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# Czechoslovakia:

## Background Notes on the Housing Sector in a Reforming Economy

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## ECONOMIC AND DEMOGRAPHIC OVERVIEW

### *Demographic Trends*

Czechoslovakia's population is currently about 15.6 million. Population decreased as a result of boundary contractions after World War II and has grown slowly in the post-war period, increasing by roughly one-third in the thirty years between 1950 and 1980. The growth rate has eased further and is now well below replacement level.

However, the flat population masks the rapid expansion in Slovaki, a rural, less-industrialized region than the Czech Republic. The census shows that in the period 1970 to 1980 the population in Slovaki increased 10 percent but only 4.9 percent in the Czech Republic. This differential growth rates likely held in the 1980s and may become more important both politically and economically if the separatist tendencies persist.

Another important demographic tend is the declining average size of households over time. Between 1960 and 1980, the number of single-person households doubled and the number of households with five or more persons fell by 50 percent. The average household size in 1980 was 2.76 persons, down from 3.13 in 1960.

### *Economic Overview*[1]

#### Organizational Reforms

Czechoslovakia has indicated clearly its intention to move to a free market economy. Following the "velvet revolution," Czechoslovakia's reform efforts began slowly; a Czechoslovakian Academy of Sciences economist has stated , "People feel they are in a vacuum. The old system has been abolished and there is not yet a substitute."[2] However, reform efforts are now starting to move more quickly. With the national elections completed the government can concentrate on planning and implementing reforms.[3]

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1 Unless otherwise indicated economic data are from EIU (1989)

2 *New York Times*, July 1, 1990

3 On June 8 and 9 the Czechoslovakians elected members of the Federal Assembly. The Civic Forum—the coalition party which led the November 1989 movement—won a majority in the two branches of the Assembly. Vaclav Havel, leader of the Civic Forum and interim president, was elected President July 5, 1990.

The country's relatively analytical approach to reform has frustrated some investors. While this approach may foreshadow the role Czechoslovakia could play in Eastern Europe's transition—a reforming state following a middle course, not as aggressive as Poland or Hungary, but neither as passive as Romania or Bulgaria—this approach may also slow the adoption of needed, specific measures. Forces within the government have been debating the proper speed of change. Finance Minister Klaus has indicated concern about a "reform trap" and the proper sequencing for reform measures. Minister Tauber has spoken of "squeezing a decade of change into a few short months, even days".[4]

The issue of separation of a Czech and Slovak (Slovaki) republic is emerging as a reform factor. The separatist note is illustrated in the new name adopted for Czechoslovakia—the Czech and Slovak Federated Republic. Local elections which bear on governing independence and implementing economic programs follow in October.

Czechoslovakia's reforms over the past two decades follow a pattern typical for the Eastern Europe countries. Reforms liberalized some prices and established additional state-owned banks. Less successful reform efforts aspired to break-up monopolies, eliminate trade associations and institute worker election of state enterprise directors.

Czechoslovakia has announced its interest in EEC membership and has also led the drive to dismantle the Comecon Eastern bloc trading apparatus. The country applied January 15, 1990 for IMF and World Bank membership and has expressed a desire for technical assistance to support its reform efforts.

The question of the private-public mix of ownership and control is unresolved, but private property and private control will play a significant role in the reformed economy. The government has moved to start financial market reforms and is planning ways to increase private ownership. During the election the Civic Forum promised that some state enterprise leaders would remain.[5] The Forum has also announced it expects the government will establish a management system based on effort.

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4 *New York Times*, July 1, 1990.

5 In the elections communists received 13 percent of the vote.

**Private Sector**

Czechoslovakia has traditionally permitted private ownership of homes and family businesses (with no full-time employees). Business enterprises have been socially owned. But the rights of private ownership are being enlarged and private business enterprises legalized. Legal status was granted to privately held companies in February, 1990. As noted, the enterprises are now permitted to issue equity stock as well as bonds with fixed payments. The question of the mix of private and public property is not resolved. The new commercial banks created in January are owned by the state.

However, the government and the economy are moving toward privatization. The Czechoslovak government is discussing a program that would issue vouchers to individuals that would be used to purchase stock. In concept, this would lead to increased firm efficiency as equity owners monitor firm management and use the developing capital market to enforce their observations. The government plans to begin privatizing an initial bloc of 1,000 companies in the fall of 1990.

