Development, legislative framework and goals of the consolidation institutions in the Czechoslovakia and the Czech Republic

Ales Rod

Ales Rod: assistant, Department of Economics, University of Economics, Prague. W. Churchill sq. 4, 130 67 Prague 3, Czech Republic. Email: ales.rod@vse.cz

Abstract:

This paper describes creation, legislative framework, development and goals of consolidation institutions in the Czechoslovakia (1991-1992) and the Czech Republic (1993 until now). According to tremendous social changes, conditions for the consolidation had not been stable; this influents establishing of several institutions and their subsidiaries with different tasks and competences, which were participating in the process consolidation of the post-communist banking sector and related financial and legal issues. The explanation and description of this institutional environment provide useful background for further analysis of issues dealing with the banking sector in the Czech Republic.

Key Words: Consolidation institutions, post-communist banking sector, transition

JEL Classifications: H700, P200, P310

1. Introduction

Consolidation institutions had played a key role in the transformation of the Czech economy because they helped to bail old bad loans out from the then creating banking sector and prepared it for a privatization[1].

As far as the transition is a great topic for economic research, there are many papers analyzing it. Linz (1996) or Clark and Soulsby (2005) provide a wide-ranging description of problems related to processes of transition and consolidation. A challenge of the transition is especially an elite competition over policy making authority, shaped and constrained by existing institutional resources (Gryzmala-Busse and Luong 2002). McAllister and White (2007) or Bielasiak (1997) discuss the crucial role of state and politics (political parties) in the change of political and economic system. Despite of all problems, the transformation of economies in the post-communist region is impossible without involvement of the state (Tsygankov 2007). A way of privatization differs among post-communist states; they have various performances and challenges, however in the majority of countries the privatization has not been completed yet (Svejnar 2002).

The situation on post-communist banking markets had formed affirmative conditions for acquisitions of successor banks by international investors. Their share of markets in post-communist region is bigger than in Western Europe (Epstein 2008). Honohan (2000) considers political interference and governmental involvement as the Achilles heel of any regulatory system, including the consolidated one. Other studies by Caprio and Klingebiel (1997) or Lingren et al. (1996) assume the whole costs of banks' consolidation being about 250 billion USD. Barisitz (2005) explains two banking reform waves – liberalization (1) and restructuring with institutional adjustments (2) when the Western European FDIs have come to dominate banking in most countries. Pleskovic (1995) sees the main issue in transforming a passive banking system into an active participator in the economy.

The consolidation was advantageous for foreign shareholders who have invested in the Czech Republic and extended their financial groups' portfolio. In 1990s, "Western" market principles were being accepted through all industries in the Czechoslovakia and Czech Republic and banking was one of them – it definitely increased profitability measures of banks working on the market with a low level of financial literacy and/or rationally-ignorant clients. Moreover, clean banks without classified loans expected to be written-off, could focus just on profit seeking and not to spend resources on management of bad loans' portfolio.

[1] For reading more about the issue of privatization, see for example Tříska (1991) or Kunert (1999).

In reality, the income diversification has been started from objective reasons. A consolidation of the Czech banking sector is one of them. Although various researchers discuss the issue, one could desiderate an explanation of the background and integrated description of the development of the consolidation institutions in the Czech Republic. Therefore, this paper describes the system of the creation and the development of Czech consolidation institutions, which were contributing to the process. This background is relevant for the analysis of the old bad loans' consolidation itself.

2. The start of the consolidation

In 1991 a transformation of the Czechoslovak economy has begun. During the years of the transformation, a centrally controlled, command economy was transformed into the market-based system. One of the key changes of the then representatives was to create a two-tier banking system. There was a spin-off of several banks from the existing monobank – The State Bank of Czechoslovakia. New commercial banks (with the exception of standard business activities) had to deal with a serious problem – a legacy of the bad loans portfolio from the centrally planned economy. An integral part of the loans were the above-mentioned loans on constantly revolving working capital, *"a specific type of low-interest loans from the time of the central plan"* (Czech National Bank Annual Report 1994, p. 7).

In January 1991, a liberalization of prices distorted by the central planning has been adopted. A price of money – an interest rate – was a part of that. Too low interest rates that were set on loans[2] used for operation financing of enterprises before 1989 were suddenly evaluated by a prism of common commercial loans. Rates were being increased up to 20 – 24 % p.a. This had a negative impact on both sides of the contractual relationship, i.e. on banks and enterprises.

The core of the problem is the following: one step transformation of the political system was not (and, logically, could not be) followed by a step change in economic transactions and partnerships created and supported by the State Planning Committee for decades, particularly in terms of production and distribution. Even after the fall of the "leading role" of the Communist Party of Czechoslovakia, local enterprises produced goods according to the State plan and its items, especially for needs of the former Soviet Block of countries. Problems with payment habits in these countries and impregnability of numerous claims ushered in financial difficulties of domestic enterprises. And, this all was enforced by the liberalization, including interest rates as a price of money.

The market approach to the banking industry quickly reflected in increasing cost of operational financing of working capital. Fees for non-financial corporate

[2]Till January 1991, a rate on credits for constantly revolving working capital was set by the legislation at level 6 % p.a.

