

DEVELOPMENT OF THE EXCHANGE RATE OF THE CZECHOSLOVAK KORUNA

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The world economy has been going through a complicated development in the past decades. The international economic environment is constantly changing. One of the reasons of these changes was the crisis of the Bretton-Woods monetary system and the formation of the new Kingston monetary system. The start and progress of political, economic, and social reforms in the former Socialist countries of Europe is playing an important role in the world. While the Bretton-Wood monetary system ensured stability in the area of exchange rates, its collapse in 1971 had brought a fundamental change in the exchange rate policy. Formerly fixed exchange rates (within certain fluctuation bands) gradually became freely floating and their mutual relations began to be determined on international foreign exchange markets.

Exchange rates play an important role in the economy of every country. Development of exchange rates is influenced by a number of factors, such as capital influx and outflow, export and import of goods and services, external purchase power of the local currency. Changes of exchange rates of national currencies have a significant effect on the local economy, but also on external exchange relations. For this reason a majority of countries have not left the exchange rate of their national currency only up to the influence of market forces, but in some cases they intervene within a chosen monetary policy. Primarily in countries with a high degree of openness, exchange rate changes have a notable effect on their economy.

The Slovak Republic started to develop market economy only a few years ago, whereby the exchange rate has played a significant role. In the first years of transformation it helped to create a stable economic environment that was necessary during a comprehensive reform of the national economy.

The integration process of the Slovak Republic into a united Europe got into a stage, when integration and membership are no longer a matter of choice but reality in itself. With the entry of Slovakia into the European Union on May 1, 2004, we are getting into the next development stage and therefore the need arises to deal with entry into the Economic and Monetary Union (EMU). Entry into the monetary union after successful completion of the integration process should be a logical culmination of the whole process.

However, the question remains of determining the optimum timing of entry. Assessing this question, it is necessary to deal with preparedness of the Slovak Republic to introduce the single European currency and at the same time maintain stability of the economic environment and competitiveness of the Slovak economy.

A brief overview below of the development of our exchange rate enables us to understand the conditions under which the Slovak koruna was created, whereby it shows the complexities of determining the exchange rate of the Czechoslovak koruna in the period of centrally planned economy until the establishment of independent Slovak Republic in 1993.

Development of the Exchange Rate of the Czechoslovak Koruna from 1945 to 1988

Only solidification of state power following liberation enabled renewing the Czechoslovak currency and thus create conditions for formulating and implementing a monetary policy. After the Second World War it was necessary to carry out monetary reform, the need for which ensued from disintegration of the currency. It was above all necessary to overcome chaos with currency in circulation, when on the territory of the liberated country, in use were Czech "Protectorate" koruna, Slovak koruna, Deutsche Reich marks, Hungarian pengő, and Polish zloty. These were currencies linked with other money issuing policies, and they had their own exchange rate. We can further add to this number of currencies koruna vouchers that, based on a decision of the Czechoslovak Monetary Office established by a decree of the president of the republic of November 1945 in London, were printed in Moscow, and from the beginning of 1945 got into circulation during liberation of the republic in eastern Slovakia as a legal tender of the Soviet and the Czechoslovak armies and the Czechoslovak authorities. Slovakia was under the influence Germany during the Second World War, whereby a disadvantageous exchange rate of its koruna to German marks was used in their mutual payments. A significant surplus of money existed that caused major inflation pressure and the currency was harmed by events of the war. The need to put foreign exchange relations in order



has led to monetary reform that gradually began to create preconditions for recovery of the monetary system of the Czechoslovak Republic.

The monetary reform carried out in November 1945 was the fourth to have been undertaken on our territory. Its priority was to harmonize the quantity of money in circulation with the economic need for money. A unified currency – the Czechoslovak koruna – was established from November 1, 1945 (until then there were two monetary areas, the area of the Czech and Slovak koruna). It replaced the currencies that have been in circulation on our territory at a ratio of 1:1. A new official exchange rate of the Czechoslovak koruna was set in the relation of 50 CSK/USD. This exchange rate expressed war depreciation of the currency toward other currencies. The exchange rate of our currency depreciated by 74.3 percent compared with 1937, when the US dollar was exchanged at a rate of 28.65 CSK/USD. The exchange rate of the koruna was also set toward the British pound at 200 CSK/GBP. The oscillation band was set at ± 2 percent. This exchange rate was determined based on comparisons of price levels in Czechoslovakia and in four developed countries (Switzerland, USA, Great Britain, and Sweden). From this ratio the currency parity of the koruna was derived, which was 1 CSK = 0.0177734 grams of pure gold. Gold content of the national currency unit had so far not been defined. In 1946, the International Monetary Fund adopted the currency parity of the Czechoslovak koruna of 50:1 with the possibility of fluctuation of ± 1 percent.