In addition Czechoslovakia is changing its commercial laws in order to attract added foreign investment. For example, Czechoslovakia guarantees repayment of investments under bilateral agreements. To date, the country has had only a few successes in attracting joint venture partners.

**Economic Performance**

In the early 1980s Czechoslovakia suffered an economic setback. A 1981-82 an austerity program reduced debt, but curtailed Czechoslovakia's technological and industrial capacity. The 1983-86 recovery did not boost exports, with the Soviets arguing that Czechoslovakia's goods are of poor quality. However, difficulties are more frequently blamed on Czechoslovakia's economic system. Whichever, the Czechoslovakian economy continues to have difficulties. Soviet demand for Czechoslovakian goods, particularly armaments, has fallen.

Eastern European countries and the Soviet Union have absorbed approximately 80 percent of the country's exports and that market is at jeopardy. But the long-term fundamentals of the Czechoslovakian economy appear sound and include:

— an educated workforce;

— a location between Austria and Germany;

— developed industrial sector;

— relatively low foreign debt.

Table 1 presents data on Czechoslovakia's economic performance. Real economic growth was positive in 1989; but Net Material Product (NMP) declined 0.8 percent compared to the preceding year growth rate of 2.6 percent.[6] Investment also dropped sharply. Preliminary data analyzed by the World Bank indicates a modest decline in living standards.

Table 2 (see the next page) presents data that describe the industrial composition of the economy, material product and employment by industry. Sixty percent of Czechoslovakia's net material output is industrial, the contribution of the other sectors' to material output is comparatively small. The concentration of output in this single sector does make the economy vulnerable. The employment data presented reveal that more than twenty percent of Czechoslovakia's employment was in a category which includes health, education, the arts, and public administration.

**Table 1**
**Domestic Economic Indicators**
(percent change from previous year)

| | 1987 | 1988 | 1989[a] | 1990[b] |
|---|---|---|---|---|
| Real NMP | 2.2 | 2.9 | 1.8 | 1.4 |
| Gross Fixed Investment | 3.8 | 4.5 | 1.0 | |
| Industrial output | 2.4 | 2.0 | 1.2 | |
| Consumer prices | 0.2 | 0.3 | 0.3 | |

[a] Estimated; [b] Projected

### Prices

Czechoslovakia indicates it will lift ceilings on most prices in the next year. Current inflation is modest, running at an annual rate of less than 10 percent. However, the Minister of Finance wants to avoid the situation Poland confronted in 1989 (70 percent per month inflation). A fundamental precept of Czechoslovakian

6 NMP is a national income measure similar to GDP, but accounts only the material value of output (i.e., NMP is equal to GDP less: excess value of non-material services (domestic and net imported); consumption of fixed capital; and transfer costs of existing fixed capital)—see United Nations (1986).

reform is to avoid inflation. The Czech notion is to create competition before eliminating price controls; the competition would then restrain inflation. The plan is to gradually remove price controls, first at the industrial level and second at the retail level. The government increased prices about 25 percent on 30,000 food items in July. Eliminating the subsidies saves an annual total of US$1.2 billion, and the government plans to distribute these on a per-capita basis (US$5.40 per month per person).[7] The government hopes to eliminate all price controls next year. Legislation will also impose a stiff tax penalty on companies that give wage increases above a 3 percent guideline.

**Table 2**
**1986 Sector Net Material Product, Employment and Population**

| | Percent NMP | Employment (thousands) | Employment (percent) |
|---|---|---|---|
| Agriculture | 8.0 | 1,000 | 13.0 |
| Industry | 59.8 | 2,875 | 37.3 |
| Construction | 10.7 | 680 | 8.8 |
| Transport | 5.1 | 514 | 6.7 |
| Trade | 13.4 | 820 | 10.6 |
| Others | 3.0 | 1,816 | 23.6 |
| Total Employment | | 7,705 | 100.0 |

**Fiscal**

Czechoslovakia has comparatively little foreign debt; foreign borrowing is less than US$4 billion. The head of the Central Bank has declared that Czechoslovakia should not borrow money which it does not need. Minister of Finance Klaus has stated that managerial ability and entrepreneurial capacity need to come before borrowing for development. Czechoslovakia wants US firms to invest and legislation has been advanced to attract foreign investment, particularly by those firms that export from Czechoslovakia. The objectives are to control inflation and build Czechoslovakia's capital market. Czechoslovakia also advocates free trade and went so far as to lead the drive to dismantle Comecon's Eastern bloc trading apparatus.

