

OBSTACLES TO THE DEVELOPMENT OF ENTREPRENEURSHIP IN CZECHOSLOVAKIA

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Introduction

On November 17, 1989, the Czechoslovak communist regime, yielding to the outcries of its citizens, relinquished power to a newly formed political group of dissidents and reformed communists. The world watched in wonder to see what political route would be taken by the newly freed country.

The new government of Czechoslovakia has begun a process of economic reform designed to culminate in the establishment of a free market system - an ambitious goal to say the least. The country is lacking all of the cornerstones of a capitalist economy such as a solid legal system, banking system, tax structure, and stock market. These institutions are, of course, vital to the economic success of the country; but even more fundamental is the development of technology, innovation, and plain economic "know how" so that Czechoslovakia can one day hope to be competitive in the international market.

The forty year period of communist control all but destroyed Czechoslovakia's industrial competitiveness. The average age of equipment and machinery is eleven years compared to five years in the West. (Brandsma, p.9) This lack of modern and more efficient equipment translates into a huge waste of labor and other resources. Specifically, Czechoslovak industry consumes almost three times as much raw material, energy, and labor as the average Western company does for the same level of production. (Brandsma, p.9)

Modern technology and innovation are needed for the economy to become competitive, but these necessities cannot simply be "given" to a country. It is true that the United States can ship a thousand home computers to Prague or German consultants can give advice on how to run a factory more efficiently; but ultimately it is up to the citizens of Czechoslovakia to determine what will work for their country. It is the people and their ability to learn, change, and grow, and most importantly their willing-

ness to take risks that will be the determining factors in Czechoslovakia's economic success or failure.

But is it reasonable to expect that Czechoslovak citizens can make this sudden radical switch to a free market system? The vast majority of Czechoslovaks have been exposed only to a centrally planned economy and therefore do not understand the fundamentals of free enterprise. Under central planning, there was no consideration for the laws of supply and demand; the determination of price and quantity seemed completely arbitrary. Everyone from plant manager to shopkeeper simply followed orders which specified how much to produce and what price to charge. The communist system was basically secure and reassuring for the Czechoslovakian people because they did not have to think for themselves or take any risks - all they had to do was follow orders.

For the people to truly learn and fully comprehend the way a free market system works, they need to become actively involved. The ideal way to accomplish this is by starting their own businesses. Entrepreneurs are indispensable to the development and growth of any economy. Entrepreneurial innovation fosters competition, increases efficiency and production, and helps to better satisfy consumer wants - all things the ailing Czechoslovak economy desperately needs. Unfortunately, there are not many people willing to take the risks.

Entrepreneurial Development

In May, 1990, the National Assembly passed a law which makes private enterprise legal and requires all entrepreneurs to register with the state. To date, there are approximately 580,000 registered entrepreneurs, but only about 20 percent of them are entrepreneurs in the true sense of the word: viz., their business is their full-time employment and is privately owned by them. (Sujan, 1991) Since registering as an entrepreneur is simple and requires only one trip to the municipal office, many people register just to keep their options open for the future. Others are simply students with small part-time businesses.

Unfortunately, there are also a growing number of people who register merely to use

their entrepreneurial status as a cover for illegal activity. For example, there are people who are employed by state companies and use company resources for their own business. There are also true entrepreneurs who have all of their employees register as entrepreneurs. In this way, the employer can avoid social security payments and wage taxes. (Brandsma, p.20) For example, Miroslav Svarc owns a successful construction company in Prague. Mr. Svarc has his 500 employees declare that they are self-employed, and as a result he can afford to pay them double or triple the average wage because he escapes social security payments and wage taxes. (Schaes, p.50)

Obstacles to Entrepreneurship

The Restitution Act

Ironically, one of the main obstacles to the development of entrepreneurship in Czechoslovakia is one of the acts designed to help privatization, the Restitution Act. The Restitution Act was passed by the National Assembly in January, 1991. The act allows the previous owners or their heirs to take back property and small businesses that were confiscated by the Communist government prior to 1948. The large corporations that were nationalized between 1945-48 will not be restored to the former owners and will be privatized by other methods. The deadline for all restitution claims was September 30, 1991.

