

EU membership and the rise of a foreign-led type of capitalism in the Czech Republic

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Abstract

During the last few years several attempts have been made to introduce the Varieties of Capitalism approach in Central and Eastern Europe. We find references to either the Anglo-Saxon or the continental European model of corporate governance being adopted in this region. This paper argues that we are not witnessing convergence to either one of these models, but rather the rise of a specific type of capitalism in Central and Eastern Europe.

This paper focuses on the Czech Republic in which -just like in other countries in the region- foreign investment plays a crucial role. The political and economic developments of transition have led to a situation in which foreign banks and corporations own a large part of the Czech economy. These actors fundamentally influence corporate governance regulation.

The paper turns its focus on the role of the EU in the establishment of this economic regulation. It argues that securing foreign investors an equal opportunity to invest has been a key issue on its agenda and that the successful attempt to influence the lock-in of newly established property rights through corporate governance regulation is an important illustration of this desire.

Introduction

No indent The choice for rapid privatisation in Eastern Central Europe (ECE) was first of all a political one, based on the neo-liberal assumption that states are not competent in (re-)organising the economy and that this task should better be left to market forces; and the fear that delay would lead to unfair insider privatisation. The choice for rapid privatisation also implied that all governance issues were left to the new owners of former state companies. However, the lack of adequate rules of ownership hindered the lock-in of newly established property rights and hence caused serious economic problems, such as the lack of corporate control. The treatment of these problems, just like the choice for rapid privatisation, has primarily been of a political nature rather than purely economic. The distribution of power between different stakeholders (shareholders, management, employers and the state to name a few) within corporations is an issue, which is essentially politically contested. However, in most of the existing literature on corporate governance in ECE, this issue is hardly discussed in this way. Rather, the focus has so far been on economic efficiency and legal effectiveness. This is reflected in the way in which the concept is defined. Most scholars focus on only one aspect, namely the question ‘how investors get the managers to give them back their money’ (Shleifer and Vishny 1996: 4). However, this approach neglects that also other stakeholders, such as employees, society as a whole and the state are players in the discussion over corporate governance. Corporate governance can therefore better be defined as ‘the relationship among stakeholders in the process of decision making and control over firm resources (with the firm itself defined as a collection of resources embedded in a network of relationships among stakeholders)’ (Aguilera and Jackson 2003: 450). The explicit reference to the process of decision-making and control over firm resources is directly related to the issues of power and thus the question of ‘who gets what, when and how’ (Lasswell 1936). The political struggle over the kind of regulation that is emerging in ECE is widely overlooked.

Where issues of power and politics have been raised, it has been done so in a national context focussing upon national public and private actors. This leads to a second neglect in the current work on economic transition in ECE: the role of transnational actors in this process is either neglected or downplayed. However this is an incorrect representation of the current developments in ECE. The task of

developing a new institutional system from scratch has attracted considerable attention from international actors that considered ECE as a ‘testing ground’ for several new policies (Deacon e.a. 1997: 149). Where national institutions were in flux during the 1990s transnational actors indeed played an important role in the establishment of the new institutional setting. Their role in the transition process is theoretically underdeveloped; the autonomy of national politics is implicitly taken for granted.

In this paper I want to make a first attempt to fill these two vacuums within the political economy of ECE. What this paper sets out to do is to discuss the changes in corporate governance regulation during the last few years from a transnational political economy perspective. In its empirical account, the focus will be on the influence of the Czech accession to the European Union (EU) on the development of corporate governance regulation. I have chosen the latter case because here corporate governance issues have been of special economic and political interest after the economic recession during the second half of the 1990s. In these discussions the accession played an important role. In 1999, the Commission criticised the Czech achievements in this field and labelled the financial system a ‘key weakness of the Czech economy,’ explicitly referring to the lack of adequate corporate governance regulation (Commission 1999: 24). In several reports, it addressed the question of state owned and controlled banks as a vital problem for good corporate governance and pressed the Czech government to privatise the banking sector (Commission 1997, 1999). In this sense, the Czech Republic constitutes the clearest example of EU involvement in the field of corporate governance regulation.