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7 *New York Times*, July 11, 1990.

The current government budget is tight and designed to control inflation, but the government is providing additional subsidies to consumers hard hit by inflation. Cash subsidies are planned to partially offset higher prices stemming from the elimination of some price controls; one example is in food purchases, noted above.

The government is also beginning to sell bonds secured by the new commercial banks; the first issue is small (CsK150,000) and is set for July. The bonds are intended to soak up liquidity as well as provide a start in making the banks accountable as they rely on the capital market for funds.

The government has announced that early next year it will make the currency convertible. This policy is intended to attract foreign investment and increase trade. However, the policy will also open up the economy to foreign competition and so it is a good indicator of Czechoslovakia's commitment to free trade and free markets.

**Financial and Banking System**

The Soviets dismantled Czechoslovakia's financial institutions after World War II. The prewar Czechoslovakian financial system had been sophisticated. The system had a central bank, commercial banks, smaller local banks and financial intermediaries—insurance companies, investment houses, large banks and brokerage firms.

The postwar Czechoslovakian banking system was restructured to provide the investment, distribution, and monitoring network needed to operate a centrally planned economy. Prior to January, 1990 the banking system had consisted of a central bank (Statni State Bank), an investment bank (Investicni), a foreign operations bank, a commercial bank (created from nationalized banks), and state savings banks in each of the two republics. The investment bank, acting as an arm of the central bank, supervised investments by state enterprises.

In January, 1990 the Czechoslovakian banking system was reorganized. The Statni Bank Czechoslovaki, the central bank, was stripped of its five commercial divisions. The bank will be involved only in traditional central bank activities—implementing monetary policies (e.g., interest rates and the money supply) and regulating banking institutions. The central bank is not independent.

Commercial operations are to be conducted by two state owned banks also created in January 1990. The two new state-owned banks were authorized in order to encourage financial competition. The two commercial banks, one in each republic, are authorized to issue and sell domestic bonds; one, the Komercni Bank, is beginning with a CsK150,000 issue in July. The bond issues are an effort to build financial capital markets and also are anti-inflationary measures.

These banking establishments provide a start. But a competitive financial market complete with secondary markets and intermediaries is also needed in order to create markets that efficiently allocate resources.

Czechoslovakia understands the need; the country has expressed a desire and need for technical assistance to overcome the absence of financial institutions, and knowledgeable staff and customers. For example, Czechoslovakia has virtually no experience issuing and rating simple home mortgages. The World Bank plans to fund technical assistance and demonstrations of financial activity in Czechoslovakia.

## THE HOUSING SECTOR

The housing sector in Czechoslovakia faces problems similar to those found in other centrally planned economies (CPEs): an inability to overcome persistent housing deficits; declining productivity and production which cannot adapt to changing household demand; and large subsidies for both home purchase and rental units. To date, only minor reforms have touched the housing sector.

In terms of scale relative to the overall economy, the housing sector in Czechoslovakia is one of the smallest in Eastern Europe. In the 1980s, housing investment in the country has fallen from 4.4 percent of NMP in 1980 to 3.4 percent of NMP in 1987 (see Table 3 on next page). Only the German Democratic Republic and Romania showed lower levels of activity. On the investment side, Czechoslovakia ranks about in the middle of East European countries. Investment in housing represented 12.5 percent of total investment in 1985 (down from 13.2 percent in 1980), about half the level in Poland and Hungary, but also about 50 percent higher than in Romania. By 1987, housing's share in total investment had declined even further to 11.9 percent.[8]

In 1985, housing accounted for about one third of the output of the construction sector, which made up 10.9 percent of NMP (EIU, 1989). This reflected the Government of Czechoslovakia's (GOC) strategy of continued heavy investment in industry. Productivity in the sector, based on the number of units

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8 Data for 1980-85 are from United Nations (1987); figures for 1987 are from United Nations (1989a).

constructed and the real flow of resources into the housing sector, has fallen by about 21 percent during 1980-85. One explanation for the fall in productivity is the steady flow of skilled labor out of the construction sector and into sectors given priority by the GOC and paying higher wages (such as chemicals and non-ferrous metals).

