process of asset disposal, the system became more efficient as for the final cost of solution to bad debts issue.

2. Speeding up of the Process

The process of asset disposal was significantly delayed. If it proves to be impossible to change the system according to the above mentioned ideas, a second best solution is to sell the assets as soon as possible in pool sales. The World Bank's Report (2000) explicitly recommended the sale or transfer of blocks of claims to private entities as one of the realistic alternatives for quickly and effectively solving the issue of non-performing loans.

As was already noted, the importance to bring the claims back to production circle represents certain justification for the process of fast asset disposal. Returning the assets back to the economy (i.e. releasing them from the Agency), is the principal mechanism for cleaning up the economy. It promotes a system of natural economic selection where assets are divided into viable, productive assets on the one hand, and those destined for liquidation on the other.

3. Introducing Rules into the Asset Disposal Process

Last but not least, we should again emphasize the selectivity of the ČKA's decisions and the issue of heterogenous conditions for debtors. The state entity decides if the asset will be enforced with bankruptcy, out-of-court proceedings or sold. Therefore the described processes of dealing with bad assets may be considered as a substantial element of economic policy. Nevertheless, rules of this "policy" are not publicly known (if they exist at all). The public should be acquainted with the rules of the processes so that the "policy" would become more transparent and could be overseen and analysed.

6 The Phenomenon of the KoB/ČKA as a Stimulator of Invisible Interventions

Throughout this thesis we have addressed the significant forces that were stimulating the development of invisible industrial policy. Specifically, they were discussed in the first part of the thesis where the evolution of the policy from the early 1990s until 1998 was reviewed. It was argued that the major forces behind the policy was mainly the determination to hold the unemployment down, strategic/political interests, deep roots of socialism (industrial path dependency), and also the role of interest groups or the Consolidation Bank itself. We can argue that these influences have not diminished even in later years.

In this section, we will emphasize the phenomenon of the Consolidation Bank because it served as the main instrument of the policy, by acting as the invisible hand of the state, and it is therefore bound with its existence in a most intimate way. We will thus discuss the role of the KoB (ČKA) itself in explaining the creation and the maintaining of the capacity for invisible state intervention.

6.1 Symptoms of a Bureaucratic Institution

The theory of bureaucracy created by W.A. Niskanen can help us to understand some particular aspects of the behaviour and development of the Consolidation Bank (later Czech Consolidation Agency). Niskanen's theory rejects the Weberian conception that perceives the state bureaucracy as a servant of public welfare whose effort is solely aimed at fulfilling tasks determined by elected representatives (Hampl, 2001:1). Niskanen, on the other hand, regards as a major problem the interests of a bureaucrat that are above all: "wage, reputation, power, the extent of competence, but capability to delegate operation of the bureau to his subordinates". A bureaucrat is therefore particularly interested to extend the area subordinated to his decisions. According to Niskanen, the fundamental difficulty is firmly rooted in a general inability to find a mechanism to get rid of an institution, the use of which was exhausted. The KoB is an institution that was not dissolved even though its original purpose has already been achieved. The existence of the KoB should originally have been limited to the short term; however, the Bank's licence was extended twice in a short time and finally granted for ten years. Afterwards, the TOZ credits were gradually repaid and thus reduction of the institution was a likely consequence. However, new strategy was prepared by the KoB (participation in enterprise restructuring) which opened a new dimension for KoB's operation in the Czech economy and resulted not only in the survival of the institution but also in the continuous increase of its portfolio and employees.

Later, the revitalisation program and its promoters potentially endangered the KoB with limitation of its business due to intentions to outsource part of its activities to private advisory companies (Latona and Lazard and later Odien). The efforts of private sector involvement were suppressed as well as ideas like fast limiting KoB's portfolio or even privatizing the institution, principally after the new Minister of Finance Jiří Rusnok assumed his office and changed the KoB's

management in May 2001. The new management also slowed down the prepared plan for sale of debts accumulated in the KoB, which further delayed the process of the institution's retreat.

The efforts to keep the portfolio already absorbed (e.g. delaying asset disposal process, or we can recall KoB's refusal to sell its share in Aero Vodochody) and to avoid limitation of already authorized activities (obstructions to private sector involvement) represent typical symptoms of a bureaucratic institution.

Active "Portfolio Sucking"

The KoB also shows signs of another connected symptom of bureaucratic institutions: *active "portfolio sucking"*, i.e. attempts to expand portfolio of its assets as well as activities. (As *passive* actions of this kind we mean the just mentioned obstructions to cut down KoB's activities.)

As *active* actions of this sort we can recall the change in KoB's strategy in 1994-1995 or recent behaviour of the institution when dealing with the heritage after the failed bank IPB.