The outcome of this reform can be summarized in four points:

1. short-term and relative stable currency in the years 1945 to 1946,
2. convertibility of the Czechoslovak koruna at a ratio of 50 CSK/USD,
3. fixed exchange rate regime,
4. unification of currency circulation.

However, the monetary reform of 1945 did not ensure a permanently stable exchange rate that would be a suitable basis for successful economic development. These goals should have been achieved by the second monetary reform after the Second World War.

In 1953, the second monetary reform was undertaken, which drew on experiences from the monetary reform in the Soviet Union in 1947. In this period, there was a marked difference between the price level in the country and in the world, which showed that the set exchange rate was not realistic. The aim of this monetary reform was to strengthen the position of the Czechoslovak koruna and increase its purchase

power. The results of the reform were the following exchange rate changes:

1. gold content of the Czechoslovak koruna was set at 0.123426 grams of pure gold, and thereby the koruna ceased to be dependent on USD parity,
2. a fixed exchange rate was set of the Czechoslovak koruna toward the Soviet ruble of 1.8 CSK/SUR. Later in 1961, when the gold content of SUR increased to 0.987412 grams of pure gold the exchange rate was adjusted to 8 CSK/SUR.

Gold content of the Czechoslovak koruna until 1953 was 0.017734 grams and after 1953 it was 0.123426 grams of pure gold, which represents an increase of the gold content 6.94-times. The exchange rate of the Czechoslovak koruna toward the US dollar was adjusted to 7.2 CSK/USD (50 CSK : 6.94 = 7.2). Setting the exchange rate at this level was explained stating that internal wholesale prices are expected to decline as a result of growing labor productivity, and this should have restored a balance between the official exchange rate and the purchase power. Ultimately, this exchange rate was firmly maintained until 1973. It neither reflected differing development of prices of goods and services here and abroad nor was it influenced by development of foreign trade. In the monetary area, together with the introduction of a foreign trade monopoly and a foreign exchange monopoly, this meant creating conditions for the detachment of local economic entities from parameters of the world market. Strong inflation pressures gradually began to arise. The foreign exchange monopoly weakened the interconnection of our economy, which led to reduced competitiveness of our goods and services abroad.

All the way until 1966, results of foreign trade were not projected in economic results of businesses. Internal wholesale prices did not reflect the level and development of world prices. Goods destined for export were purchased from companies for internal wholesale prices, whereby to calculate foreign exchange revenue from export, a so-called official exchange rate was used determined for a foreign trade company. This official exchange rate did not allow direct comparisons of our costs and prices with foreign prices. This exchange rate did not fulfill one of its basic functions, the function of a measure of values and a measure of prices, which caused that the condition of foreign trade of companies could not be effectively evaluated.

In 1967, measures were gradually implemented to make the exchange rate of the Czechoslovak koruna

¹ Commercial payments represent a settlement of claims and obligations and other transfers of finances in direct or indirect connection with foreign trade operations.

² Noncommercial payments are not linked with foreign trade operations.

more realistic. A method started to be used of determining the exchange rates on the basis of reproductive costs of exports to two currency areas, i.e., the US dollar and the Soviet ruble. Mutually interconnected exchange rate-budgetary instruments were introduced:

1. internal reproductive price adjustment,
2. rectification,
3. price discounts and surcharges to official exchange rates for commercial payments to convertible currencies,
4. separately set exchange rates for socialist countries.

Internal Reproductive Price Adjustment

Introduction of this method enabled adjusting the official exchange rate by a surcharge. Originally, this measure was introduced only temporarily but later it defended its existence as a permanent phenomenon. An exchange rate coefficient was set separately for the Soviet ruble and separately for convertible currencies. It was set based on average reproductive costs of export to earn a unit of foreign currency. For the Soviet ruble area, the rate was set of +125 percent to the official exchange rate, whereby the exchange rate including the coefficient represented 18 CSK/SUR. This rate was not constant. Internal reproductive price adjustment was different for commercial¹ and non-commercial² payments and it was also different for socialist and non-socialist countries. The individual coefficients were as follows:

- Commercial payments – for the area of socialist countries, the coefficient was set at 2.25, which represented increasing the exchange rate by 125 percent. In relation to the Soviet ruble the exchange rate had the value of 8 CSK times 2.55 = 18 CSK (18 CSK/SUR). For the area of non-socialist countries the coefficient was 3.75, i.e., 275 percent to the previous exchange rate. Following this adjustment the US dollar had a value of 7.2 CSK times 3.75 = 27 CSK/USD.