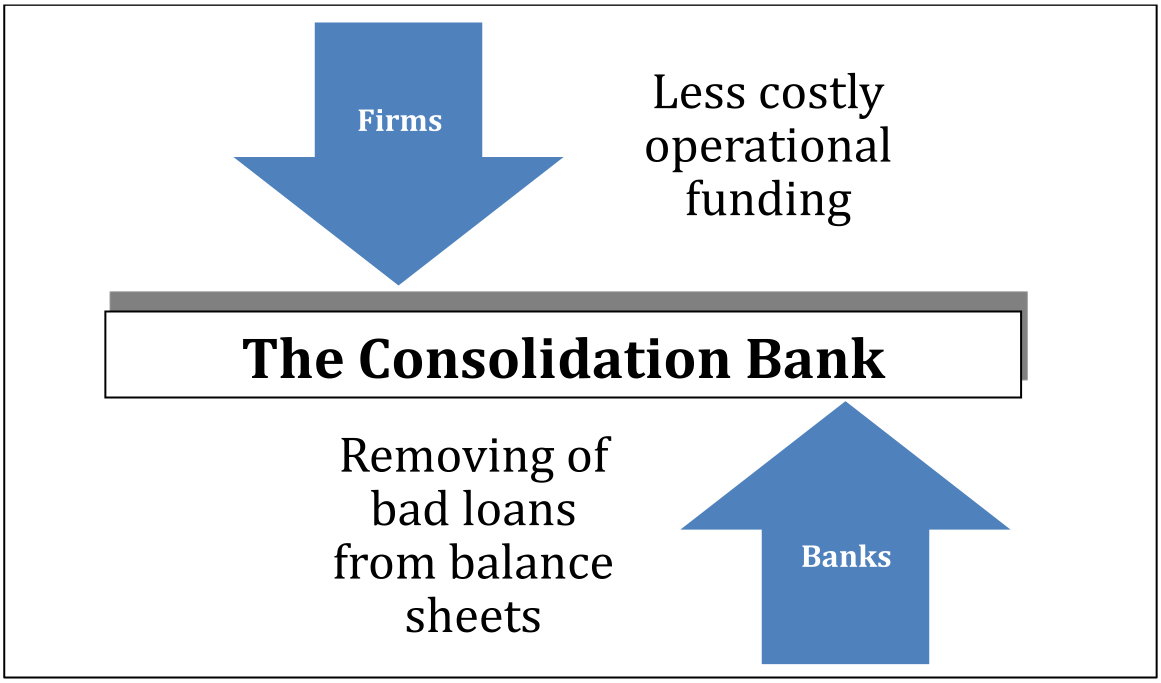
sector increased from the state-guaranteed level (6 % p.a. before 1989) to the level even six times higher. Efficient companies (even able to repay these loans) were being limited in so necessary fixed capital formation and investment opportunities, and thus they couldn't increase quality nor competitiveness of their products with regard to the competition from foreign entities whose products, by the way, Czech customers strongly preferred.[3] For other businesses the mechanism mentioned above was a burden that could lead to insolvency. Of course, insolvencies of firms (borrowers) were reflected in the banks' balance sheets, which registered exponentially increasing volume of classified loans.

As a partial solution of the situation, the government allocated 50 billion CZK of future revenues from the privatization on the account of the National Property Fund in advance.[4] In the system where activities of banks and activities of the enterprises were closely related through the State plan, this action was not sufficient.

"The funds were distributed to commercial banks, which still represented nothing than formally and organizationally separated parts of the former State Bank (of Czechoslovakia), which were paid through the tasks assigned to enterprises by this Plan. Due to this fact, banks did not have sufficient personnel or other equipment. The fundamental problem was the lack of information about indebted companies. In these state-owned enterprises, the state as a manager was totally failing in the management. Within the system, banks were doing transactions on the one hand and government was providing subsidies on the other hand. Subsidies were not based on clear rules and conditions that would ensure their efficient using in correspondence with goals of restructuration of businesses and their adaptation to emerging market environment." (Chaloupka 2009, p. 157)

[3] This was very similar in all pos-soviet economies – people living in a „cage of consumption" of socialist products for decades had become to consume foreign goods and services just for the fact they were from abroad. This was another difficulty Czechoslovak enterprises had to deal with after 1989.
[4] In Czech: Fond národního majetku.

