

1-1-1992

The Legal Aspects of the Transition

Jamie L. Wine
Lehigh University

Follow this and additional works at: <http://preserve.lehigh.edu/perspectives-v10>

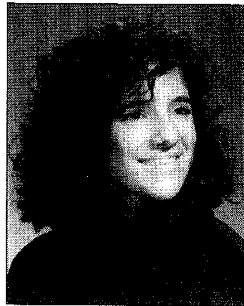
Recommended Citation

Wine, Jamie L., "The Legal Aspects of the Transition" (1992). *Czechoslovakia in transition*. Paper 10.
<http://preserve.lehigh.edu/perspectives-v10/10>

This Article is brought to you for free and open access by the Perspectives on Business and Economics at Lehigh Preserve. It has been accepted for inclusion in Czechoslovakia in transition by an authorized administrator of Lehigh Preserve. For more information, please contact preserve@lehigh.edu.

THE LEGAL ASPECTS OF THE TRANSITION

Jamie L. Wine



Introduction

In the Czechoslovak Revolution of November, 1989, a non-communist government took power and vowed to reform the country's economic system. Vital in instituting this change was the finance minister, Vaclav Klaus, a believer in free markets and a disciple of Milton Friedman. (Speck, 1991) Klaus and his supporters urged a rapid transition from a communist to a capitalist economy, arguing that the economic conditions in Czechoslovakia needed to be rectified immediately. Opponents claimed that a rapid change would only lead to confusion, and thus recommended a much slower transition so that the system could be restructured and improved before privatization. Klaus and his supporters won the battle, though, and a plan for change was put into effect at once.

The new government set up a plan to privatize all businesses in Czechoslovakia starting in January, 1991, and to complete the process within three to four years. (Mejstrik, August 5, 1991) Though the government was quick to start the privatization process, it did not foresee all of the legal complications inevitable with

this drastic change. The main problem is that for the economy to change, new legislation must be written first; and Parliament simply has not been able to write new laws as quickly as the new government would like in order to initiate the rapid transition.

In this paper, I will explain three of the major laws that have already been written to begin the privatization process: the Small Scale Privatization Act, the Large Scale Privatization Act, and the Restitution Act. I will also discuss several additional pieces of legislation that have been passed or are expected to be passed in the upcoming year. Finally, I will examine some of the legal problems that have arisen as a result of the haste to implement the economic changes as quickly as possible.

Privatization

Small Scale Privatization

To initiate the transition, two privatization acts have been passed: the Small Scale Privatization Act (Law #427, 1991) and the Large Scale Privatization Act (Law #92, 1991). In small scale privatization, smaller businesses

are sold through public auctions. A privatization commission in each city has been set up to organize the auctions along with the Ministry of Privatization. Any Czechoslovak citizen may participate in these auctions. At the auctions, a citizen may "buy" property, but in many cases the "purchase" is in fact a leasing agreement between the government and a private citizen, rather than what is usually termed private ownership. The citizen must pay rent to the government for two years, at which time he may then make a deal to extend the lease. Curiously, the rental price for the property is unknown to the buyer at the time of the auction, although maximum rents do exist. (Mejstrik, August 9, 1991)

Originally, the government had planned to have all small businesses privatized within three to four years, but this expectation now seems too ambitious. As of August, 1991, 8,000 small businesses have been privatized, (Mejstrik, August 5, 1991) but there are still about 100,000 more that remain. Though this small scale privatization scheme may seem reasonable, it has not, however, worked out in practice exactly as planned. The local municipalities have complete discretion as to which properties are to be leased. As noted above, many of the local privatization commissions have been very reluctant to actually sell the properties outright, because the government wants to retain total ownership of the businesses and profit from them. (Svoboda, 1991)

Large Scale Privatization

In large scale privatization, large businesses have a choice of procedures that they can choose for privatizing: direct selling, auction, selling of shares domestically or to foreign investors, or the voucher system. (Speck, 1991) The first three choices involve more traditional ways of privatizing companies, but the fourth option, the voucher system, is the most innovative. In this process, vouchers are sold at a nominal price to Czechoslovak citizens with the intention that all citizens will be able to obtain vouchers and have a chance to share in the wealth of the country.

Each large enterprise wishing to be privatized must prepare a privatization project in

which it determines which of the above procedures it will use. The project must then be approved by the Ministry of Privatization. If the project is approved, it will finally be passed to the National Asset Fund, which makes the technical arrangements for selling large businesses. The government of Czechoslovakia is aiming to privatize about 7,000 large businesses in three or four one-year waves, the first wave having started on January 1, 1992. (Mejstrik, August 5, 1991) Again, as with the small scale privatization, this prediction may be a bit unrealistic.