The Czech Consolidation Agency's intentions seemed to be to take over as many assets as possible from this heritage. ČSOB took over IPB after it was put under conservatorship in June 2000 with all IPB's assets guaranteed by the state. While general director Ziegler managed the Consolidation Bank, it was assumed that ČSOB will transfer only small part of IPB's assets (generally assets of companies participating in revitalisation program) to the KoB. This implicit assumption might be also detected from the published agreement between ČSOB and the state (Agreement and State Guarantee). However, later, when the management changed and the KoB was transformed to ČKA, we can detect gradual change in the strategy of the state institution. The "portfolio sucking" activity culminated with governmental resolution no. 225 from March 6, 2002. The resolution reflected the intention of the state to take over assets from IPB's portfolio that were remaining in special regime in ČSOB, as soon as possible. (In the case of these so called "grey" assets it was not decided until then if they were going to be transferred to ČKA or would be left in ČSOB.) The resolution was aimed to constrain the volume of assets that could be retained by ČSOB.¹⁰⁷ As the general director of ČKA Pavel Řežábek noted: *"The state concluded that ČSOB wont be allowed to keep all items that they want to keep"*.¹⁰⁸

The relevant state representatives have never satisfactorily explained this decision. ČSOB pays a charge for every asset that is kept in its portfolio. Moreover, we have mentioned the lower efficiency of state institutions in dealing with non-performing loans, but also the detrimental influence of the ČKA, particularly on the assets in its possession, and foreign experience that advised to leave dealings with bad assets to the private sector if possible. Mr. Řežábek justified

¹⁰⁷ The government resolution also shows signs of another phenomenon described by Niskanen – information asymmetry among politicians and subordinated bureaucrats. It can be assumed that the majority of the government had no idea about the impacts of the resolution, e.g. on the state budget.

¹⁰⁸ MFD, April 25, 2002, Řežábek: ČSOB s námi nekomunikuje

state behaviour with following statement: "*The state is interested in verifying how the assets were managed...*"¹⁰⁹

The absorption of significant part of IPB's portfolio obviously ensures ČKA's subsistence further prolonging active functioning of the Agency. Some of the assets will require extensive attendance and human resources. For instance, we can mention the case of Cayman Funds and their complicated structure that was created by IPB and inherited by ČSOB. The Funds contained asset amounting to billions CZK.¹¹⁰ ČSOB proposed liquidation plan under its conduct and supervision of the Agency, however, ČKA has tenaciously endeavoured for managing the funds on their own. Or to give another example, ČKA required some particular assets to be transferred to the Agency. Such was the case of the real estate agency IPB Real. ČKA decided that it would manage sale of IPB Real by themselves whereas originally it was assumed that the sale would be conducted by the ČSOB and only supervised by the Agency.¹¹¹ ČKA also demanded several tens of companies around well-known Czech businessman A. Charouz to be transferred and refused to approve the agreement reached between ČSOB and A. Charouz while the long time prepared agreement was about to solve the complicated situation around these assets. Again the ČKA's decision was left unexplained.¹¹²

What do ČKA's decisions suggest? Primarily, we can argue that the Agency has, as a typical bureaucratic institution, its own interests. Its motivation has always been to stay under way and preferably to expand (maximize) the portfolio of its activities and consequently its influence. As we have seen, the institution was rather successful regarding this intention. KoB/ČKA's power has grown quite substantial, considering the extent of portfolio managed.

However, the "portfolio sucking" perhaps need not to be explained only due to bureaucratic essence of the institution, although it is no doubt one of the major factors stimulating its expansion.

6.2 The ČKA as a Source of Power

The "portfolio sucking" phenomenon serves not only the sole purpose of ensuring survival of the institution; the effect is also an increased power of the entity. The development of KoB/ČKA indeed indicates that the institution became an instrument of power. But whose power? Firstly, we have discussed how the Consolidation Bank served as a convenient executor of state interventions in the economy, used by each political representation. Secondly, in the previous section it was argued that bureaucrats in the Agency might take advantage of their position. And last but not least, we have also made several hints about various interest groups exploiting favourable situation created due to the state institution to their own benefit as the system has

¹⁰⁹ MFD, April 25, 2002, Řežábek: ČSOB s námi nekomunikuje

¹¹⁰ Detailed information about Cayman funds can be found in the study Rise and Fall of IPB (2002), or on the web page www.kajmany.cz