Picture 1: Goals of the Consolidation Bank

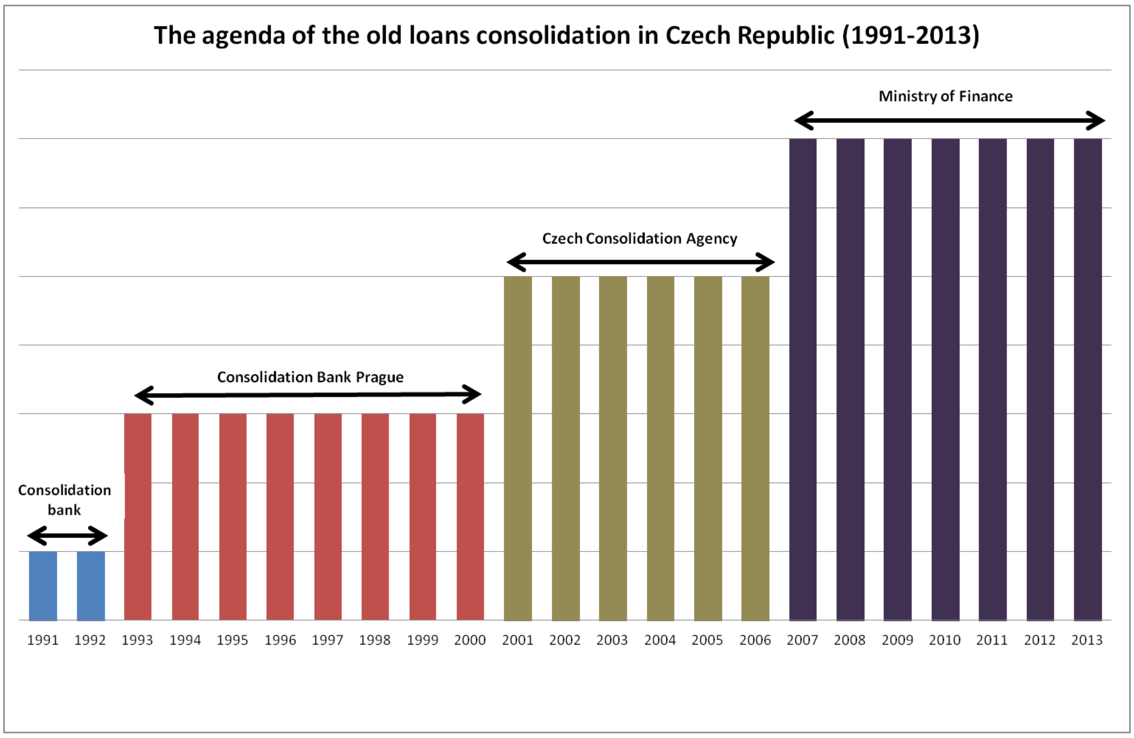


Source: Own production.

The government was increasingly realizing the unsustainability of the situation, and therefore decided to establish a special institution for this purpose. The institution was called the Consolidation Bank, state financial institution (CB, s.f.i. or just CB)[5]. It should concentrate loan receivables of newly established banks (i.e. to improve loan portfolio of banks mainly through cleaning of loans from the constantly revolving working capital) more efficiently, transforming them into conventional bank loans, adjust their interest rates downwards (the interest rate reduced to 13% p.a.) and extend their maturity to 8 years (The CBP Annual Report, 1994). The goal of all of this was clear – to relieve the financial burden from firms that were undertaking a tough test of survival after opening to foreign competition. Starting the process of price liberalization and the strict application of both monetary policy and fiscal policy necessary for that has made solving of bad loans problem through a high inflation impossible. The development is provided on the graph below.[6]

[5] The Czech shortcut frequently used was KOB (Konsolidační banka)
[6] As a reminder, the same graph is used also in the chapter 3.

Picture 2: Consolidation institutions in Czechoslovakia and Czech Republic



Source: Own production.

3. The Consolidation Bank, s.f.i.[7] (1991-1992)

The Ministry of Finance of the Czech and Slovak Federative Republic established the Consolidation Bank on February 25th, 1991. The CB was a specific banking house, which had operated within the whole Federation, but with the limited banking license and without the network of branches. The CB has special goals, different from receiving deposits from clients and providing loans for them (as is usual for a standard bank). The main task of the CB was *"... to deal with the consequences of certain decisions from the time of the centrally planned economy, when loans failed to meet their main economic role of a mechanism for the optimal allocation of capital. Interest rates were fixed at a very low level. Moreover, all of this had happened within the conditions of the monobank."* (The CBP Annual Report, 1994, p. 7)

The CB was sometimes called as "the institution for dark tasks of the transition", and it was entirely correct. It should help making business in the private sector, especially for to-be-privatized corporations. Immediately after getting into operation, the CB took over credits for constantly revolving working capital of four banks which have begun to provide services on the liberalized banking market in Czechoslovakia – Komerční banka, Investiční banka, Všeobecná úvěrová banka and Československá obchodní banka. Efcept of these bad loans, the CB was extending its activities. It should help the Czech economy overcome difficulties related to the

[7] s.f.i. = state financial institution, from the Czech equivalent "státní peněžní ústav".

transformation and to prepare good conditions for a quick and smooth privatization. The wider assistance to the banking sector was also included. In 1992, the Consolidation Bank purchased other packages of bad loans from Komerční banka and Investiční banka. These loans had already been (or were expected to be) in repayment problems; all worth a total of 14.7 billion CZK (The CBP Annual Report, 1993).

Let's go back at the beginning. The CB ended the year 1991 total assets of volume 119.9 billion CZK, of which 83.5 billion CZK were accounted for entities within the territory of the Czech Republic. In 1992, the portfolio increased by 4 % to 107,2billion CZK, especially thanks to other credits on constantly revolving working capital transferred to the balance sheet. The share of distribution of assets between the Czech and the Slovak part of the federative balance stayed almost unchanged.

Table 1: Balances of the Consolidation Bank, s.f.i. (1991-1992)

Consolidation Bank	**31. 12. 1991**	**31 .12. 1992**
Total assets	111,9	107,2
- Czech portion	*83,5*	*79,9*

All items are in billions of CZK. Source: Financial Reports of the Consolidation Bank.

The process of both preparation and approval of the financial statements for 1992 were de facto the very last activities of the federative Consolidation Bank. Then, the CB's administration was transferred to brand new subjects – the Consolidation Bank Prague and the Consolidation Bank Bratislava.

4. The Consolidation Bank Prague, s.f.i. (1993-2000)

After the division of Czechoslovakia into two sovereign states, the division of the Consolidation Bank (till that time under the federative administration) was a commonsense step. The CBP, state financial institution (s.f.i.) was established as a successor institution for the Czech transition. Similarly, the CBB, state financial institution was established as an institution helping with the Slovak transition (The CBP Annual Report, 1994). The process of economic transformation in the Czech Republic has required a continuous support, so on January 23rd, 1993 the CBP had begun to operate. It was legally founded on December 22nd, 1992. All assets and all liabilities from the federal CB were transferred to the successors.