The problem with this system is that the restitution claims will take a considerable amount of time to process due to the many complications that are involved. Often there are many heirs to a given property, and each one must be tracked down before the property can be legally divided. Further complications arise when there was more than one owner of a property and, therefore, at least two sets of heirs.

Many of these properties have depreciated, and adequate compensation for the heirs must be decided upon. This is difficult to do since most properties have not had a true market value since about 1959 when the last of the small private businesses were nationalized. Consequently, a current market value for them

is difficult to determine. The lack of an accurate current market value also causes problems when the property in question cannot be turned over to the heirs because it is being used for other purposes. Adequate compensation is then difficult, if not impossible, to calculate.

These problems with the restitution of property mean that it will take longer than intended to restore the property to the original owners, and as a result it will take time before these properties can be used for productive purposes. Many are small businesses which will remain idle until these complications are resolved. Given that the country wants to privatize as quickly as possible, this delay is a significant setback.

The Auction Method

The Small Business Privatization Act passed on October 25, 1991, allows public auctioning of about 130,000 small businesses, such as retail shops and restaurants, that were formally state owned. A list of properties which are to be auctioned is publicly posted thirty days before the auction date. The first round of auctions is open only to Czechoslovak citizens. After the first round is completed, the auctions are opened up to foreign investors. Participants in the auction must pay a non-refundable entrance fee of 1000 Kcs (or about 30 dollars) and put down 10 percent of the initial auction price of the property. The amount put down is returned if the participant does not become the owner of the property.

Only about 20 percent of these properties are to be auctioned for actual ownership; the rest are to be auctioned for rent only (Mejstrik, 1991). In other words, in the remaining 80 percent of the auctions participants are not bidding for the ownership of the property but for the right to rent the property from the government for a period of five years with no guarantee for renewal. (Brandsma, 1991) The rental time period was initially two years but was recently extended to allow for longer-term investment decisions. (Brandsma, 1991)

There are three reasons for this five year limitation: (1) there are still many restitution claims to be settled and therefore many prop-

erties cannot be permanently sold; (2) most people do not have enough money to purchase the property outright; (3) the government would rather wait and sell the properties at their full value than sell them now at a reduced price.

Although this system on the surface appears to be sound, it is riddled with problems and complications. First, the rent that will be charged during the five year period is not negotiated until after the property is auctioned. There are upper and lower limits, but difference between these limits is large enough that the actual rent can vary considerably. (Mejstrik, 1991) If the rent cannot be paid, the investors have no rights and lose their initial investment capital. Therefore, it is no wonder that many people are reluctant to participate in the auction.

Obviously the risk factor involved is high, and as a result there are only a small number of people "buying" retail properties. To make matters worse, this group is comprised largely of former communist officials or black marketers. They are the only people who were wealthy under the former regime and who therefore now have the needed start-up capital.

This situation is detrimental to the morale of the Czechoslovak people and is fostering a feeling of resentment towards the new system because it appears as if the old power structure is reemerging. Many claim that they cannot start up a business because they don't have any "black market" money. To remedy this problem, legislation was recently proposed that would require all auction participants to prove that their money was "clean"; however, the legislation was not well received by the national assembly for fear that it would slow up the privatization process. (Brandsma, p.15)

Another problem with the auction method is that because much of the property is only being rented, new owners have no incentive to make improvements or expansions. Even though the rental period has been extended from two to five years, this is still generally not enough time to justify any significant investment of money and effort. With the property perhaps being repossessed in five years by the government, any investment will be lost.