This paper is divided into three sections. I start by giving an outlook on the broader discussion of what type of capitalism is emerging in the Czech Republic. I will argue that the *Variety of Capitalism* approach (VoC) does not provide a concrete answer to the question what type of capitalism is being brought about in the transition process, because it fails to grasp the transnational context in which national economies function. In the case of ECE, it therefore neglects the fact that countries do not have full political independence to choose between different policies. The political and economic developments of transition have led to a situation in which foreign banks and corporations own a large part of the Czech economy, so that the organisation of corporate governance is not a question of regulation by the national government but rather an issue that is being imported by corporation procedures. I

argue that what we are witnessing in the Czech Republic is a foreign-led type of capitalism. Section two discusses the specific role of corporate governance issues in ECE and their appearance on the political agenda. During the second half of the 1990s the initial emphasis on privatisation shifted towards ‘reforming the reform’ (Dragneva and Simons 2001: 94), i.e. the institutional underpinnings of the transition process. Problems that had arisen from the initial legislation were reconsidered and readdressed, in order to make the region more attractive for foreign direct investment (FDI). Section three then deals with an empirical account of the political struggles over these issues in the Czech Republic in the face of EU accession from the late 1990 until the early 2000s.

On the type of capitalism in the Czech Republic

In the last years, the *Varieties of Capitalism* approach (VoC) has attracted increased attention within the field of political economy. Departing from an interest ‘in the differences in economic and political institutions that occur across countries’ (Hall and Soskice 2001: 1), a variety of scholars has set out to describe and characterise the different types of capitalism throughout the world. Issues of corporate governance constitute a vital role in this debate as the discussion between the different types of capitalism is centred on the question what ‘the ultimate role and purpose of the company in a capitalist society’ (Albert 1991: 13) is. In most of the literature two types of capitalism are discerned. On the one hand there is the so-called Rhineland model (Albert 1991) or coordinated market economy (Hall and Soskice 2001) that is characterised by substantial governmental influence in the national economy. While pursuing industrial and macro-economic policies governments directly influence the behaviour of major players in their economies. With regard to corporate governance this model is characterised by cross-ownership and an important role of banks in the provision of investment capital. Stock markets play a subordinated role. Corporations are regarded as complex entities in which various stakeholders have an interest, resulting in strategic planning, employment security and high-quality production strategies and thus a long-term outlook. In Anglo-Saxon model or liberal market economies, on the other hand, governments tend to keep companies at an arm’s length as they see their primary task in providing a functioning market in which the different corporations can compete. Corporations are seen merely as a property of their owners,

in most cases the shareholders. The corporation's value at the stock market is seen as the decisive indicator of its success and its health as it most effectively demonstrates the returns on invested financial capital (Rubach and Seborá 1998: 169). Following from this view, the focus of the corporations is on pleasing shareholders, resulting in a short-term outlook. As corporations in the Anglo-Saxon model depend highly on the stock market as means to gather finance, this encourages 'firms to be attentive to current earnings and the price of their share on equity markets' (Hall and Soskice 2001: 27).

During the last years several attempts have been made to categorise the emerging forms of capitalism in ECE in one of these varieties, either implicitly or explicitly (see for instance Lane 2000 for Russia; Buchen 2004 for Slovenia and Estonia). This is no different in the case of the Czech Republic. Here, however, analyses tend to differ quite substantially. In 1992 David Stark predicted a tendency towards Anglo-American capitalism with a strong focus on 'raising investment funds through markets' instead of the more "European" solution of bank monitoring (Stark 1992: 36). The Czech privatisation has been the most 'marketised' form of privatisation in the region and in this respect comes closest to an Anglo-Saxon form of capitalism in the sense of popular shareholding. However, in practice Investment and Privatisation Funds (IPFs) played a crucial role in mediating between individual citizens and corporate control over companies. Therefore, at the end of the 1990s Neumann and Egan (1999: 175) classify the Czech economy as a combination between the German and the Anglo-Saxon model, with 'cross-ownership among banks, investment funds and firms along the same lines as the German or Rhineland model.' This idea of the development of a hybrid between the Rhineland and Anglo-Saxon model of governance has also been supported by other scholars (Palda 1997: 93)

Martin Myant (2004) contests this idea of the development of a hybrid as he argues that we are witnessing the rise of a distinctly *European* model of capitalism. He argues that the initial attempts to develop a Czech model stranded in the economic crisis of the late 1990s. On the basis of the distinction between US capitalism based on 'stronger direct business representation in political life, less balancing influence for other social interests, less regulation of the labour market, a greater role for private enterprise and heavier reliance on the stock market for finance and control of enterprises' (Myant 2004: 1-2) and European capitalism, Myant argues that the Czech

Republic is moving towards the latter. Myant substantiates his claim by pointing at four different features: (1) the number of foreign owned firms steadily increased, (2) banks are largely under West-European ownership, (3) all important policy areas are constrained by the EU and (4) the way in which the pension reform is being conducted resembles some kind of Swedish model.