In addition to the administration of so-called old bad loans, the CBP had to append even a greater involvement in the support of Czech entrepreneurs and enterprises during the early transition. Except of a purchase of bad assets from banks, there were activities such as the following:

- Providing banking services for legal entities (opening and maintaining current accounts, setting up accounts for term deposits, etc.)
- Providing special accounts for trustees in bankruptcy

- Providing assigned loans for a development of technologies and production volumes
- Providing syndicated loans to support a cooperation between enterprises and small and medium-sized banks (especially to promote employment and export activities)
- Providing loans for export deliveries with deferred maturity

Loans should stabilize the situation in enterprises (and thus help the government to solve the problem with structural unemployment) and thus became a very substantial part in the portfolio of activities of the CBP. The Czech companies were persistently failing in meeting obligations in time. The situation was very similar across all sectors. However, due to the structure of the economy, the crisis was obviously noticeable in primary production. A pragmatic solution was proposed – to capitalize debts and change them into acquisitions of the CBP (i.e. state) in these companies. This process focused mainly on companies detecting "a strategic interest".[8]

Despite the ongoing privatization and efforts to restrict state ownerships in business entities, the opposite phenomenon occurred by activities of the CBP. Planning of strategic and development financing of chosen entities had begun already in 1993. The CBP prepared its entering to the Czech capital market and, in 1994 it became one of the most important players on the interbank market in the Czech Republic; especially with a short-term and medium-term liquidity. In the same year, the activities associated with the state's capital allocation into chosen companies through equity had started. For example, the capital investments in the holding Aero, Czechoslovak Airlines, Škoda Mladá Boleslav or Zetor Brno were made in 1994 (The CBP Annual Report, 1994). It is interesting that ownerships in enterprises in the following years were partially following restructuring and revitalization programs (the Government's issue) but also own investment activities motivated by economic interests and profit seeking of the CBP.

Based on the continuing problems with transiting of enterprises combined with the circumstances presented and caused by the method of privatization, activities of the CBP had extended more and more. The so-called *"domestic way of privatization" of* the Czech economy meant that there was no remarkable increase of foreign capital in the Czech undercapitalized companies, although it was expected. According to the unsatisfied situation of fixed assets of companies, huge investments were necessary to be allocated there. It was the only way how to ensure competitiveness of the economy. On the other hand, it consumed almost all available resources. This compounded requirements on the state to co-finance the

[8] The term "strategic interest" is very wide, so one should not be surprised that it could affect practically any branch of economy.

transformation from the production based on the Plan to a production based on actual needs and interests of markets. Tools for that should be bank loans.

On the Czech banking market, domestic banking institutions implied new methods of risk management. It tightened conditions for firms to get a loan. Banks ceased to accept trades with a high degree of risk without adequate collateral[9] and started to collect debts vigorously. The volume of loans, whose owners were not creditworthy, enlarged every day. The Czech government realized that unless competencies on the consolidation institution were extended, there was no chance to efficiently solve these problems. The so-called "market solution", i.e. the best one from liberal point of view, would probably mean bankruptcies of thousands of businesses associated with a rise of unemployment and instability of the banking sector. Therefore, some steps were taken to secure that the Consolidation Bank Prague began “to work full-time on behalf of the transformation".

In 1995, the CBP got the full license for providing banking services in the local currency (CZK) in the Czech Republic. It had become a special bank fully owned by the state and with state guarantees for all its obligations (The CBP Annual Report, 1995). Through the National Property Fund, the Consolidation Bank Prague increased its reserve fund by 15 billion CZK. A subsidiary named KOB Invest providing trading and leasing services had been established. Over time, the portfolio of the Consolidation Bank Prague expanded on foreign exchange activity (in 1997 the CBP got the Foreign Exchange License of third degree from the Czech National Bank), bond issues, providing of syndicated loans, collecting of import deposits from commercial banks with subsequent restoration, purchasing of receivables non-banking companies, debt pay-offs by entities in bankruptcies, and last but not least active participation in the preparation of the sale of state shares in enterprises to strategic investors. In 1997, the financial restructuring of Zetor Brno and Aero Vodochody, two firms with important ownership of the CBP, was completed.

According to the Czech Government Resolution No. 249 (23rd of April, 1997) the CBP got the exception from the process of dealing with equity in the business of legal entities, for allocating of the state property into private businesses and for establishing of new subsidiaries and associates, if the value of the following funds expended in each case does not exceed CZK 500 million. The procedure had to be in each case discussed in advance with the founder and the Supervisory Board (The CCA Annual Report, 2001).

The deteriorating situation of the domestic economy put also other claims to the CBP. Not only management of receivables from the credits for constantly revolving working capital coming from the centrally planned economy was an issue

[9] Of course, exceptions were observable. They were based on missing information about a debt history of subjects, or on illegal transactions and frauds of banks’ employees – some loans were provided to “secret partners” with the clear purpose – to make the loan default and got a commission (bribe) from that.

to deal with. It was proven that sales of state-owned enterprises to private (foreign) investors would be very difficult without further major restructuring of them. It concerned especially banks (Investiční a poštovní banka; Česká spořitelna). Moreover, postponing of the sale threatened their existence. That is why the CBP implemented providing of more and more guarantees and also offered comprehensive payment services, both domestic and foreign ones. The above information shows how important role did the state the state play in the transformation process in the Czech economy during the nineties.

"The property of the CBP does not form any part of the state budget of the Czech Republic. Due to the nature of activities of the CPB, the government was empowered to use the National Property Fund of the Czech Republic and to apply NPF assets to strengthen a stability of the CPB, by the Act No. 171/1991 Coll. The resources could be re-allocated in connection with activities in the process of bankruptcy and settlement proceedings and to cover losses incurred in the CBP in connection with the fulfillment of the tasks set by the government decisions. This mandate has been used a total of three times. The total assets of the CBP had been strengthened by almost 34 billion CZK. In addition, commitments of the CBP were secured by legal guarantees of the Czech Republic."