**Table 3**
**Housing Investment and Production**

| | 1980 | 1985 | 1987 |
|---|---|---|---|
| Housing Investment (percent): | | | |
| in Net Material Product | 4.4 | 3.7 | 3.4 |
| in Total Investment | 13.2 | 12.5 | 11.9 |
| Housing Stock (millions) | 5.29 | 5.69 | 5.81 |
| Housing Production (thousands) | 128.8 | 104.4 | 79.6 |
| Production by (percent): | | | |
| Public sector | 40.4 | 24.9 | 27.8 |
| Cooperatives | 38.6 | 54.4 | 47.9 |
| Private | 21.0 | 20.7 | 24.3 |

Source: United Nations (1989a).

### *Housing Production and Delivery*

#### Housing Stock and Production

The 1980 census of housing registered 4.9 million occupied dwellings in Czechoslovakia (ECE Committee, 1987). The average age of the housing stock was 34.5 years—down from the 45.5 years recorded in 1970 as a result of the high levels of production in the early 1970s. Ownership of housing in 1980 was about evenly split between individual owners and public sector owners (such as local housing authorities—known as National Committees—and state-sponsored cooperatives); 49.7 percent and 50.2 percent, respectively.[9] The composition of the stock is also about evenly split between one- and two-family units (49.5 percent) and multi-family dwellings (50.5 percent).

[9] The remaining 0.1 percent are owned by foreign citizens and other non-state organizations.

Annual housing production (new construction) has declined relentlessly since 1975, when the state sector constructed 144,700 units (Miskiewicz, 1986). In 1985, total annual production was 104,400 units and by 1988, it had fallen to 82,900 units (see Table 3). By any measure, this is a very low level of production: the 1985 level represents only 2.0 percent of the housing stock (at that time) of 5.7 million units; it also only accounts for two thirds the number of new households formed in Czechoslovakia (through marriage and divorce) that year (United Nations, 1987).

The combination of declining housing production, a high loss rate in the housing stock, an increasing rate of household formation, and a shrinking average household size implies that the housing shortage is probably getting worse. Another factor adding pressure on the housing sector is the increase in money incomes of most households, which creates increased interest in home-ownership and adds demand for higher quality units.

The 1980 census reported that the number of households exceeded the number of existing housing units by 98,000. However, this simple measure understates the actual shortage. In terms of occupied units, the number of households without dwellings of their own is 466,000 (ECE Committee, 1987). The difference is explained mainly by the mismatch between households and the housing stock in rural and urban areas. In rural areas, the number of dwellings is sufficient; in urban areas (especially large towns and industrial centers), the housing shortage is acute. The expansion of the housing stock in urban areas is also hindered by a shortage of capacity and investment funds for the expansion of central heating systems and water supply.

The average waiting time for a unit in 1985 was about 5 years (United Nations, 1987); this has probably lengthened with lower levels of production. Worse, the shortfall in housing production is understated by the previous measures, since it does not take into account the very high rate of demolition and retirement of units from the stock nor the high level of substandard units.

In 1986, it was estimated that about 20,000 units were lost annually and that a total of 220,000 were uninhabitable or slated for demolition. Overall trends indicate improved levels of quality in housing—a rise in the average floor space per unit from 39.2 square meters in 1970 to 43.8 square meters in 1980; a fall in the average number of occupants per unit from 3.4 to 3.1 during the same time period;

and a rise in the proportion of units with three or more rooms (not including kitchens and bathrooms) from 30.6 percent in 1970 to 45.8 percent in 1980. However, a large share of the housing stock is crowded and lacks basic amenities. For example, in 1980, over 40 percent of households had less than 8 square meters of floor space per person and 1.2 million units (about one quarter of the stock) had no toilet facilities within the unit. In addition, many large scale housing developments have been constructed in recent years without sufficient supporting infrastructure. In Bratislava, for example, dormitory communities have been constructed which house over 100,000 persons, but which lack adequate transport and roads, health clinics, and shopping facilities (Miskiewicz, 1986).