Legal Complications With Privatization

There are many technical problems associated with the two privatization acts. First, the government has neglected to establish a satisfactory way of determining the real value of each company, but instead is simply relying on people's bids to reflect the worth of each company. Second, the Ministry of Privatization has not yet published any guidelines for companies to follow when preparing a privatization project. According to Mejstrik (August 5, 1991), nobody in the companies really understands what the Ministry wants to see detailed in these projects; and so far it has been necessary to have inside information from someone connected with the Ministry in order to prepare a project that will ultimately be approved. Finally, when a company is being sold by auction, only Czechoslovak citizens are allowed to bid in the first round of auctions. If the company is not sold in this round, there is a subsequent round of auctions in which foreigners are allowed to participate. However, many citizens are making illegal deals with foreign investors in the first round (Mejstrik, August 5, 1991), and the government has yet to institute punishment for such actions.

Restitution

The third major act regarding the change to a free market system that has already been put into effect is the Restitution (Rehabilitation) Act. This act was born out of a desire of the new government to rid itself completely of all traces

of the communist system and to give back to the citizens what was rightfully theirs. The Restitution Act returned the property that the communists confiscated from Czechoslovak citizens beginning in 1948. The act did not, however, return the property that was taken by the Germans in 1939 from the Jewish community; nor did it return property, mainly large industries, that was nationalized during the 1945-1948 period before communist rule. (Svoboda, 1991)

The intention to give back to the people the land they once owned is commendable, but it has been much more difficult to formulate a law which would encompass all aspects of restitution. The following rules comprise the major provisions of the Restitution Act:

(1) Original property owners had six months in which to claim their property, or else it would be privatized without restitution. The original property owner had to first notify the person currently holding the property. The title then had to be transferred within thirty days of initial contact to the original owner. However, if the current holder refused to give up the property, the claimant had one year in which he could file a suit in court to attempt to get his property back.

(2) If there was more than one original owner of a property, only those original owners making claims within the specified six months were granted restitution and considered sole owners of the property.

(3) If the condition of the property had deteriorated to the extent that it could not be used without reconstruction (such as a building that was left uncared for and is now unstable, or farm land that lay waste and now was not arable), the claimant could request a financial settlement from the government instead of reclaiming his property.

(4) Properties that had lost their original function through reconstruction, such as a factory which was converted into apartments, were not returned to the original owner; however, the original owner did receive the ownership of the land on which the building stood so that he could at least own real estate and charge rent if he desired.

(5) If the original owner had owned a vacant lot upon which the state had since built prop-

erty, then that land was not returned to the original owner, though a financial settlement could be requested.

(6) Any land or building declared a natural or cultural site was not returned to the original owner, though again a financial settlement could be requested.

These six basic provisions spelled out in the Restitution Act touch on some major aspects of restitution, but many questions still remain unanswered. Numerous problems have arisen concerning who in particular would get their property back, what would happen if the property had increased or decreased in value since original ownership, or what would happen if the property had been altered or destroyed. More specifically, there are no guidelines for determining how much money the claimant should be awarded in financial settlements. Moreover, there are no guidelines for determining when the property condition has deteriorated to such an extent that it can no longer be used. Also, the law does not explain how the original owner is supposed to prove his ownership. Many records have been destroyed over the years; and it is consequently difficult for many of the citizens to prove that they were, indeed, the original owners of that land. To make matters worse, additional problems arise when the current owners refuse to hand over property, which is very likely to occur if the original owner does not have proof of his claim. Finally, considerable dissatisfaction has erupted among Czechoslovaks who have moved to the United States, because the Restitution Act pertains only to those people currently living in Czechoslovakia. (Levy, 1991, and Lelyveld, 1991) Many of these citizens feel that such an exclusion is unjust and that they should have the same restitution rights.

Unfortunately, while the Restitution Act does establish some rules for returning property, it obviously fails to clarify all of these issues. Even the most optimistic estimates predict that only ten to twenty-five percent of all real estate will ultimately be returned to the original owners through this scheme. (Sujan and Vesely, 1991) However, there have not as yet been any published accounts on the actual number of returned properties, and many property disputes are still tied up in the courts.