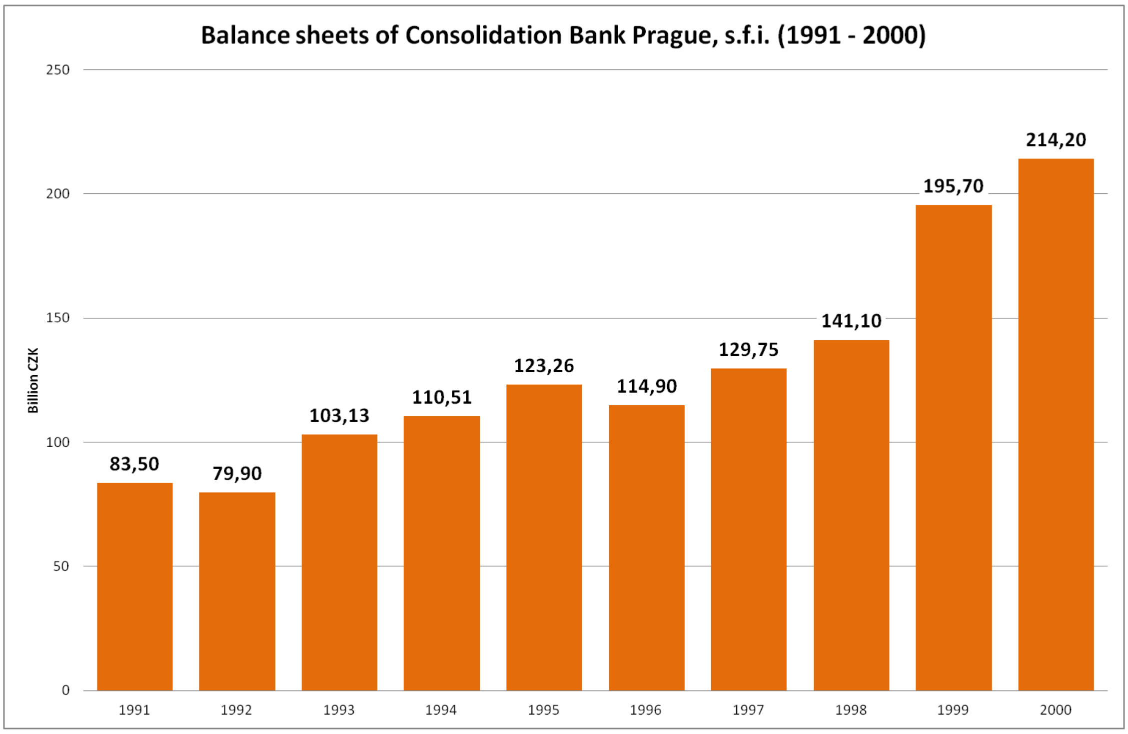
Source: The Czech Consolidation Agency Annual Report, 2001, p. 22.

A growing participation of the state on fixing transformation processes could be characterized by increasing balance sheet assets under the management of consolidation institutions between 1991 and 2000. See the Picture 3 (in 1991 and 1992, only the assets of Czech entities under the administration of the federal Consolidation Bank are taken into account). Total assets grew at the average of 11.84 % annually and they had more than doubled in the period 1991-2000 and reached the level 214.2 billion CZK.

The CBP should influence especially an inflow of foreign direct investments and participated in formation of the Czech secondary market with receivables. This should increase a transparency in the Czech business environment, because its weaknesses still represented large barriers to more intensive cooperation with foreign entities and thus to easier entering foreign markets by domestic producers.

Even in the beginning of the 1990s, it was clear that economic costs of the transformation would be non-zero. The problem related to these costs, relationships in consolidation institutions, their subsidiaries institutions and the whole impact on public finances of the Czech Republic was gradually getting into the attention of the Czech public. In 2000, major changes in the public sector of consolidation institutions occurred. These institutions were divided into two groups - consolidation ones and development ones. The CBP [10] that was covering the area of restructuring and reorganization activities through the Consolidation Bank Financial Group [11] terminated. The CBP was then transformed from a banking house to the institution dealing with a problem of credits for constantly revolving working capital, bad loans, and problematic assets with the legal status set by particular laws. That's why the agenda and some activities of the CBP were moved to other institutions with the state participation in 2000 and 2001.[12]

Picture 3: Total assets managed by consolidation agencies within the Czech Republic (1991 – 2000)



Note: The data from 1991 and 1992 relates only to entities from the Czech Republic. Source: Financial statements of the Consolidation Bank, s.f.i., and the Consolidation Bank Prague, s.f.i.

[10] *„Legal status of the CBP substantially changed during the time. The Act No.165/1998 Coll., amending the Act No.21/1992Coll. on Banks, became effective on 1st of September, 1998. It provided that the state financial institutions, occurred before the effective date of this Act (i.e. the CBP) will be governed by the Banking Act only till the adoption of a special law, for a maximum period of up to1st of September, 2001."* (The CCA Annual Report, 2001, p. 21). This de facto meant the CBP was going to be transformed.

[11] The CBP Annual Report, 2000. The financial group of the CBP was parted by following institutions: KONPO s.r.o.; PRISKO a.s.; REVITALIZAČNÍ AGENTURA, a.s.; SANAKON s.r.o.; ČESKÁ FINANČNÍ, s.r.o. The last institution was bought from the Czech National Bank.

[12] For example, at the end of the year 2000 activities in financing of development projects in areas of transport, telecommunication, water infrastructure, and ecology (parted by the loans at Česká spořitelna, ČSOB, and Českomoravská záruční a rozvojová banka) were moved out. It reduced the total balance sum by 30 billion CZK.

