IMF, 'free market' looting steers Czechoslovakia toward social explosion

by Paolo Raimondi

The report which follows was written in the autumn of 1991 as part of a Special Report on eastern Europe, issued in German by EIR Nachrichtenagentur, GmbH. Although it has not been possible to bring all the data fully up to date, the picture holds true and serves as a warning to all those foolish enough to follow the Jeffrey Sachs model in the states recently freed from communist rule.

Two years after the "Velvet Revolution" which overthrew communism in the Czech and Slovak Federated Republic (C.S.F.R.), the country is heading for a social explosion: mass strikes and demonstrations against the radical free market program of Finance Minister Vaclav Klaus, which has brought the national economy, already exhausted by Soviet looting, to its knees.

The best way to analyze the disastrous impact of the free market reforms is to look at the "country study" on Czechoslovakia published in May 1991 by the World Bank, under the title "Transition to a Market Economy." The World Bank is the sister organization of the International Monetary Fund, and has the task of taking a softer public relations approach to the austerity policies that the IMF carries forward, in secrecy, with the utmost brutality.

There are three general points made in the World Bank report that characterize its global approach. The first is its fanatical ideology: "There is a certain risk of delaying or implementing the reforms only partially, because it may be felt that actions are not required with the same degree of urgency as in some other countries. This would be a serious mistake, since delay in moving to a market economy would not only render the transition process more difficult, but also increase the costs associated with such a transition." Second, the report emphasizes the existence in Czechoslovakia of "highly qualified cheap labor," hinting at a plan to make Czechoslovakia the Mexico of continental Europe. And third, the World Bank underlines the importance of the fact that Czechoslovakia is in the heart of Europe, the crossroads between West and East. This explains why so much attention is being devoted to Czechoslovakia, which could become either the technological bridge from western continental Europe to the republics of the former Soviet Union, or, if the Anglo-American free market policy continues, a blocking point, a dam between West and East.

"The 'Economic Reform Scenario' developed by the present government and adopted by the Parliament in October 1990 emphasizes the need for a radical transformation of the economy, with a comprehensive set of reform measures," announces the World Bank. Let us look at the concrete effects of these reforms.

Price 'liberalization'

As a first step, Klaus reduced subsidies for food in July 1990, resulting in a 25% increase in food prices. This was only partially compensated by a monthly transfer payment to all citizens. On Sept. 1, 1990, passenger railroad fares were raised by 100% and bus fares by 30%. By the end of October 1990, gasoline prices had doubled compared with their levels at the beginning of the year. In the first nine months of 1990, the inflation rate was 7.2%, according to very conservative calculations. But in the third quarter of 1990, the rate went up to 14.4%, and later Josef Tosovsky, the president of the State Bank, reported an inflation rate of 14% and a 10% collapse of the GNP for 1990.

On Jan. 1, 1991, there was a more general price liberalization, which produced 37-40% price increases in the first quarter: January 25%; January-February 50%, with some food prices rising over 100%, milk and milk products went up 51.5% and bread 43.8%; March was less, and April 6%. Finance Minister Klaus, fearing a social explosion, felt compelled to delay some other price increases. Later, he revealed that his bosses at the IMF had expressed their concern about the delay in price increases for heating and other fuels. In fact, an 80% increase in energy prices was scheduled for May. Overall the impact of inflation has been a little bit worse in Slovakia than in the Czech Republic. The official plan of the central government for 1991 intended to mantain inflation at 30%, and the loss in real wages at 10-15%.

Wages

On May 1, 1990, the government lifted all controls over private sector wages, except for the minimum wage provision. The IMF wants wages to be related to productivity as an incentive, due to the fact that productivity is collapsing. The World Bank report says that "the need to control cost-

© 1992 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

push inflation may justify the continuation of some form of wage controls in the state sectors," where politically motivated wage increases are feared. In March 1991, it was reported that there had been a loss of 28% in real wages, compared with the year before, "compensated" by a wage increase of 9%. Real wages were expected to decline by about 5% in 1990, but actually declined more.

The budget

With an incompetent accounting mentality that ignores the real economy, Klaus wanted to demonstrate that from the beginning he could "balance the books." Because it is not difficult to achieve that with massive austerity measures, Klaus simply cut all expenditures drastically and blocked all necessary investments in the social sectors of the budget. For example, as the World Bank report demands, "subsidies to the consumers and producers are expected to be reduced and phased out almost completely." Indeed, subsidies to consumers went down from 50 billion crowns in 1989 to 19 billion in 1990.