Too Much Too Soon

The problems pointed out with the Restitution Act reflect the difficulty that the new government in Czechoslovakia in general is facing while effecting the economic changes in a hurried fashion. Since the government wants the changes instituted as rapidly as possible, the legislature is under great pressure to pass new laws quickly. But as Czechoslovak attorney Jonathan Gafni claims, this haste may result in unsatisfactory legislation. Gafni points out that the members of the legislature have been trained under communist rule, and are therefore inexperienced in writing democratic legislation. He also notes that, with the changes occurring so quickly, often a new law will be amended within a month of being passed or amended many times over the course of a few months. Naturally this leads to much confusion. Finally, Gafni describes the workload of Parliament as being overwhelming. In 1990 alone, 200 new laws were passed, compared to only 15 in 1986. The fear, again, is that sound legislation is being sacrificed for quick legislation. (Gafni, 1991)

Legislative Activity

A New Constitution

Even though there has been an enormous amount of legislative activity, the revision of the Czechoslovak legal system is still going to be a very long and arduous process—especially since the legislature is working on a new constitution while amending the old one day by day to keep up with all of the changes. The new constitution, expected to be adopted in October of 1992, will address four major aspects of Czechoslovak life: (1) abolishing communism, (2) transforming Czechoslovakia from a communist to a free market economy, (3) defining the concept of private ownership, and (4) controlling the problems associated with the wave of nationalism which threatens to split the two republics of Czechoslovakia. (Gafni, 1991)

An amendment to abolish communism, the first goal of the legislature, has already been added to the existing constitution. The privatization and restitution acts have also been

passed, thus addressing the second goal of transforming Czechoslovakia into a free market society. Defining the concept of ownership, however, is one task that may be considerably more complicated. Under communism there was virtually no private ownership, so it is hard for the Czechoslovak citizens to understand how private ownership will work. For instance, as Gafni points out, prior to the transition Czechoslovakia had neither a commercial code nor bankruptcy laws, since these were unnecessary in the absence of private ownership. In addition, in the Small Scale Privatization Act it has already been seen that some privatization efforts are in fact merely rental or leasing agreements. Defining and codifying the concept of private ownership so that every citizen may understand what it entails may be the toughest challenge for the Czechoslovak legislature.

New Legislation

Although the privatization and restitution acts have attracted the most attention, many additional pieces of legislation are being written or have already been completed. For example, new foreign investment legislation has been passed, providing guidelines for joint ventures, foreign economic relations, and foreign trade. A bankruptcy act has also been enacted, with United States bankruptcy laws used as a model since communist Czechoslovakia had no need for bankruptcy laws. (Tesar and Kucera, 1991) The legislature is currently in the process of developing a new tax law which is expected to be adopted in January of 1993. (Svoboda, 1991)

The existing labor code is also being amended, with a completely revised labor code expected to be passed sometime in 1992. Under communist rule, the labor code had many stipulations which made it almost impossible to legally fire an employee, even if he were incompetent. (Mejstrik, August 5, 1991)

Some of the most important legislation on which the government is currently working is the commercial code. The commercial code, which includes company law and regulation, is expected to be passed in 1992. It will consist of a number of acts pertaining to joint ventures, the protection of competition (analogous to U.S. anti-trust laws), and the prohibition of

unfair competition. (Gafni, 1991) All of this legislation is meant to protect Czechoslovak businesses in order that they have a chance to survive and grow in this crucial initial phase of capitalism.

A securities act is also in the process of being prepared at the time of this writing. This act will provide for the establishment of a stock exchange, and will deal with requirements for trading, licenses for companies involved in trading, regulations, the keeping and handling of securities, and the supervision of the market. (Tesar and Kucera, 1991)

Yet another issue which the legislature will have to address is unemployment. In the next few years the unemployment rate is expected to rise sharply, and some predict that it may even hit a level of twenty-five percent because of the rapidity of privatization. (Sujan and Vesely, 1991) Unemployment, of course, is a problem to which the Czechoslovaks are not accustomed. Under communism reported unemployment rates in Czechoslovakia — as in most of the Eastern Europe communist countries — were very low, even though there was much hidden unemployment. Currently, the unemployment laws in Czechoslovakia provide for one year of unemployment benefits for jobless workers. Each unemployed citizen can receive sixty-five percent of his previous salary for the first six months of the year, and sixty percent of his previous salary for the next six months. (Sojka, "Labor Unions and Unemployment," 1991) If unemployment is going to rise as high as many have predicted, these unemployment benefits are going to be very difficult and costly for the government to provide.

The legislative agenda also includes plans for the eventual establishment of a constitutional court, the functional equivalent of the U.S. Supreme Court. However, the legislature fears that if such a court is established now, it could declare all of the present activity unconstitutional since a new democratic constitution

has not yet been written. Although to some this fear may seem groundless, the legislature has nevertheless delayed the establishment of this court until it has completed the drafting of the new constitution. (Mejstrik, August 5, 1991).