5. The Czech Consolidation Agency (2001-2007)

The Czech Consolidation Agency (CCA) was one of them. It commenced its' activities[13] on September 1st, 2001, as the legal successor of the Consolidation Bank Prague. This was done on the basis of the Act No. 239/2001 Coll.[14] The Czech Consolidation Agency has become a new central institution in the Czech Republic that manages consolidated assets transferred from the CBP.

Unlike the CBP, the Czech Consolidation Agency was not the bank licensed by the Czech National Bank. The decision was made on purpose – thanks to this new status the CCA could easily access the information necessary for the successful completion and transformation of the Czech economy and especially to newly acquired majorities in an ownership structure of restructured enterprises. The CBP had not been allowed to do this. On the other hand, the CCA had lost an opportunity to provide banking services, especially to take deposits and provide capital to individual firms through credits and specific loan products.[15]

The main defining point of the activities of the CCA remained the same – the state guarantee for all its' liabilities. For this reason, the Czech National Bank assigned the "zero risk level" to the CCA and furthermore the Czech National Bank confirmed the position of the CCA as a financial institution without a banking license. The Board was appointed by the proposal of the Ministry of Finance; the Chamber of Deputies of the Czech Republic elected the Supervisory Board of the CCA.[16] The key task of the CCA was to achieve maximum return on debts discharged from banks and other businesses during the 1990s in portfolios of the CB, respectively the CBP, with minimal cost to the administration process. Restructuring of enterprises and gradual privatization were continuing. Entities with the state participation, the CCA should help to complete the process of financial stabilization and to assist in finding of strategic partners (investors).

---

[13] To this date, the Consolidation Bank Prague was deleted from the Commercial Register of the Czech Republic.

[14] *"By the Act No. 165/1998 Coll., amending Act No.21/1992Coll.,it was determined that CBP may exist under this Act and takes actions no later than 31 August 2001.The Act No.239/2001Coll. pertaining to the Czech Consolidation Agency has been adopted. This law provides a legal continuity between the state-owned financial institution CBP and the CCA, including the legal and procedural succession and the transfer of all rights and obligations. Under the new law, the CCA is a legal entity that manages state property, and the property to which it becomes entitled to manage in the provision of specified activities, or in connection with this activity. The CCA is entered into the Commercial Register, and the registration is declaratory in its nature. Under the Act, the CCA shall expire on 31st February 2011 without liquidation. The Law on Banks is not applicable on the CCA, exceptions are possible."*(The CCA Annual Report, 2001, p. 23).

[15] Limitations of the Banking Act were provided in the §3/1/e of the Act about CCA. The CCA is required to complete all activities and transactions that took over from the CB, which can be done by all rights, options and tools that the CBP disposed of.

[16] The Board had a statutory governing body and decided on all matters of the CCA. The executive power of the Board was legally limited by a nature of transaction and by a volume. Large loss-making operations were approved by the Supervisory Board of the CCA and by the Ministry of Finance (The CCA Annual Report, 2001, p. 4).

In the very first months of its operation, the Czech Consolidation Agency had to solve one of the biggest problems of the Czech transformation process (The CCA Annual Report, 2001, p. 4): *"As the result of the imposition of forced administration of the IPB in June 2000 and of the state guarantee given to Československá obchodní banka (ČSOB), the CCA launched transfers of bad assets of the former IPB (former owner) from the ČSOB (actual owner)) to the CCA. This happened in the second half of 2001."*

Transferring of assets between the CCA and the ČSOB was de facto a cleaning process in which non-performing assets of the IBP were moved into the portfolio of the CCA. This process was virtually completed in 2004 and it contributed to the decision to help solve the problem with CCA's assets as soon as possible. The collaboration between the CCA and the Ministry of Finance in early 2002 led to developing and adopting the strategy of rapid exit of assets from the portfolio of CCA. *"Immediate collection and minimizing the cost of managing the assets over time should be implemented. The main tool for the implementation of rapid exit of assets was determined by use of "block sales of assets" in the tens of billions CZK. In 2002 the Czech Consolidation Agency subsequently prepared and successfully executed the largest block sale of non-performing assets (receivables) ever" (The CCA Annual report, 2002, p. 2).* The value of these sales is amounted to nearly 38 billion CZK.

The CCA continued in a "monetization" of receivables as quick as possible and used a few available methods for that; particularly individual progress and also block sales in the following years. Due to the methods used (analyzed below) and apparent effectiveness of them, the Czech officials had started to consider reducing the length of the existence of CCA shortly after the start of sales of receivables. By the then-effective legislation, the CCA should terminate on December 31st, 2011. However, politicians were thinking about doing it 4 years earlier – at the end of 2007. The Czech Government Resolution Decree No. 45 from January 14th, 2004 eventually acknowledged the earlier termination. The CCA was restructured in 2004 to set conditions for "The Project 2007" – the termination of the CCA's existence. In 2005 the CCA got the first profit in its history. In the next year, the Government decided the CCA to take over the assets from nine health insurance companies. Subsidiaries of the CCA were under the closer control due to the approaching term 2007.[17]