**Construction and Building Materials Industry**

Housing production in Czechoslovakia, like most other East European countries, is split between the state, state-owned enterprises (SOEs), cooperatives, and private individuals. Since the mid-1970s, the production has been shifting away from SOEs and towards cooperatives: SOEs' share of production has fallen from 24 percent in 1975 to 8 percent in 1982; in the same period, the share of production by cooperatives rose from 27 percent to 41 percent (rising further to 48 percent in 1987).[10] The shares of production by the state (including SOEs) has fallen from 40 percent in 1980 to 28 percent in 1987. Production by private households has edged up slightly in the same period, from 21 percent to 24 percent of the total (United Nations, 1989a).

A total of 65 SOEs, ranging in size from 100 to 9,000 employees, controlled by the Ministry of Building Construction accounted for 62 percent of all building construction work carried out in 1985 (ECE Committee, 1987). About 90 percent of housing built by SOEs uses pre-fabricated, large-panel construction technology. As in other CPEs where this method is used, this requires that state-built housing be developed near the pre-fabrication factories and that several hundred (or more) units be constructed on a single large site to capture the technology's economies of scale.

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10 In Czechoslovakia, cooperatives may act either as a developer (contracting with a SOE to provide construction services) or a developer/constructor (whereby the cooperative undertakes the construction work itself without reliance on state construction enterprises or private firms). Most cooperatives are apparently organized primarily as construction units which members join in order to gain improved access to housing (i.e., the queue is shorter than for state rental housing, but the household bears a larger share of the costs).

However, these systems have not been effective in Czechoslovakia in achieving their scale economies or producing housing which meets household demand. The SOEs do not face suitable incentive structures for the timely completion of projects or adequate quality control. Poor quality components require expensive and labor-intensive on-site repair and finishing work to compete construction of the units. Households complain that the units do not respond to their needs (particularly with respect to amenities such as heating and ventilation).

In 1982, cooperatives counted just over 1 million members and had produced about 700,000 units (or 15 percent of the housing stock). GOC policy changes in 1982 called for cooperatives to replace enterprises as producers of housing, mainly because of misallocation and speculation in SOE-produced housing. To a certain extent, cooperatives have improved the performance of the housing delivery system; a young couple can often obtain a unit within 2 to 3 years (Blaha, 1984). However, cooperatives, because of their decentralized nature and difficulties with access to materials, have proved to be far from efficient.

Private construction firms apparently account for only a small part of recorded construction activity—official statistics state that almost all construction activity outside SOEs is carried out by other construction units controlled by central government ministries or by local government and by co-operative building corporations. Thus, private construction activity is probably very small in scale and confined to the "second" economy outside the control of the central planning apparatus or takes the form of household self-help.

Construction sponsored by private individuals remains a significant proportion of construction, but has not been a readily available alternative for most of the population. Labor and building materials were often in short supply. Although the law allows households to "borrow" construction equipment (while paying for costs associated with its use) from SOEs as long as the enterprise's production activities were not hindered, in practice this has been difficult. The law also provides for local authorities to "guarantee" access by households building units privately to 23 basic building materials, though it is not clear how well this program has functioned (Blaha, 1984).

**Housing Allocation and Tenure**

Rental units in state-owned blocks are intended to be assigned to the most socially disadvantaged citizens, but misallocation of these flats has been widespread

(Pisova, 1990). Since 1966, the GOC has made state rental housing available for sale, although it was not until 1978 that sales could go ahead without the concurrence of *all* tenants in the building. In 1984, the most prized apartments in city centers (though often lacking modern comforts) were selling for CsK100,000 (about US$15,000).[11] More modern units of moderate size (about 2 to 3 rooms), in better condition, sold for CsK200,000 (US$30,000). Of course, demand always far exceeded supply.[12]

Czechoslovakia has permitted individual ownership of homes and apartments. An individual can own one residence and one vacation home. Owners can buy and sell homes in the private market. Land for private housing construction has been available from both local authorities and private landowners. Land (up to 800 square meters) could be purchased from the state at a cost ranging from CsK4 to CsK15 (US$0.60 to US$2.30) per square meter, depending on the location. About a third of private housing constructed in 1985 were built on land obtained—apparently on a free-market basis—from private landowners or on family-owned land (Blaha, 1984).