As can be seen, the bulk of the legislation so far has been directed towards economic issues, since this is the area that needs to be changed in order to facilitate the transition to a capitalist society. Not surprisingly, the civil code is also in need of extensive revision, but this task has been put on hold until the economic legislation is complete.

Conclusion

It is hoped that a smooth and successful transition from communism to capitalism takes place in Czechoslovakia; but considering the many problems that the new government must face, one must be cautious in assessing the chances for success. Among the many challenging problems Czechoslovakia faces, that of revising the legal system may perhaps be the most formidable.

It goes without saying that proper care must be taken in the writing of new legislation. A country needs stability in order to achieve economic success, and this stability must originate in its laws. If the laws are sound, then the transformation of the economy will occur all the more smoothly.

It is difficult to appreciate the enormity of the task which the Czechoslovak legislature faces. Yet, the legislature is also under pressure to draft new legislation as quickly as possible so that the transition to capitalism can occur rapidly. Perhaps it would have been better for the transition to have occurred at a less rapid pace, but only time will tell whether the decision which the Czechoslovak government has made was the correct one.

REFERENCES

- Ash, Nigel. "Starting from Scratch." *Euromoney*, June 1991, p. S19.
- Benacek, Vladimir. "Internationalization of Czechoslovak Markets." Presentation at the Center for Economic Research and Graduate Education, Prague, August 7, 1991.
- Bilek, Jiri. "Joint Ventures." Discussion at the Center for Economic Research and Graduate Education, Prague, August 7, 1991.
- Charap, Joshua and Dyba, Karel. "Transition to a Market Economy: The Case of Czechoslovakia." *European Economic Review*, April 1991, p. 581.
- Gafni, Jonathan. "Legal Aspects of the Transition." Discussion at the Center for Economic Research and Graduate Education, Prague, August 6, 1991.
- Holman, Richard L. "Prague Details Privatization." *The Wall Street Journal*, August 16, 1991, p. A4.
- Lelyveld, Michael S. "Czechoslovakian Property-Claims Law Kindles Disputes." *Journal of Commerce and Commercial*, February 28, 1991, p. 1A.
- Levy, Clifford J. "East Europeans in U.S. Reclaiming Lost Estates." *The New York Times*, August 13, 1991, p. A7.
- Mejstrik, Michael. "Conclusions." Discussion at the Center for Economic Research and Graduate Education, Prague, August 9, 1991.
- Mejstrik, Michael. "Macroeconomic Policy in Czechoslovakia." Paper presented at Charles University, Prague, August 5, 1991.
- Mejstrik, Michael. "Transition Measures and External Shocks in Czechoslovakia in 1991." Paper prepared for Comparative Systems Seminar at the London School of Economics, January 30, 1991.
- Mejstrik, Michael. "Transition to the Market and Privatization." Discussion at the Center for Economic Research and Graduate Education, Prague, August 5, 1991.
- Myant, Martin. *The Czechoslovak Economy 1948-1988*. New York: Cambridge University Press, 1989.
- Novak, Paul. "Entering the Market in Czechoslovakia: Perspectives for Western Europe." Discussion at Charles University, Prague, August 7, 1991.
- Rockwell, Keith M. "Czechs Launch Program to Privatize 50 State Enterprises This Year." *Journal of Commerce and Commercial*, June 14, 1991, p. 3A.
- Sojka, Milan. "Labor Unions and Unemployment." Discussion at Charles University, Prague, August 9, 1991.
- Sojka, Milan. "Effects of Transition on Individuals." Discussion at Charles University, Prague, August 9, 1991.
- Speck, Janet. Discussion at the United States Embassy, Prague, August 5, 1991.
- Sujan, Ivan and Vesely, Zdenek. "Current Economic and Business Trends in Czechoslovakia." Discussion at the Federal Statistical Office, Prague, August 6, 1991.
- Svoboda, Zdenek. Discussion with Association of Entrepreneurs, at Charles University, Prague, August 8, 1991.
- Teichova, Alice. *The Czechoslovak Economy 1918-1980*. New York: Routledge, 1988.
- Tesar, Vlastimil and Kucera, Miroslav. "Banking During and After the Transition." Discussion at Charles University, August 8, 1991.
- Tesar, Vlastimil and Kucera, Miroslav. "Capital Markets and Financing the Transition." Discussion at Charles University, Prague, August 8, 1991.
- Vydra, Anthony. "Accounting for the Transition: New Opportunities for Business in Czechoslovakia." Discussion at Charles University, Prague, August 5, 1991.