¹¹¹ MFD, May 5, 2002, Největšího stavitele bytů, IPB Real, prodá stát

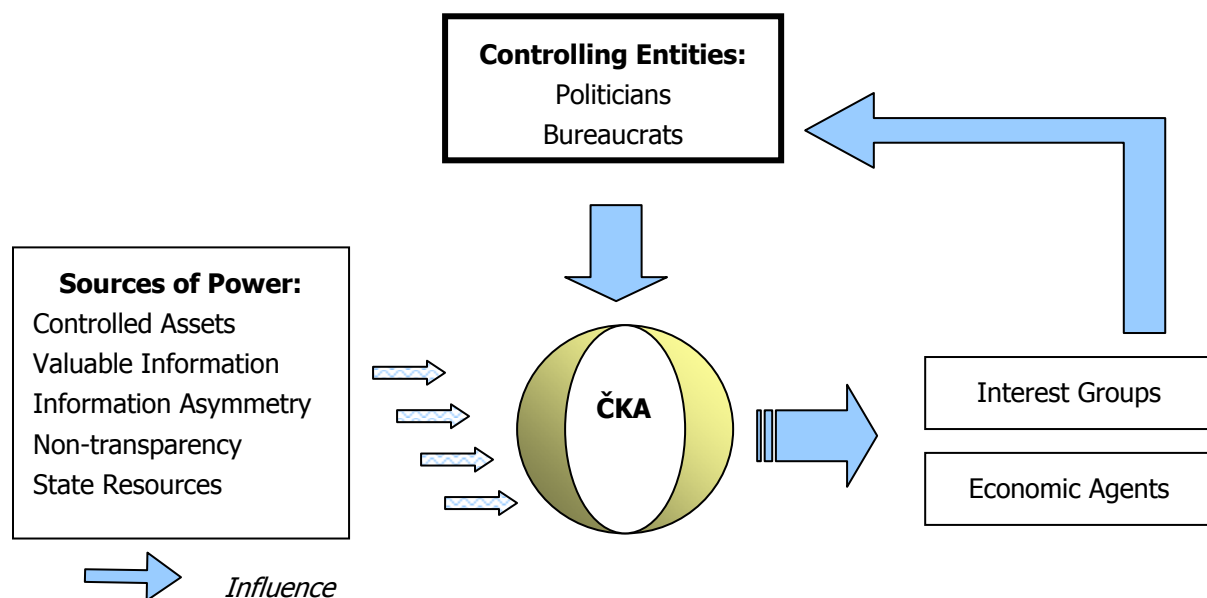
always enabled preferential treatment of selected entities financed from state resources. Such possibilities naturally attract rent-seekers and stimulate tendency to misuse the power of the institution, which can lead to corruption. But we need not to go that far. Due to the power of the Agency the state has also fortified its influence in the economy.

As we have mentioned, in the case of ČKA, the power accumulated by the institution is rather substantial. Some of the assets have considerable strategic interest – we can again mention the Cayman Funds that comprise (among others) fundamental corpus delicti for the arbitrages between the Czech Republic and Nomura, especially for the famous Czech Beer case.¹¹³

However, the Agency's power is not only the result of assets piled up in the Agency. The power also stems from information asymmetry and non-existence of clear rules for handling with assets, which enables discretionary decisions. All these aspects result in significant autonomy of those who control the Agency, and consequent power that is aggravated by the general non-transparency of ČKA's activities. We can perceive the situation around KoB/ČKA as if there has always been a veil over its activities.

Moreover, it has to be taken into account that ČKA is a reservoir of sensitive information that can be perceived as a valuable and strategic commodity. The information obtained with transferring an asset can be even worth more than the asset itself. We cannot forget that the Consolidation Agency is also a living chronicle of Czech transition due to unique records in its archives that have never been disclosed.

Scheme 10: ČKA as a Source of Power



¹¹² Lidové noviny, October 31, 2002, O firmách kolem Charouze rozhodne stát

¹¹³ Nomura used the Cayman Funds for accomplishing the transaction called "Czech Beer". Two significant Czech breweries (Plzeňský Prazdroj and Radegast) were merged and sold to strategic partner under Nomura's control. It is argued that Nomura's rip off from this operation amounted to CZK 9 bil. (For more information see The Rise and Fall of IPB, p. 47 – 50)

Therefore, "portfolio sucking" tendency seems to be stimulated due to an assumed desire to increase the sole power of the institution. Nevertheless, the power hidden in the Agency attracts pathological entities that want to misuse the power to their own benefit at the expense of others. The institution controlling the power will thus always be a target of pressures of those rent-seeking entities. Expansion of the Agency's portfolio results in extension of potential for rent-seeking. And, if there are no substantial constraints, the possibilities opened to the controlling entity will naturally tend to be misused.¹¹⁴ The only possible solution is therefore to limit (or at best to destroy) the power – in our case the power could be constrained, to some extent, by clear and transparent rules and measures mentioned in the previous chapter.