These descriptions pose problems for the VoC in various ways. First, 'the new hybrid game' (Stark and Bruszt 2001: 1130) is irreconcilable with the idea of institutional complementarities, which is an inherent part of this approach. According to the VoC, the whole system would collapse if different parts of the political economy were organised in a tense relation to each other. Secondly, the VoC approach struggles with the question of transnational phenomena and actors. This is not to say that the VoC does not acknowledge the influence of externalities, nor does it ignore that different countries face different challenges that stem from the exogenous processes. The key point, however, is that, first, states react differently to the same challenges because they have different institutions and constellations of actors and second, that because they react differently 'varieties of capitalism persist in the face of internationalization' and that even 'if policies and economic performance converge, institutions do not' (Thatcher 2004: 752-753). Since there is no convergence on a certain institutional setting and differences persist, the nation state remains the key object to study when it comes to the future of capitalism within the VoC approach.

However, what we are witnessing in ECE cannot be caught in either the emergence of an Anglo-Saxon type of capitalism or a Rhineland model. Rather what we need is an approach transcending the level of the nation state, which focuses on the origin and function of the newly established institutions. Only then we are able to discern the development of a specific variety of capitalism that is based on an increasing dependence of the Czech Republic on West European corporations. The Czech Republic has been the biggest receiver of what of FDI in the region from the 1998 onwards. Reassuring Western investors by complying with the demands of Western international organisation for institutional reforms has been an active part of the Czech government (Jacoby 1999: 173). West-European corporations dominated these flows (see table 1 and 2).

Table 1.

FDI net inflows % GDP	
1989	0
1990	0
1991	0,6
1992	2,4
1993	3,7
1994	1,9
1995	2,1
1996	4,9
1997	2,5
1998	6,5
1999	11,6
2000	9,0
2001	8,6
2002	13,8

Table 2.

Origin of foreign investments as of 12/ 2002	
Netherlands	34 %
Germany	22 %
Austria	11 %
France	6 %
United States	4,9 %
Belgium	4,8 %
Switzerland	3,5 %

This dependence on foreign capital is further spurred by the influence of transnational actors such as the EU and international financial organisations (for instance, the IMF, WB). The irreversible lock-in of ECE into the world economy has been on top of their agenda from the start of the transition process. The opening up of new markets, and making them safe for foreign investments, has been part of attempt to make this region ripe for a neo-liberal market economy.

This does not lead to the conclusion that the advocated recipes have remained static throughout the 1990s. We are able to discern a shift in the behaviour of international actors during the early years of transition and their agenda during the second half of the 1990s. During the early years, the international financial institutions of the Washington Consensus favoured a clear-cut break between the socialist era and the post-socialist period. Liberalisation and privatisation demanded a hands-off approach when it came to government-induced organisation of the economy, thus bringing about a process of deregulation. However, due the Asian crisis - and, as we shall see in the next section, the stagnation of economic recovery in ECE - international organisations placed more attention on the institutional underpinnings of the economic markets, resulting in something Higgot refers to as a 'Post Washington Consensus' (Higgot 2000). Within this Post Washington Consensus

increased focus was placed on what we might refer to as *reregulation*. This is not be confused with the idea of a return of the socialist practices and redistributive policies. Rather, what the international organisations started to advocate was the reinforcement of state practices to provide a stable underpinning for international capital flows. The creating of markets and their institutional lock-in into the wider socio-economic system does in ECE not require state retreat but rather *redesign*.