Lack of Capital

The level of personal savings in Czechoslovakia is low, and what little there is belongs to a small percentage of the population. Overall, it is estimated that Czechoslovakia has a savings base of \$267 billion Kcs (about \$8 billion dollars). Approximately one third of it is held by only five percent of the population, most of whom as noted were black marketeers or past communist officials. One quarter of the population have no savings at all. (McDermott and Mejstrik, p.29)

For the majority of people who have hopes of becoming entrepreneurs, their only chance is a bank loan. Unfortunately, at the present time a bank loan is extremely difficult to secure. Currently, only about four percent of the auction purchases are financed by bank loans. (Brandsma, p.15) One problem is that most bank employees are not skilled in evaluating loan applications. More importantly, since these businesses have no credit history or record of profits, there are few criteria on which to base a loan decision. As a result, banks have been very reluctant to grant loans to small businesses.

Lack of Entrepreneurial Characteristics

As has been discussed above, there are many financial and legal obstacles to the development and growth of entrepreneurship in Czechoslovakia. However, the most fundamental obstacles may lie within the minds of the people, and these may be the most difficult to change. During the forty years of communist control, the Czechoslovak people have been educated and trained not to be creative, competitive, efficient, or innovative. This means that the majority of Czechoslovakia's younger generation, the future entrepreneurs, have had no opportunity to develop entrepreneurial characteristics.

Czechoslovakia is in great need of innovative people with fresh ideas. The country cannot hope to become competitive in the world market without using the latest technology and without developing new products. The problem is that among the very small number of people who have the means and the interest to

start their own business, an even smaller number are interested in exploring new markets. There is such a shortage of the most basic consumer products that most entrepreneurs are concentrating on filling that void instead of investing in research and development. As a result, few new products are being developed.

Obviously the lack of creativity and innovation will be a problem for the development of entrepreneurship, but even more problematic is the absence of any contact or experience with privately run businesses. The Czechoslovak economy, unlike that of Poland and Hungary, was completely nationalized by 1959; even the smallest family-run businesses were put under government control. Therefore, the majority of people have no knowledge of privately run enterprises whatsoever.

A specific example clearly illustrates this point. While in Prague in the summer of 1991, I purchased postcards and stamps from a young man who had his own stand. He tore off each stamp one at a time instead of tearing them off by rows. He then looked through several different sheets of paper to find the price of each postcard, and without the aid of a calculator he laboriously added up the total. It was a time-consuming process that could have easily been streamlined and made more efficient. He either did not realize or care that potential customers were passing by his stand because of the slowly moving line. Or more simply put, he did not understand the capitalist rule of thumb - time is money.

Not only is there a lack of knowledge about "good business practices," but for the past 40 years any information about capitalism was extremely negative and probably rather distorted. From the communist point of view, the private businessperson was evil and exploitative; and in fact some people may still subscribe to this point of view. Others have a negative image of entrepreneurship because, at the moment, most of the successful entrepreneurs (former communist officials or black marketeers) have a shady past. Furthermore, it must be remembered that most people have never had to deal with economic inequality. If one of their neighbors suddenly becomes a well-to-do entrepreneur, feelings of jealousy may emerge.

A fundamental fear of failure also needs to be overcome if the entrepreneurial spirit is ever to flourish in the Czechoslovak economy. Under the former regime, an individual did not have to rely on him or herself to survive; the state was there to take care of him or her. Now the economic rules have changed, and people are confronted with the very real possibility of economic failure. Adding to this fear is the instability of the current government and the lack of a solid legal structure. There are no stable and secure institutions because the entire economy is in the process of being reconstructed.

Conclusions

Although there are many problems that Czechoslovakia faces during this time of tran-

sition, the people as a whole have a great desire to make a free market system a reality in their country. There is, however, still much work to be done. Besides the development of private businesses, the Czechoslovak economy also needs a new legal system, a banking system, a new tax structure, and a stock market.

Although these obstacles may seem to be insurmountable, the desire and will of the Czechoslovak people should not be underestimated. These are the same people who peacefully overthrew their communist government - a goal that at the time clearly seemed impossible. At this point, whether the transformation of the Czechoslovak economy will be successful cannot yet be determined. However, it is a good bet that the determination and courage of the Czechoslovak people may surprise the world once again.

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