¹¹⁴ To illustrate the situation better, we may be inspired by J.R.R. Tolkien (1954) and use the analogy of the 'One Ring' as an appropriate metaphor. This "power" aspect may be referred to as *the One-Ring Syndrome*: Not only that many entities will try to empower the benefits of the power but the power itself corrupts and it is inevitable. The controlling institution will also refuse to give up the power – self-destruction of the power thus cannot be expected. These statements are certainly valid not only in Tolkien's world.

7 Concluding Remarks

It seems that invisible state interventions became deep-rooted in the Czech economic environment. The same applies to the main instrument of these interventions – the Consolidation Bank, later the Czech Consolidation Agency. Although there has been a dilatory retreat from state aid to selected companies, we have seen that veiled state involvement has changed its form and is still present in the economy in a large extent due to accumulation of bad debts in ČKA and solution to the problem. If we review the development that was outlined in previous parts of the thesis, we can argue that state involvement through the mentioned institution became a continual (one can even say a systemic) element of the economy always keeping and fortifying its positions.

The expansion of KoB's activities during the Czech transition as well as the obvious resistance to attempts to limit the power of this institution in later stages sufficiently demonstrate the long-term tradition of the phenomenon in the Czech economy. Once invisible state interventions took roots in the Czech political and economical environment, it became an element that is counted upon, and therefore it became difficult to suppress it, even though the attempts existed. The influence of this element has been rather substantial if we consider for instance the volume of accomplished interventions that were described as well as the extent of asset portfolio of the KoB/ČKA.

The thesis aimed at elaborating the diagnosis concerning the case of this transformation institution and its influence in the economy. It is important to realize that the system created around the KoB/ČKA leads to active state participation; it produced and maintained capacity for state interventions in the economy that are relatively "hidden" from the public and are therefore difficult to control. The system has many fundamental failures as the findings of the thesis aimed to show.

Above all, we can mention that practices of the KoB/ČKA have mostly been asystemic and shortsighted. The support to distressed companies was aimed at keeping companies afloat and was not conditioned with restructuring measures. Generally, no constructive strategy of the institutions' direction has been implemented. State interventions have been lacking clear rules and the system thus generates ad hoc, discretionary decisions.

We also cannot omit that invisible interventions of the state introducing preferential treatment of selected entities have always been a part of the system. Selected companies were disposed of debts or helped with preferential credits or guarantees. Similarly, the treatment of assets accumulated in the ČKA results in heterogeneous conditions for the debtors when decisions are made by the Agency about ways that will be taken to enforce a claim.

Moreover, penetration of the KoB in the economy and maintaining the capacity for state interventions occurred in an unrestrained manner being probably formed and drawn, to some

extent, by influence of various interest groups and the system was certainly not all the time harnessed in a way to accomplish long-term state interests (i.e. interests of tax payers).

These findings above all should support the argument that a reform of the system is necessary. For many years ahead, the state will have to deal with the debts accumulated in ČKA, especially with repayment of the losses stemming from these debts. The debts are the consequences of the transition and they obviously have to be born – there is no way how to avoid them. As we have seen, bad debts are not an exceptional phenomenon in standard market economies as for example the U.S.A., Sweden, or Korea. All of these economies have their own “Consolidation Agencies”. However, we described the Czech system for dealing with bad debts and it was shown that it is beyond standard models that are considered effective and acceptable. Deviation of the Czech situation has harmful impact not only on the assets in ČKA and relevant debtors but also on entities that have to deal with the Agency on a more equal basis – e.g. the banks transferring their assets to the Agency. Behaviour of the state institution thus apparently affects a significant part of the economy.

Reform of the system, perhaps according to suggestions outlined above, should therefore be one of the priorities in economic policy of the country. However, deep roots of the system and the current political constellation probably does not allow much perspective for some substantial change, which would certainly require sound political consensus. Therefore, an important role remains for economists and economic journalists to ask for systemic solutions, raise requirements for information and public control and discuss necessity and justification of every state support or involvement.