Nor does it mean that the policy initiatives advocated by Western advisors have resulted in the same outcomes for each country. Rather, these initiatives had to be translated into political and economic policies that at the one hand satisfied these institutions and at the other hand were politically feasible in the different national contexts. Capitalism in ECE has distinct features stemming from its Leninist legacy that stay intact as long as they do not hinder the lock-in into the world market. In the Czech case, this goes for tri-partite arrangements between the government, employers and organised labour. From the early 1990s on there appeared to be ‘something of a corporatist framework for managing the labor relations along German/Austrian lines’ (Rutland 1992: 121) that helped to maintain social peace. However, at the same time all initiatives remained with the Czech government, which is why David Ost called real corporatism in ECE an illusion (Ost 2000). Even the ministries that were thought to traditionally have ties with organised labour such as the ministry of Trade and Industry began to speak in terms of the ‘competitiveness of Czech industry’ (FT 2001) and hence to adhere to the neo-liberal discourse.

The same goes for ownership structure, where, at first sight, we also seem to witness the appearance of a German type of cross-ownership in which banks play an important role. But although it is true that the stock market is not the predominant place to raise money (see table 3) it should not be ignored that it is foreign banks, which control the Czech economy. Economic dependence on foreign investment - predominantly from the EU - is on the rise; a tendency that cannot be caught when looking at the national level type of capitalism in which banks are just simply banks, regardless of their ownership structure. (see tables 5 and 6).

Table 3 Market Capitalisation in the Czech Republic

Year	Market Capitalisation In bil. CZK
1994	353
1995	479
1996	539
1997	495
1998	416
1999	480
2000	443
2001	340
2002	478
2003	644
2004	976

Source: Czech Info Center

As foreign banks dominate the Czech banking sector, their role regarding corporate governance issues is of vital importance. After an explosion in the number of banks during the first three years after the breakdown of the socialist system, we have seen on the one hand a steady decrease of national banks, and an increase in the influence of foreign banks on the other (see table 3). Most of the privatisation that started in the late 1990s and continued early 2000s took the form of the sale to European foreign investors that were eager to invest in the region. The Commission has applauded this development, as ‘foreign ownership has been crucial in enhancing corporate governance and pushing forward business reorientation in the banking sector’ (Commission 2002: 43).

As the Czech state, just as any other state in the region, is in search for foreign capital to fuel economic growth, it pursues a policy that actively tries to attract foreign investments, among others reflected in the drop of corporate tax rates from 28 % in 2004 to 24 % in 2006, which would lead to an effective tax rate of 17,05 %. As a result from this strategy Austrian banks in 2001 made 1/3 of their profits in ECE, whereas they only had invested 10% of their assets there. The IMF reports that ‘margins have consistently higher and loans losses lower than in the mature banking markets of Austria’ (FT 29 October 2002: 4). At the same time European banks actively supported neo-liberal reform initiatives, for instance of national political actors such as the ministry of Finance who favoured the privatisation of the pension system. Up till now the Czech Republic constitutes an exception in the region for not going down the path of privatisation of the pension system, mainly because of the fact that the relative low public debt allowed opponents of privatisation to block the ministry of Finance (Müller 2002). However, the rapid increase of public debt during

the last years might strengthen the position of the ministry of Finance and thus the agenda of transnational actors vis-à-vis other domestic actors (table 4).

Table 4.
Government Debts

Date	Government Debts – total in mill \$
31.12.1993	2.747,6
31.12.1994	3.526,2
31.12.1995	2.902,8
31.12.1996	2.145,3
31.12.1997	1.730,7
31.12.1998	1.405,9
31.12.1999	1.146,2
31.12.2000	1.079,5
31.12.2001	863,3
31.12.2002	1.607,9
31.12.2003	2.718,5
30.09.2004	5.285,0

Source: CNB

Table 5
Foreign ownership in Czech banks

Date	Total number of active banks	Number of foreign dominated banks
1 January 1990	5	0
31 December 1990	9	0
31 December 1991	24	4
31 December 1992	37	11
31 December 1993	52	18
31 December 1994	55	21
31 December 1995	55	23
31 December 1996	53	23
31 December 1997	50	24
31 December 1998	45	25
31 December 1999	42	27
31 December 2000	40	26
31 December 2001	38	26
31 December 2002	37	26
31 December 2003	35	26
30 September 2004	35	26

Source: CNB

Table 6
Ownership structure of Czech banks by share of equity, in %

Year	Total Foreign	Of which EU	Of which USA
1995	22.8	13.3	Na
1998	38.7	28.6	4.6
2000	54.5	43.5	7.7

Source: Hanousek et al 2002

The influence of these two external forces - FDI and capitalist institutions - and the dependence of the Czech state on FDI for its economic growth lead to an lock-in of the Czech economy into the world capitalist system. However, this development is not restricted to the Czech case. In many ways the developments in the Czech Republic resemble the process of restructuring in other former socialist countries, such as the former GDR. In both cases a 'Treuhand-model of investor-led restructuring with a greater role for commercial banks' (Stratman 2000: 61) is among the main characteristics of the reforming plans. The resemblance with the German model of capitalism is not very surprising if we take into account that 'the spontaneous expansion of German business and the resulting structural dependency of the Czech political economy on Germany are indisputable' (Jeřábek and Zich 1997: 190).