As a result of these measures, the 1990 budget was planned to have a 0.7% surplus, and the "anti-inflationary" budget of 1991 a 3% surplus. The consequences are obvious to the gentlemen of the World Bank, who blandly predict that "public expenditures, in the medium term, will decline significantly." Martin Bojar, the health minister, warned in March 1991 that his budget would only last until autumn, and then he would have to consider charging people for each day of hospitalization. Petr Miller, the minister of labor and social affairs, said that if inflation goes over 50% and unemployment over 10%, then his budget will not be able to cover the social security benefits any longer. Official institutes report that there were 700,000 people living under the poverty line at the end of 1990, and 1,300,000 were expected by the end of 1991.

Industrial restructuring

Czechoslovakia has a history as a great technological and industrial country: In the late 1930s it numbered among the 10 most developed countries, with an industrial sector larger than that of Italy. After the communist takeover in 1948, the Soviets exploited the reservoir of industry and skilled engineering and labor, and for decades Czechoslovakia was the most important machine tool supplier to the Soviet empire. This, more than many other reasons, explains the Soviet military intervention of 1969.

At the time of the "Velvet Revolution," industrial output was divided among these areas: 22% machinery production, 14% chemicals, 14% food processing, 14% rubber, 9% metallurgy, and 9% electronics. The Klaus reforms hit industry like a tornado. The steel sector, for example, has a capacity of 16 million tons per year. The reform plan is to cut capacity by 40-50%, and bring the work force down from 160,000 to 60,000. In 1990, there was a 3% reduction in overall industrial output, and consequently a 3.5% loss in the national income. The first quarter of 1991 registered a 12% loss in total production, compared with the same period of the year before. The construction sector lost 35.8%, textiles 16.2%, food processing 17.1%. If one compares the figures of production at the end of March 1991 with March 1990, the overall reduction of industrial output was 25%, the construction sector 43.9%, coal 11%, machinery 7.5%, chemicals 7.1%. This reduction has affected real national income, which went down 35% in the same period.

This industrial collapse was *double the rate of the average collapse per year in the four years after the Great Depression of 1929!* Even Klaus admitted in June 1991 that the cut in subsidies led to a 30% reduction in the construction sector. There are other sectors, which have been totally oriented toward the Soviet market, which could end up in an even worse situation if no serious industrial program is implemented. The weapons industry, for example, involved 200,000 people directly in production, of which 80,000 were in 110 firms in Slovakia. Most of the furniture-building industry in Slovakia, which employs 30,000 people, could be severely affected by the collapse of trade with the former Soviet Union. The decline in the volume of transportation is a reflection of the development in production. During the first eight months of 1990, freight railway transport was 10% lower than in 1989, despite a strong increase in the transport of ore in August.

Agriculture

Agricultural production in 1990 was significantly lower than the year before, with a loss estimated around 3.5%, while animal and milk production registered bigger losses. The situation was expected to be much worse in 1991, because the cut in subsidies will be more strongly felt: In the 1980s, more than 50% of all state subsidies went to agriculture.

Unemployment

"Open unemployment is expected to rise significantly during the transformation to a market economy . . . but experience suggests that a slower pace often implies higher total adjustment cost," says the World Bank's report. Measures suggested to deal with the problems are ridiculous: extension of primary education by one year; increase of vacation periods by one week per year; more part-time jobs for women; and a program for retraining workers, for which there is no budget allocated. In a country like Czechoslovakia, where unemployment was zero, this problem will inevitably become a source of social tension and explosions. A social safety net was considered in the study, but "the benefits have not to be so generous that they seriously limit the incentives to seek and accept new employment."

As a result, in September 1990 there were already 440,000 registered unemployed, and some of them then took

part-time jobs. In Slovakia at the end of the first quarter of 1991, there were 116,000 unemployed, and a very conservative estimate pointed to about 350,000 by the end of December.

Klaus admitted that the unemployment rate at the end of 1991 would be 7% of the labor force. Realistic statistics indicate that out of 1.1 million people working in heavy industry, 40% will be laid off, and at least 250,000 who are currently employed in the state bureaucracy will have to be fired. The disastrous policy will hit young workers hard—those that are coming out of the schools and universities without the prospect of a job. Many of these youth were involved in the anti-communist revolution, and they will not understand why the new society is brutally punishing them.