8 References

- Cowling, K.; Sugden, R. (1992). *Current Issues in Industrial Economic Strategy*, Manchester, UK, Manchester University Press.
- Čermák, V. (2000). *Česká cesta privatizace a selhání bank. Případová studie ČKD Praha Holding, a.s.*, In *Oeconomica*, no. 2/2000, Praha, Karolinum, 2001, p. 79-104.
- Desai, R.M.(1995). *Financial-Market Reform in the Czech Republic, 1991 - 1994. The revival of Repression?*, Praha, Working Paper Series, no. 86, CERGE-EI.
- Dvořák, V. (1997). *Privatizace českých bank a zhodnocení postupu IPB*, In *Oeconomica*, no. 1/1997, Praha, Karolinum, 1997, p. 65 – 78.
- EBRD (1999). *Transition Report 1999*, European Bank for Reconstruction and Development, London.
- European Commission (2001). *Ninth Survey on State Aid in the European Union*, Brussels, <http://europa.eu.int>
- E-Merit (2002). *Rise and Fall of IPB*, Praha, www.historieipb.cz
- Frydman, R., Gray, Ch. et al (1997). *Private Ownership and Corporate Performance: Some Lessons from Transition Economies*. Working Paper, June 1997, World Bank, Washington, D.C.
- Gunning, J.P. *Understanding Democracy*, Chapter 16, <http://www.fortunecity.com/meltingpot/barclay/212/votehtm/vm-16.htm>
- Hámpel, M. (2001). *Teorie byrokracie v pojetí W.A. Niskanena*, In *Politická ekonomie*, no. 1/2001, Praha.
- Hellman, J.S., Jones, G., Kaufmann, D. (2000). *Seize the State, Seize the Day: State Capture, Corruption and Influence in Transition*. Working Paper, September 2000, World Bank, Washington, D.C., www.worldbank.org
- Kábelová, J. (2000). *Privatizační, úvěrové a investiční hry v průběhu velké privatizace*, Bachelor Thesis, IES FSV UK, Praha.
- Konsolidační banka (1993 – 2000). *Annual Reports*. www.czka.cz, Praha
- Laštovička, R., Marcinčin, A., Mejstřík, M. (1994). *Privatization and Opening the Capital Markets in the Czech and Slovak Republics*, Working Paper Series, no. 54, April 1994, CERGE-EI, Praha.
- Matoušek, R. (1999). *The Restructuring and Consolidation of Commercial Banks: Causes and Solutions in Transition Economies (Lessons from the Czech Republic)*, In *Oeconomica*, no. 2/1999, Praha, Karolinum, 2000, p. 127-148.
- Mejstřík, M. (ed.) (1997). *The Privatization Process in East-central Europe. Evolutionary Process of Czech Privatization*. Massachusetts, Kluwer Academic Publishers.
- Mejstřík, M. (1999). *Předpoklady využití mimosoudních a soudních forem restrukturalizace firem*, In *Oeconomica*, no. 1/1999, Praha, Karolinum, 2000, p. 9-16.

- Mertlík, P. (1998). *Privatization and Restructuralization of Czech Industry in the Economic Transition*, Habilitation Thesis, IES FSV UK, Praha.
- Neprašová, M. (2000). *Česká cesta privatizace a její následky. Případová studie Škoda,a.s.* In *Oeconomica*, no. 2/2000, Praha, Karolinum, 2001, p. 105-123.
- Poláčková Brixí, H., Ghanem, H., Roumeen, I. (2000). *Fiscal Adjustment and Contingent Government Liabilities: Case Studies of the Czech Republic and Macedonia*, World Bank, Washington, D.C.
- Polouček, S. (1999). *České bankovníctví na přelomu tisíciletí*, Ostrava, Ethics.
- Schwarz, A. (2000). *Privatisation, Corporate Governance and Restructuring in Advanced Transition Countries: The Case of the Revitalisation Agency in the Czech Republic*, Paper presented at the Conference "Transition and Enterprise Restructuring in Eastern Europe", 17-19 August 2000 in Hillerod, Denmark, <http://www.cbs.dk/centres/cees/network/pdf2000/Schwarz.pdf>
- Stein, J. (2000). *National vs. Rational Capitalism. The Privatization of ČSOB*. Anglo-American Business Institute, Praha.
- Tolkien, J.R.R. (1954). *The Lord of the Rings*. HarperCollinsPublishers, London, U.K., 1995.
- Tollison, R.D., Congleton, R.D. (eds.) (1995). *The Economic Analysis of Rent Seeking*. Aldershot, U.K., Edward Elgar.
- The World Bank (2000). *Czech Republic: Completing the Transformation of Banks and Enterprises – A World Bank country study*. Washington, D.C.

Magazines:

- Bankovníctví, July 25, 1997, Pomocná ruka z České finanční, p.5
- Euro, January 18, 1999, Resuscitace nebo smrt, Dolečková, M., Šperkerová, M.
- Euro, February 1, 1999, Bitva na Králově poli, Dolečková, M., p. 26
- Euro, February 22, 1999, Grégr od volantu, Dolečková, M., Páral, P., p. 24
- Euro, February 22, 1999, Oral jsem oral, Dolečková, M.
- Euro, June 21, 1999, Živé smlouvy mrtvého manažera, Růžičková B., Lékó, I., p. 28
- Euro, June 18, 2001, Vznikne pět dcer
- Euro, August 27, 2001, Poměrně drahá válka s poradcem
- Euro, October 29, 2001, Radost z Američanů
- Euro, March 25, 2002, Proti politikům fungují cizinci, an interview with Cheon-Hong Kim, general director of KAMCO
- Euro, April 29, 2002, Součástková velmoc
- Ekonom, August 24, 1995, Konsolidační banka mění strategii, p. 24
- Ekonom, August 8, 1996, Většina leteckých podniků, p.24
- Ekonom, August 22, 1996, Daň z nechtěného dědictví (2), p.16
- Ekonom, November 9, 2000, Revitalisation in the Czech Republic – Overused but Little Understood, Saran, M., (source: www.czka.cz)
- Ekonom, January 4, 2001, Spolana with a state majority
- Ekonom, June 19, 2001, Poradíme si bez poradců

Ekonom, June 6, 2002, Nová Huť: Dobožováno

Ekonom, December 12, 2002, Prodáno

Nový život, September 26, 1996, Union banka už je šestá v ČR, p.7

Prague Business Journal, March 5, 1999, A change of plans, www.pbj.cz

Respekt, August 12, 1996, Perspektivní podnik před krachem, p.6

Respekt, February 7, 2000, Už teď jsme se bohatě vyplatili, Němeček, T., p. 8

Respekt, March 6, 2000, Předběžný účet: dvě miliardy, Cenek, R., p.9

Respekt, May 21, 2001, Mlha nad Tatrou, Respekt, 21.5.2001, Němeček, T.

Respekt, March 6, 2002, Loupež století u konce

Týden, March 20, 2000, Progress with the revitalisation programme (source: www.czka.cz)

Daily Press:

Českomoravský profit, June 8, 1998, Škodovka běží na velmi dlouhou trať

Český týdeník, March 1, 1996, Moravia Steel si půjčí od státu, p. 23

ČTK, July 23, 1999, Revitalizace Vítkovic bude znamenat zřejmě další propouštění

ČTK, July 26, 1999, ČKD Dopravní systémy by měly plnou výrobu obnovit do půlky srpna

ČTK, August 11, 1999, Falbr chce kvůli Zetoru iniciovat schůzku na úrovni ministrů

ČTK, August 25, 1999, Škoda Plzeň radikálně sníží základní jmění o více než 8,5 mld. Kč

ČTK, August 28, 1999, MfD: Stát pomůže Vítkovicím téměř třemi miliardami korun

ČTK, August 29, 1999, Strategického partnera pro Tatru hledá Konsolidační banka

ČTK, September 15, 1999, Zaměstnanci ČKD DS nedostávají výplatu a ztrácejí trpělivost

ČTK, October 19, 1999, Stát získal majoritu v Tatře Kopřivnice, drží 58,5 procenta akcií

ČTK, November 3, 1999, Ve vládním revitalizačním programu je devět podniků

ČTK, November 9, 1999, MfD: Věřitelé ZPS Zlín přihlásili pohledávky za osm miliard

ČTK, November 18, 1999, Ziegler: RA je jen prvním stupněm řešení špatných aktiv KoB

ČTK, November 18, 1999, Činnost RA neoslabuje činnost věřitelských výborů

ČTK, December 9, 1999, Janík: Vítkovice opět mají nedostatek financí

ČTK, February 21, 2000, Revitalizační agentura dnes oficiálně zahájila prodej Tetry

ČTK, February 23, 2000, Vláda má v pondělí schválit vyrovnání a kapitalizaci dluhů ČKD

ČTK, March 7, 2000, MfD: Věřitelé Vítkovic kritizují vládní plán záchrany

ČTK, March 24, 2000, Projekt Škoda Holding zahájil restrukturalizaci Škody Plzeň

ČTK, March 29, 2000, Vláda vybrala návrh Revitalizační agentury na pomoc Zetoru

ČTK, April 3, 2000, Věřitelé rozhodnou, zda Zetor půjde do konkursu

ČTK, April 14, 2000, KoB rozhodla o kapitalizaci směnek Škoda Holding za 2,1 mld. Kč

ČTK, May 18, 2000, MPO: Vítkovice se přemění na holding, předpokládá se propouštění

ČTK, June 21, 2000, Zetor se vrátí do rukou státu a ten se jej pokusí ozdravit

ČTK, June 23, 2000, Akcionáři Zetoru snížili základní jmění na 4 mil. z 2,5 mld. Kč

ČTK, July 25, 2000, HN: Ministr Mertlík uvažuje do budoucna o privatizaci KoB

ČTK, August 8, 2000, Zámečník: Dřívější pokusy ozdravit Zetor nebyly efektivní

ČTK, April 8, 2001, LN: Česká finanční nabídne ke koupi těžko vymahatelné úvěry bank