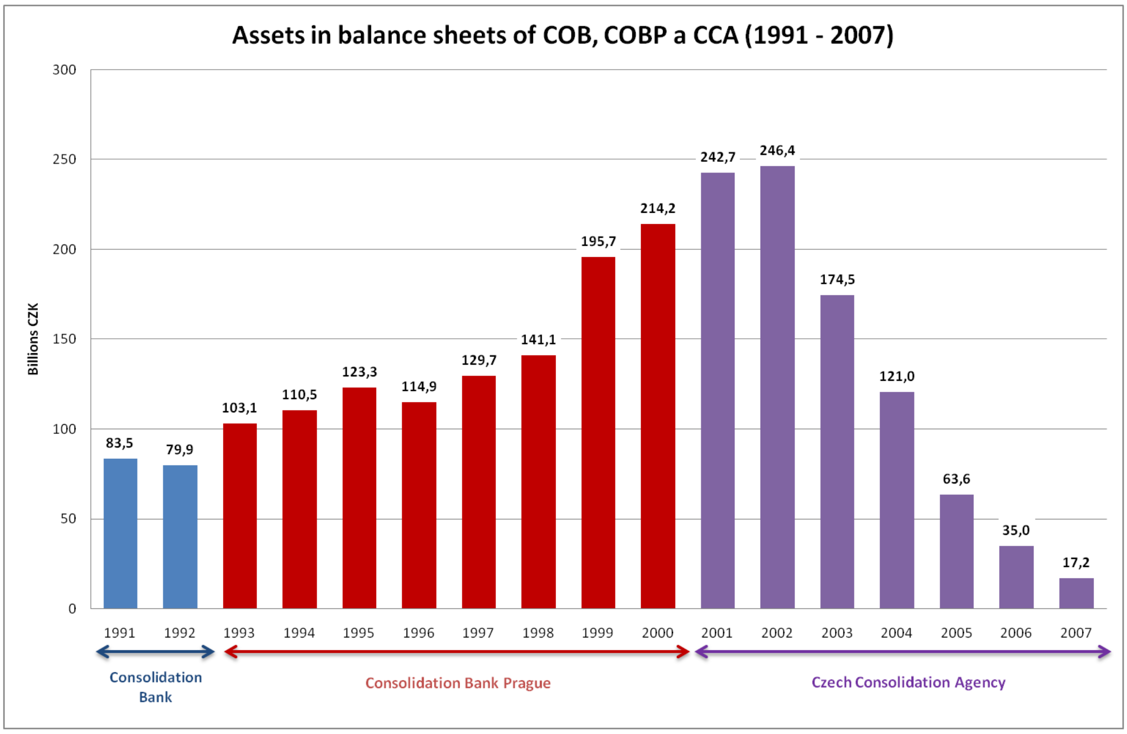
The CCA was terminated on December 31st, 2007, as the result of (already mentioned) the Czech Government Resolution Decree No. 45 and the Act No. 239/2001 Coll. (§ 20), about the Czech Consolidation Agency and amending laws (The CCA Annual Report, 2007). The succession in terms of rights and obligations of the CCA has been moved to the state, i.e. the Ministry of Finance of the Czech

[17] *"On the basis of contracts and due to the§153C of the Commercial Code, the CCA took assets and liabilities of the dissolved companies Konpo, s.r.o., and Česká finanční, s.r.o. Both companies were dissolved without liquidation on 31August 2006."* Source: The CCA Annual Report, 2006.

Republic. Legally imperfect assets, however, were carried into the specially established company. *"In 2007, the CCA has solved the majority of the legally defective claims of so-called residual portfolio of the CCA. According to the Government Decree from 28 February 2007 (the Act No. 176) a trading company has been established for these business purposes. The CCA transferred all state assets in the amount of 12.3 billion CZK into this company called ASSET PARK s.r.o. In June 2007, a sale of the ASSET PARK to a non-state entity through a public tender had begun. In November 2007 the Government approved the winner of the tender and at the same time a transfer of 100 % of the shares in ASSET PARK s.r.o. was done."* (The CCA Annual Report, 2007, p. 4)

Among four subjects, the highest amount of money in the tender offered AB-CREDIT, a.s. and thus won the block sale of assets. The winning pay-check was signed in the amount of 585.5 million CZK. The contract of transfer of shares into the company ASSET PARK s.r.o. was co-signed on February 22nd, 2007.

Picture 4: Levels of balance sheets of the Consolidation Bank, the Consolidation Bank Prague and the Czech Consolidation Agency (1991-2007)



Note: The CB refers to assets legally belonging to the Czech Republic.
Source: Own production from financial statements of the Czech consolidation institutions.

The existence of the Czech Consolidation agencies and the purpose of their existence (mainly the collection of state firms' receivables) could be well portrayed by the development of total assets in balance sheets. The volume of the CCA's balance sheet reached the peak in 2001 – 2002, when the privatization of Czech banks culminated as well as the crisis after the collapse of the Investiční a Poštovní Banka. The amount of assets reached 242.7 billion CZK (246.4 billion CZK) and, consequently, the volume of assets were decreasing as the sale of receivables to third parties was being enacted.

In 2005, the volume of assets managed by the CCA decreased by 50 % to 63.6 billion CZK. A similar development – i.e. a decrease by a half of assets per year – followed for the next two years. The Czech Consolidation Agency terminated its activity on December 31st, 2007 with a balance sheet of 17.2 billion CZK.

6. The Ministry of Finance, Czech Republic – Dept. 46 (2008 until now)

The termination of the Czech Consolidation Agency was based on the Act No. 239/2001 Coll. about the Czech Consolidation Agency and amending laws. Its property, remaining activities and all competences were transferred to the Ministry of Finance of the Czech Republic. Since January 1st, 2008, the Department 46 – "International legal issues and the agenda taken from the CCA" has dealt with these issues.[18]

As mentioned above, assets with strategic interest of the state parted the remaining portfolio. It consisted also from the residual assets with claims contained serious legal defects. These defects prevented their transfer to third parties, thus immediate individual or block sales before the end of the Project 2007.