- Noncommercial payments – for the area of socialist countries, the coefficients were set with regard to purchase power parity. For example the exchange rate of the koruna to the Soviet ruble was 10 CSK/SUR. For the area of non-socialist countries, a surcharge was set of 75 percent and additionally for tourism additional +125 percent. Then the exchange rate of the US dollar was for example 1 USD = 6.15 + 75 percent + 125 percent; i.e., 24.21 CSK/USD.

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Exchange Rate Coefficients for Commercial Payments

Year	Official exchange rate		Internal reproductive price adjustment rate	
	USD	SUR	USD	SUR
1967	7.20	8.00	3.75	2.25
1971	6.63	8.00	3.75	2.25
1973	5.92	8.00	3.75	2.25
1977	5.92	8.00	2.65	1.85
1981	5.92	8.00	2.25	1.50
1983	5.92	8.00	2.25	1.40
1984	5.92	8.00	2.50	1.40
1988	5.92	8.00	2.70	1.30

Source: Bankovníctvi, 13/1997

The aim of this instrument was to take into account foreign prices in relation to the internal economy. The exchange rate of the Czechoslovak koruna was derived from the golden parity, and it was adjusted by coefficients, whereby it got more realistic values in relation to foreign countries.

Rectification

Rectification represented increasing or decreasing the unified rate of the internal reproductive price adjustment for individual currency areas, where payment and settlement contact is regulated on a clearing basis in accordance with short-term fluctuations.

The exchange rate of the Czechoslovak koruna was divided to two types of exchange rates, for commercial and noncommercial payments.

The exchange rate for commercial payments was derived from wholesale prices of exported goods and their foreign prices. A decisive part of export headed to counties of the COMECON. The exchange rate did not correspond to purchase power parity, convertible currencies, or the relation of demand and offer for these currencies. The exchange rate was set at 27 CSK/USD. This exchange rate was later subject to administrative adjustments.

The exchange rate for noncommercial payments was introduced to express more favorably the internal purchase power parity toward foreign currencies. Its level was derived from the parity of local retail prices and from a selected basket of consumer goods and services. The exchange rate was practically determined administratively. Following the devaluation of the US dollar in 1973, the exchange rate of the Czechoslovak koruna temporarily depreciated but it gradually began to return to its previous level.

A so-called tourist exchange rate was derived from the exchange rate of noncommercial payments. The



following relation was used to determine the exchange rate:

$$5 \text{ CSK} = 1 \text{ TK}^3 \text{ and } 7 \text{ TK} = 1 \text{ USD} \\ \text{from that } 1 \text{ USD} = 35 \text{ CSK}$$

In 1989 this relation was adjusted to the following values:

$$3.5 \text{ CSK} = 1 \text{ TK} \text{ and } 9 \text{ TK} = 1 \text{ USD} \\ \text{from that } 1 \text{ USD} = 31.50 \text{ CSK}$$

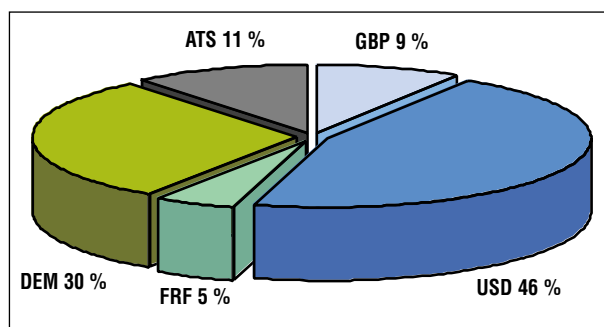
This exchange rate level represented the official exchange rate. Apart from this there existed a black market exchange rate and its level was adjusted based on black market demand and offer.

Until the end of the 1970s, the balance of payments deficit of the Czechoslovak Socialist Republic continued to deepen in convertible rubles and convertible currencies. The effort to restore a balance between convertible foreign exchange resources and needs after 1980 was accompanied by a decline of effectiveness of exports and declining foreign trade in relation to capitalist countries.

In the 1980s, the exchange rate of the Czechoslo-

vak koruna was overvalued toward non-socialist currencies. In 1981, the State Bank of Czechoslovakia began using the method of a currency basket with the aim of reflecting mutual exchange rates of convertible currencies into the exchange rate of the Czechoslovak koruna toward these currencies. The first currency basket had five components with the following weights: 0.4583 USD; 0.2978 DEM; 0.1065 ATS; 0.0906 GBP, and 0.0468 FRF. In connection with this development, the need has arisen to replace the two-component exchange rate by a one-component exchange rate.

Currency basket of the CSK in 1981



³ The abbreviation TK was used for TUZEX koruna.

To be continued in Volume 2/2004