ČTK, October 1, 2001, Soud povolil ČKD Praha Holding vyrovnání s věřitel

ČTK, October 4, 2000, Výbor ČKD DS schválil smlouvy o koupi Siemensem, podpis 8. října

ČTK, October 20, 2000, MF navrhne vládě garanci FNM k úhradě závazků Královopolské, ČTK

- ČTK, November 7, 2000, Konsolidační banka se stala největším akcionářem Korada
- ČTK, November 23, 2000, MfD: Kabinet tají, jak pomohl Vítkovicím a AliaChemu
- ČTK, May 14, 2001, Respekt: Rusnok označil Odien, nástupkyni RA, za podivnou firmu
- ČTK, June 20, 2001, AliaChem uhradí snížením kapitálu na 4,3 mld. Kč předchozí ztráty
- ČTK, June 25, 2001, Restrukturalizace Vítkovic má zachránit 26.000 pracovních míst
- ČTK, September 13, 2001, Roman: Konkurs Škody a.s. neohrozí činnost Škody Holding
- ČTK, November 13, 2001, MF: Stát má prodat Unipetrolu 81,6 procenta Spolany za 569 mil.Kč
- ČTK, November 30, 2001, ČKA zvýšila podíl v Zetoru z 50 procent na 97,7 procenta
- ČTK, December 3, 2001, Odien odstoupila z prodejního procesu Zetoru; dokončí jej ČKA
- ČTK, February 1, 2002, Euro: Škoda Holding se zřejmě bude na jaře prodávat
- ČTK, May 26, 2002, Euro: ČKA vytáhla Spolanu z krize, povolila odklad splacení úvěru
- ČTK, April 10, 2002, Konsolidační agentura nechce poslat Setuzu do konkursu
- ČTK, April 24, 2002, HN: Šmejcová firma proti tomu, aby její závazky spravovala ČKA
- ČTK, June 12, 2002, Tatra Kopřivnice navýšila základní jmění o 4,1 na 5,2 mld. korun
- ČTK, October 7, 2002, Do revitalizačního programu půjdou Obráběcí stroje, Elite a Metra
- Denní telegraf, July 28, 1995, Aero Holding navrhne na příští valné hromadě snížení jmění, p.6
- Denní telegraf, July 25, 1996, Konsolidační banka nekoupí Holding Aero, 25.7.1996, p.6
- Hospodářské noviny, February 9, 1995, Úkol: zrychlit privatizační tempo, p.5
- Hospodářské noviny, May 31, 1995, Konsolidační banka financuje dráhy, p.2
- Hospodářské noviny, July 17, 1995, Škoda Plzeň se zajímá o významné podíly v českých podnicích
- Hospodářské noviny, October 17, 1996, Část dluhů Tatry možná vyřeší stát
- Hospodářské noviny, July 25, 1997, Na některé ozdravné projekty firem vláda zatím nechce moc slyšet, p.5
- Hospodářské noviny, February 24, 1998, Pomoc malým bankám brzdí legislativa, p.2
- Hospodářské noviny, September 1, 1998, Nad Královopolskou visí konkurs
- Hospodářské noviny, February 21, 2000, ČKD: Konkurs odvrácen, pokračuje ozdravení
- Hospodářské noviny, October 31, 2000, Konsolidační banka lets off steam, www.czka.cz
- Hospodářské noviny, January 15, 2001, Vítkovice - případ, který trvá
- Hospodářské noviny, March 19, 2001, Česká konsolidační agentura podle představ ODS
- Hospodářské noviny, November 14, 2001, Investor pro Zetor zatím v nedohlednu
- Hospodářské noviny, March 26, 2002, Vláda schválila plán na oddlužení Škody
- Lidové noviny, Příloha Koruna, January 21, 1995, p. I
- Lidové noviny, August 8, 1996, O Aero je zájem s podmínkou, p.12
- Lidové noviny, August 11, 1998, Zarytý "znalec" průmyslu, p. 10
- Lidové noviny, August 27, 2001, Revitalizace neproběhla, tak jak původně měla, Interview with Michael Saran
- Lidové noviny, October 31, 2002, O firmách kolem Charouze rozhodne stát
- Mladá fronta Dnes, Příloha Peníze, August, 3, 1995, Aero: namísto plynulého letu stále akrobacie, p.VI
- Mladá fronta Dnes, June 21, 1996, Zadluženému Aeru Vodochody asi v nejbližší době pomůže stát
- Mladá fronta Dnes, July 12, 1996, Třineckým železárnám se podařilo prodat všechny vydané dluhopisy, p.14
- Mladá fronta Dnes, July 29, 1996, Splacení starých úvěrů KoB se pravděpodobně protáhne, p.14
- Mladá fronta Dnes, July 29, 1996, Konsolidační banka oživuje podnik, p.1
- Mladá fronta Dnes, January 29, 1998, Stát má více dluhů, než přiznával