The case of corporate governance in the face of EU enlargement

Many of the developments discussed above can be illustrated with examples from the policy field of corporate governance. Views on the role and function of the firm reflect broader societal views - thus, by investigating the political struggles over the function of the firm within society, we are able to make valid statements about the broader socio-economic configuration of varieties of capitalism. Apart from this heuristic feature, issues of corporate governance play another important role in the context of the economic transition: the institutional lock-in of changed property rights.

During the last years of the communist regimes and the first years of the transition, the liberalisation of prices and the imposition of financial discipline were emphasised. After this first step of liberalisation, in phase two the focus shifted towards the restructuring of property rights. In the early 1990s, privatisation was at the heart of the political and academic debate or as former Czech minister for Privatisation Dusan Triska put it: 'Privatization is not just one of many items on the

economic program. It is the transformation itself' (Triska in: Nellis 2000 page number). However, when the first two waves of the transition process had passed by, privatisation proved not to be the panacea many had hoped for. Although the private share in GDP went up, none of the former communist countries, except for Poland, had reached the 1989 GDP level in 1997. Furthermore, the transformation had been primarily focused on the downsizing of production, assets and employment. This defensive strategy was not accompanied by any deeper restructuring aimed at investments and innovative business strategies as the World Bank reported (World Bank 1996: 47).

The literature on the economic transition contributes these developments to the lack of proper institutions to guide the transfer of property and regulate corporate control in the newly privatised companies. Privatisation without underlying corporate governance mechanisms does not 'clearly solve the problem of having well-identified private owners who actually control and govern newly privatised enterprises... qualitative privatisation could only be achieved by coming to grips with the corporate governance issues' (Andreff 1996: 59- 60). Acknowledging these problems, governments turned their attention to mechanisms 'to remedy problems identified through the experience of the initial legislation, to improve the quality of law-making and law-enforcement, but also to offer more effective and forward-looking solutions' (Dragneva and Simons 2001: 94). Corporate governance issues therefore constitute the *third step* of the economic transformation in ECE after the initial phases of stabilisation and liberalisation.

The Czech Republic constitutes perhaps the clearest example of this development. The method of voucher privatisation led to considerable problems in the field of corporate control and a chaos in financial structures. IPFs got their hands on over 50% of the shares and were subsequently alleged to act on behalf of the fund managers instead of the shareholders. With disclosure rules still limited throughout the 1990s, IPFs, banks and firms did not give full account of their performances, thus hindering effective shareholder control. As the IPFs and banks did not control the corporations they owned, corporate governance issues were transferred to the level of these institutions without being solved, begging the question of 'who guards the guardians?' (Stiglitz 1999). The relative strong position of (fund) managers stands in contrast to other former communist countries. Corporate governance problems were

substantial smaller in ECE transition countries that opted for direct sale to foreign corporations, like for instance Hungary.

The politics of corporate governance in the Czech Republic in the face of EU enlargement

The right-wing government under leadership of Klaus hardly addressed the question of financial transparency during its rule and focussed predominantly on rapid privatisation, thus leaving all issues of corporate governance for the future. In contrast to that, the social-democratic minority government that took over in 1997 addressed the question far more to the likings of the Commission. Shortly after the Social Democrats gained office the Financial Times already concluded that the 'period of reforming the reform programme can begin now' (FT 2 December 1997: 18). The inherent fear behind the reform programme of the Klaus government was that the transition to a market economy would fail because of over-regulation. According to the Klaus' government the transition was best managed by leaving the markets to do their job.(insert quote) As a result from its attempts to depoliticise the economy, 'the Czech government impeded institutional development to aid firm restructuring and creation' (McDermott 2004: 189). The neglect for institutional underpinnings of the new market economy is also reflected in the Klaus' government approach towards privatisation. Stark (1992: 50-52) describes the Czech method of voucher privatisation as a means of the first Czechoslovak government to win popular social support for a market economy. The introduction of IPFs was considered to be a compromise, saving best of both varieties of capitalism as discussed above, and allowing the government to adopt a hands-off approach towards corporate restructuring. Policy makers favoured voucher privatisation because it was expected to create 'an active capital market as in the United States,' whereas at the same time they 'fully recognized that individual citizens would have neither the capability nor the incentive to provide any meaningful governance, so they accepted the necessity of capital aggregation in the hands of financial intermediaries' (Fitzsimmons 2002: 6).