Trade

The collapse of internal production, the collapse of trade within the Council for Mutual Economic Assistance ("Comecon") and in particular with the Soviet Union, the utter lack of ability to compete with western goods, except on the basis of extremely cheap labor, the necessity to operate only on hard currencies, the new oil bill with the Soviet Union, abruptly calculated in dollars and at market prices—all this will have a devastating effect on trade. Prior to the "Velvet Revolution," 55% of all trade was with the Comecon, and the Soviet Union alone took 30% of all C.S.F.R. exports up through 1990; but for 1991 it is expected to take only 11%. In the first nine months of 1990, there was an estimated 5.8% loss in total trade. The first quarter of 1991 registered 20% less than the same period of the year before: Exports went down 21.6% and imports 17%.

Monetary policy, debt, and privatization

The "free market" IMF/World Bank approach is not really so "free." "There is no choice but intervening directly in credit allocation in order to balance concerns over inflation and supply responses"—i.e., credit restriction—says the report.

To prevent demand pressure on the money supply, Klaus announced three measures: 1) A "realistic exchange rate"—i.e., devaluation. During 1990 there were three devaluations of more than 100%, which together fixed the exchange rate at 17 crowns to 1 deutschemark (which was then equivalent to about 67¢). 2) "Positive real interest rates"—i.e., higher lending rates. Interest rates for domestic entrepreneurs who want to create an industrial *Mittelstand*—the German term for middle-sized industry—are about 24%. There is no industrial sector that can survive at such lending rates, with the exception of tourism, hotels, and casinos. 3) "Prudent wage policy"—i.e., wage cuts.

The $1.5 billion credit allocated by the IMF to Czechoslovakia was absolutely not for new investments or industrial restructuring, but was a technical instrument to make possible the so-called internal convertibility of the crown, which started on Jan. 1, 1991. This naturally came after the devaluations, and was supposed to make possible transactions and exchanges on the world markets. The consequences are seen immediately in the foreign debt. Czechoslovakia, which is definitely in the best shape of any of the eastern European countries, had a debt of $7.9 billion in 1990 and $12 billion in 1991. Central bank hard currencies and gold reserves dropped in the first nine months of 1990 from $2.4 billion down to $1.4 billion.

In such a situation, the privatization policy is equivalent to a cheap sellout to the big international companies, and does nothing to create a national private *Mittelstand*. Out of the big state firms, it is expected that 1,400 (50-60%) will be able to adjust by themselves, 650 (25-35%) will need substantial restructuring—mainly the heavy engineering and electronics sectors—and 300-350 will have to be liquidated. Because privatization is the centerpiece of the Klaus-IMF reforms, and is supposed to be done immediately, only foreign financial institutions or the old Communist Party *nomenklatura* would have the resources to buy. The voucher system, i.e., the sale of shares in a company to its workers at cheap prices, was just a propagandistic scheme, and it was never implemented anyway. The World Bank report opposed it, on the grounds that the low prices will not mobilize enough resources, will produce discontent, and in the end will just create pressure to bail out the firms in trouble.

Klaus's monetarist ideology

Klaus and company claim that all this hardship is the price that has to be paid for a better, prosperous future; but nothing could be further from the truth. Indeed, the worst is yet to come. The question which many pose, then, is how is it possible that political leaders like Vaclav Klaus could be so nasty to their own people, after all the suffering of a 40-year communist dictatorship. Klaus is a monetarist ideologue, a devotee of Adam Smith, the spokesman of the colonial British System against the American System of industrial capitalism. Klaus is also committed to his teacher Milton Friedman, whose classes Klaus attended at the University of Chicago. Friedman's obsession with the free market economy brought him to the point of supporting the free production and consumption of heroin and cocaine.

In a speech at the Institute of Economic Affairs in London on March 25, 1991, Klaus was at pains to favor integration of Czechoslovakia with the IMF rather than with Europe: "One of our election slogans in the first free elections in June 1990 was: 'Let us go back to Europe.' Some of us took the initiative in our contacts with the European Community, and others concentrated their efforts on worldwide institutions like the IMF, World Bank, GATT, etc. I have to confess that I belong to the second group, because my understanding of freedom and prosperity correlates with and is founded upon a system of worldwide free trade, not upon man-made institutions."