- Mladá fronta Dnes, March 27, 1998, Skryté dluhy státu přesahují 170 miliard, p.14
- Mladá fronta Dnes, February 23, 2000, Vítkovice s vysokou ztrátou
- Mladá fronta Dnes, June 12, 2000, Stát: rychle prodáme úvěry
- Mladá fronta Dnes, August 11, 2000, Škoda Holding má znovu velké potíže
- Mladá fronta Dnes, November 14, 2000, Sen o velké revitalizaci končí
- Mladá fronta Dnes, November 18, 2000, Tatra opět vydělává a zvyšuje výrobu
- Mladá fronta Dnes, November 18, 2000, Škodu Holding převezme stát
- Mladá fronta Dnes, May 18, 2001, Řežábek: Vláda chce o prodeji úvěrů vědět
- Mladá fronta Dnes, March 26, 2002, Do Škody Steel míří zahraniční banky
- Mladá fronta Dnes, April 25, 2002, Řežábek: ČSOB s námi nekomunikuje
- Mladá fronta Dnes, May 5, 2002, Největšího stavitele bytů, IPB Real, prodá stát
- Mladá fronta Dnes, August 1, 2002, Stát začal prodávat dluhy předem vybraných firem
- Moravskoslezský den, June 4, 1997, Tatře pomůže s dluhy Konsolidační banka
- Moravskoslezský den, August 24, 1998, Americká společnost stále usiluje o kopřivnickou Tatra
- Plzeňský deník, August 11, 1998, Vláda podrží Škodu Plzeň
- Právo, July 15, 1996, Konsolidační banka by oddlužením holdingu ovládla Aero Vodochody, p.10
- Právo, July 29, 1996, Zbrojařina se u nás dělá spíš jako zájmová činnost, p.1
- Právo, October 17, 1996, Vláda umaže Aeru dluh, p.2
- Právo, November 21, 1996, Motokov chce výrazný podíl v brněnském Zetoru, p.15
- Právo, October 12, 2000, KOB increases ownership interest in Tatra, Press release: www.czka.cz
- Právo, January 15, 2001, Konsolidační banka zaútočila na starou Škodu Plzeň
- Právo, March 1, 2001, Revitalizace AliaChemu ve vládě
- Právo, March 29, 2001, O špatné úvěry KoB je na internetu zájem
- Rovnost (Jihomoravský deník), August 12, 1998, Královopolská volá SOS
- Svět hospodářství, December 15, 1995, CHZ Sokolov s novou továrnou do privatizace, p.6
- Svět hospodářství, August 29, 1996, Záchrana Aera Vodochody je nadosah, p.7
- Svět hospodářství, March 12, 1998, Aero Holding je na konci cesty, p.7
- Svět hospodářství, April 2, 1998, FNM očekává v roce 1998 příjmy zhruba 16,1 mld. Kč, p.3
- Svět hospodářství, April 9, 1998, Aero Vodochody už nemělo na vybranou, p.6
- Zemědělské noviny, May 27, 1995, Zetor se finančně připravuje na hlubší dohodu s Deere & Company, p.5
- Zemské noviny, July 16, 1997, Likvidací Zetoru by přišlo o místo deset tisíc lidí, p.6
- Zemské noviny, September 2, 1998, Královopolskou strojírnou převzal stát, ale hrozba konkursu nadále trvá

Web Sites:

- http://www.cili.org.uk/student_visitors/shared_resources/czechsurvey.htm
- <http://www.cka.cz>
- <http://www.czfinanc.cz>
- <http://www.euro.cz>
- <http://europa.eu.int>
- <http://evropska-unie.cz>
- <http://www.fnm.cz>
- <http://ies.fsv.cuni.cz/casy/index.htm>

<http://www.respekt.cz>

<http://www.vláda.cz>

<http://www.worldbank.org>

Interviews/e-mails:

Doc. Ing. Pavel Mertlík – November 2002 – May 2003

Ing. Miroslav Zámečník – April 2, 2003

Other Sources:

Bauer, M., Streblov, P.(2001): *Eastman Sokolov*, Case study presented at the 5th Annual John T. Garrity Conference, held by the Leadership Forum, November 2001, Prague, <http://ies.fsv.cuni.cz/casy/index.htm>

Other sources were the lectures in the course New Institutional Economics I held by Prof. Ing. Karel Kouba, DrSc. and PhDr. Martin Gregor in winter term 2002 – 2003 and interviews with people from Czech banking and financial sector during author's participation in the research concerning the fall of IPB.