During the first years these reforms were widely applauded by the international financial institutions that had a considerable influence on their development and implementation. Although dependence on financial support of international financial institutions, such as the World Bank and the IMF, ceased

shortly after 1993, Meaney concludes that during the first years of the transition foreign experts have been more influential in shaping the mode and practices of privatisation in the Czech Republic than in neighbouring Poland and Hungary, as they enjoyed 'the unqualified support from the head of state' (Meaney 1995: 303). The outspoken right-wing coalition clearly committed to reforms determined the course of transition until 1998 (Tomásek 2001: 2) contrast most of the other ECE cases where either the Social Democrats or Socialists gained office after the second elections. The role of the Washington Consensus organisations was therefore first and foremost 'to help its protagonists overcome the main political opposition to their designs' (Dangerfield 1997: 440).

However, as the recession hit the Czech Republic in 1997 the call for stable institutional underpinnings was most loudly heard in Prague, and international institutions became aware of the importance of a sound legal foundation. Almost overnight the Czech Republic was no longer the Washington Consensus' favourite pupil, but a rather weak student. Most critique was aimed at the banking sector that was left 'intentionally nonprivatized' (Havrdá 2003: 133), which led The Economist to conclude that the Czech banking sector was 'parochial and politicised.' (Economist 31 May 1997: 65) In the 1992 voucher programme the Czech government had only privatised parts of the four largest banks of the country, while keeping a significant degree of the shares in those banks during the following years. The European Commission was becoming increasingly critical of Czech performances, highlighting the lack of corporate governance structures and the weakness of the banking and financial system and criticising the Klaus government for lacking commitment and unimplemented reforms.

The privatisation of the banking sector only got under way after the Social Democrats seized power in the 1997 elections. Though campaigning as strong opponents of letting go of the state's bank shareholdings, they proved to be able to appease the EU by privatising the last publicly controlled bank in 2001. Overall the Social Democratic minority government was far more EU minded than its centre-right predecessor. This is not to say that all government members agreed on the pursued strategy. Especially Industry and Trade Minister Miroslav Gregr and Finance Minister Pavel Mertlik collided on several occasions. Whereas the latter was able to get things his way during the first years of the Zeman government, he resigned after a struggle over the privatisation over publicly controlled power companies. Their biggest

controversies considered an ambitious revitalisation programme aimed at the restructuring of some big and highly indebted corporations. Initially, the Commission was very positive of the Mertlik's version as it stated that the Revitalisation Programme 'could be a step in the right direction' (Commission 1999: 26) because the plan that was submitted was 'non-interventionist and market-oriented' and 'will abide by the provisions of the European agreement and the acquis' (idem: 39). Two years later, after the resignation of Mertlik the Commission was more critical as it argued that the 'momentum of restructuring and privatisation, which was noted last year, appears to have slowed down as regards major industrial undertaking' (Commission 2001: 75). Though it recognised that the Agency had promoted enterprise restructuring and privatisation in the industry sector (idem: 41), it urged that the completion of the restructuring and re-privatisation should be a top priority for the Czech government (idem: 75).

It seems that the main differences between the EU and the Czech government are more related to pace and sequencing of the restructuring of the Czech economy rather than a return to socialist practices. Also on other corporate governance issues the Czech Republic received appraisal from the Commission. The 2001 report already stated that 'good progress' had been made in 'strengthening protection of creditors and minority shareholders' (Commission 2001: 51) and called the reforms in the field of accounting and disclosure that allow for the implementation of the International Accounting Standards an improving of the already solid basis (idem: 48). In 2002, the Commission concluded that 'privatisation and consolidation have laid the foundations for a solid financial sector, which is able to fulfil its intermediation role' (Commission 2002: 43). So despite the fact that rhetoric sometimes suggested the opposite, subsequent Czech governments complied with European guidelines and policy advices though differences regarding pace and sequencing remained.