7. Conclusion

The aim of this paper is to describe the creation and development of consolidation institutions in the Czechoslovakia, respectively Czech Republic, and explain legislative and political background of their operation. Undoubtedly, the consolidation institutions had played a major role in the transition of Czechoslovak (Czech and Slovak) economy, especially in 1990s during the early old bad loans' consolidation. At the period from 1991 to 1992, the federative Consolidation Bank took over the bad assets provided before 1989 and set the administration for this kind of institution together with the then government, especially the Ministry of Finance. After splitting the Czechoslovakia on January 1st, 1993, successors in the Czech Republic (The Consolidation Bank Prague) and the Slovak Republic (The Consolidation Bank Bratislava) had taken the control. The process of transition and related structural changes during 1990s were requiring a continuous extending of CBP's competences, i.e. involvement of the state. In 2001, the administration of banking sector' consolidation was passed to the Czech Consolidation Agency. Till its termination in 2007, the CCA administered the portfolio of tasks and provided sales of receivables relating to old bad loans. Since 2008, all duties related to administration of the remaining portfolio of assets, claims and legal disputes have

[18] The data to 31 December 2007 stated on the website of the CCA were transferred into the website of the Ministry of Finance (The archive of the CCA. Source: The website of the Ministry of Finance, online, March 17th, 2013. Link: http://bit.ly/1FsBpWp).

been passed to the Ministry of Finance (Dept. 46 – International legal issues and the agenda taken from the CCA).

Involvement of the state had formed good conditions for rent-seekers, who speculated with receivables against old bad loans. So, the official succession of the Ministry of Finance is really important here – it plays a major role in taking the last step in old bad loans' consolidation.

8. References

BARISITZ, S. 2005. Banking in Central and Eastern Europe since the Turn of the Millennium – An Overview of Structural Modernization in Ten Countries. *Focus* 2, 05.

BIELASIAK, J. 1997. Substance and process in the development of party systems in East Central Europe. *Communist and Post-Communist Studies*, 30(1), 23-44.

CAPRIO, J.G., Jr. and KLINGEBIEL, D. (1996). Bank insolvency: bad luck, bad policy, or bad banking?. In: *Annual World Bank conference on development economics* (Vol. 79). Washington: The World Bank.

EPSTEIN, R. A. 2008. The social context in conditionality: internationalizing finance in postcommunist Europe. *Journal of European Public Policy*, 15(6), 880-898.

CHALOUPKA, L. (2009). Fiscal imbalances in the Czech Republic and related explicit and implicit The Fiscal Imbalance in the Czech Republic and its explicit and implicit implications (in years 1995 - 2005) (dissertation thesis). Brno: MU.

CLARK, E., & SOULSBY, A. 2005. Organizational change in post-communist Europe: Management and transformation in the Czech Republic. London: Routledge.

GRZYMALA-BUSSE, A. and LUONG, P. J. (2002). Reconceptualizing the state: lessons from post-communism. Politics & Society, 30(4), 529-554.

HONOHAN, P. 2000. Banking system failures in developing and transition countries: diagnosis and prediction. *Economic Notes*, 29(1), 83-109.

KUNERT, J. (1999). Czech Banking – Certainly Not in Year Zero. Czech Journal of Banking and Finance, 49 (6), p. 307-314.

LINDGREN, C., GARCIA, G. and SAAL, M. 1996. *Bank Soundness and Macroeconomic Policy*, Washington: International Monetary Fund.

LINZ, J. J. 1996. Problems of democratic transition and consolidation: Southern Europe, South America, and post-communist Europe. Maryland: JHU Press.

MCALLISTER, I., and WHITE, S. 2007. Political parties and democratic consolidation in post-communist societies. *Party Politics*, 13(2), 197-216.

PLESKOVIC, B. 1995. Financial policies in socialist countries in transition. *Communist Economies and Economic Transformation*, 7(1), 117-128.

ŠVEJNAR, J. 2002. Transition economies: Performance and challenges. *Journal of Economic Perspectives*, 3-28.

TSYGANKOV, A. P. 2007. *Modern* at Last? Variety of Weak States in the Post-Soviet World. *Communist and Post-Communist Studies*, 40(4), 423-439.

TŘÍSKA, D., 1991. Privatization: Czechoslovakia, Eastern European Economics, 22-27.

ANNUAL REPORTS:

- THE CONSOLIDATION BANK (OF CZECHOSLOVAKIA):
  - The Annual report 1991
  - The Annual report 1992
- THE CONSOLIDATION BANK PRAGUE:
  - The Annual Report 1994
  - The Annual Report 1995
  - The Annual Report 1996
  - The Annual Report 1997
  - The Annual Report 1998
  - The Annual Report 1999
  - The Annual Report 2000
- THE CZECH CONSOLIDATION AGENCY:
  - The Annual Report 2001
  - The Annual Report 2002
  - The Annual Report 2003
  - The Annual Report 2004
  - The Annual Report 2005
  - The Annual Report 2006
  - The Annual Report 2007

LEGISLATION:

- Act No. 21/1992 Coll. (the Banking Act)
- Act No. 165/1998 Coll. (amending Law no. 21/1992 Coll., the Banking Act, as amended, and certain other Acts)
- Act No. 239/2001 Coll. (the Czech Consolidation Agency Act)
- Decree of the Ministry of Industry and Trade of the Czech Republic No. 102/1997 Coll. (amending and supplementing the Decree of the Ministry of Industry and Trade of the Czech Republic No. 90/1997 Coll., the introduction of import deposits)
- Decree of the Ministry of Industry and Trade of the Czech Republic No. 206/1997 Coll. (repealing the Decree no. 90/1997 Coll., the introduction of import deposits, as amended by the Decree No. 102/1997 Coll.)
- Government Decision No. 59 + P (agreed on 13/01/2012)