### *Housing Finance*

#### Rental Housing

Flats constructed by the state are financed entirely out of the government budget. In 1985, GOC outlays to support state-sector construction of housing and supporting residential infrastructure totalled CsK14.5 billion—2.6 percent of NMP (ECE Committee, 1987). Rents in state and enterprise housing are fixed according to floor area and amenities (but not location) and have not been changed since 1964. Further progressive rent reductions ranging from 5 to 50 percent are available according to the number of children in the household. Additional rent subsidies are also provided to students, apprentices, the elderly, and disabled persons.

Low rents and ineffective management of state housing has forced the GOC to continually provide funds to subsidize operating expenses. About 60 percent of all recurrent costs for state rental housing are funded out of the state budget

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11 US dollar equivalents are given based on the official exchange rate for the year quoted.

12 Blaha (1984) is unclear as to whether these are market-driven or administratively-set prices.

(Pisova, 1990). These subsidies represent 20 percent of all public sector on-budget spending on housing and were equal to 1.0 percent of NMP in 1985 (ECE Committce, 1987).

Despite these subsidies, most blocks of flats are in poor condition as public funding for the housing sector was mainly devoted to new construction, neglecting repair and maintenance, as were necessary building materials and skilled craftsmen. It is currently estimated that CsK30 billion (US$1.8 billion or about 4.9 percent of 1989 NMP) is required for necessary repairs to the state-owned housing stock (Pisova, 1990). The repair bill is likely to climb over time as further defects emerge in recently constructed blocks which utilize pre-fabrication technology.

**Finance for Home Purchase**

As part of the shift in policy away from state-provided housing, programs were adopted to provide subsidies in order to move families into the homes and cooperatives. In 1985, about CsK6.1 billion (1.1 percent of NMP) was spent on direct capital subsidies supporting cooperative and individual housing construction. (Indirect subsidies provided through very low-interest mortgages have not been estimated.)

Subsidy programs were offered based on the purchase price and a sliding need-based scale (Pisova, 1990):

— Private construction: 40-year loan at 2.7 percent annual interest from state bank (with 10 years grace) for CsK120,000 (about US$7,700 in 1989), about 30 percent of the cost of an average unit;

— Cooperatives: 40 to 50 percent of construction cost financed through 40-year loan at 1.0 percent annual interest loan from the state—cooperative members agree to provide between 2,500 and 3,000 hours of work for the cooperative on the housing site;

In addition, employees of SOEs in priority sectors may qualify for additional support in the purchase of a cooperative housing unit or interest-free loans for housing built by the SOE itself. Subsidized loans are available for up to 100 percent of the construction cost for workers in nuclear and non-ferrous metal industries. Workers in other industries, such as heavy chemicals, ceramics and glass, and metallurgy, can receive subsidized loans for up to 75 percent of the cost of the unit.

Mortgages have in the past been offered through institutions such as the

Slovenska State Savings Bank (similar to a savings and loan institution); however, with virtually no price and risk rationing. Banking reform might convert the Slovenska State Savings Bank into an organization to lend with home mortgages. The bank's function has been to hold the people's savings, similar to a savings bank. The bank's targeted client base is individuals and small enterprises.

These extensive subsidies mean that households, on average, devote a very small part of their net disposable income to housing. A 1985 survey found that industrial workers spent only 2.1 percent of their income on housing (rent or loan repayments). A further 5.1 percent is spent on utilities, such as water, heat, electricity, gas (ECE Committee, 1987).

***Future Directions in Housing Reforms***

Czechoslovakia currently lags behind Poland and Hungary in its reform process. However, discussions are now under way to develop a new housing policy which addresses some of the problems facing the sector. Pisova (1990) reports that, unlike Poland, Czechoslovakia is likely to follow a gradualist approach, with the transition period lasting through 1993-95. Key areas of reform will include:

- Redefined property relations allowing additional forms of property ownership and leasehold with considerations for tenant rights;
- Reform of public sector financing for the housing sector, including rents, operating subsidies, and lending;
- Privatization of both housing and the construction industry.

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