However during the first decade of the transition the relationship between the EU and the Czech Republic changed in two ways. Until the Accession Treaty of 1998 EU influence remained rather informal and predominantly took the form of policy advices. With the signing of the Accession Partnerships the EU possessed a bigger carrot and therefore also a firmer stick. From 1998 onwards the EU could impose conditionalities upon applicant states such as the Czech Republic, which ended a period of negotiations that had more of a bargaining character (Grabbe 1999). Jacoby (2001) speaks in this respect of a shift from voluntary and functional compliance to

certain European templates towards less voluntary thresholds. From then on the rules of the game had been fundamentally changed and the concessive Social Democratic governments were criticised on several occasions for not reforming in a pace acceptable to the Commission. Moreover they were lectured with regard to state aid and other types of public influence in the private sector. Second, as a result from this increase in influence, the Commission also met growing resistance from the ruling government. So instead of immunising government policies from domestic opposition as it had done during the first years, the EU used its influence to speed up the reform process.

The motivation of the Klaus government to follow the advices of international institutions was also internal, i.e. also driven by its Czech neoliberal sentiments, which overlapped with the views of Western institutions. As the lack of institutional underpinnings became increasingly evident first frictions appeared. These frictions continued, or at least seemed to continue, after the Social Democrats won office in 1997. The Social Democratic government favoured restructuring of public corporations before privatising them and here, its agenda showed important differences with that of the Commission. Between 1998 and 2002 the Commission's judgement on the Czech progress towards accession swayed between appraisal for the overall intensions and criticism with regard to the practical implementation of these reforms. As joining the EU was given priority over control over the pace of the transition process, the Social Democratic Zeman government accepted EU pressures for further and more rapid reforms. Compliance with the Copenhagen criteria and the *acquis* required substantial reforms that were politically feasible in the light of joining the EU, seen as the nonplus ultra success of the reform programme and the ending of the transition period.

Conclusion

'A common perception in CEE is that convergence with West European models is part of economic and social "modernization" and the "return to Europe."' (Grabbe 2003: 248). The question however is whether this common perception is correct. After less than one year of EU membership it is too early to fully assess the impact of the EU, but ECE is still far away from the full and equal political and economic participation with the rest of Europe (also see Holman 1999). Although at

first sight it might seem that we have been witnessing a process of convergence on what, a closer look teaches us that the resemblance is only superficial. What we are observing is certainly the return of ECE to the capitalist world, although it is doubtful whether ECE ever totally left the capitalist world economy (see Böröcz 1992). Rather, right now it appears that the region has remained its position in the capitalist world economy as some sort of semi-peripheral area (Böröcz 2004) than that it is being incorporated within the economic core of Western Europe. The new type of capitalism emerging in ECE can best be characterised as based upon foreign investments with some post-socialist characteristics that result from the communist period and the process of privatisation. From these features, the penetration of the region by foreign capital will be the most important trait of developing type of capitalism.

Securing foreign investors an equal opportunity to invest has been a key issue on the agenda of the international actors involved, including the EU. The successful attempt to influence the lock-in of newly established property rights through corporate governance regulation is but one – though important - illustration of this desire. International institutions applauded the 1993 constitution that held a clause in which the ‘obligation on the government to protect the property rights of foreign investors as the rights of domestic firms’ (Schütte 2000: 58) was secured. In practice, however, this clause did not provide enough institutional safeguard as the clause was breached on several occasions. In this regard the EU Accession Treaty can be considered to be a far more successful attempt to institutionalise the rights of foreign investors. This type of ‘new constitutionalism’ as Gill calls it, involves ‘a particular set of political and constitutional changes linked to the reconstitution and protection of capital on world scale’ (Gill 1998: 1). In this sense the influence of the EU can be understood as getting the institutions in place that provide this kind of protection. This also implies that the Czech state is not withering away, but rather is adjusting itself to its new role (Shields 2004). This calls for a closer examination of the role of politics in the economic restructuring in ECE and contests the assumption that economic transition is only about de-politicising the economy. The rhetorical adherence to de-politication only hides processes that have everything to do with politics.

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