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Abstract

Joining the Club: The Impact of Europeanization on Czech Economic and Institutional Reforms [1]

The transformation of the centrally planned economies to market principles and private property is one of the most remarkable changes in the post-war period. While discussions about a "return to Europe" shape domestic agendas in Central and Eastern Europe, the literature on enlargement has been dominated by the effects of increased membership on Community policies, practices and institutions. This paper explores key implications of the accession process in terms of domestic adjustments to highlight the institutional choices and economic governance reforms that have been undertaken to meet the *acquis* in the Czech Republic. The paper highlights how the European accession process is influencing the domestic institutional framework governing markets, in crucial areas such as competition policy, financial markets and corporate governance. In doing so, the paper questions the assumption that institutions establish relatively stable frameworks that can result in lock in and path dependent effects, by demonstrating the malleability of institutional choices, and the possibility of institutional change and adaptation to meet market pressures and conditionality demands of "returning to Europe."

[1] I wish to thank Jusuf Fuduli and Petra Ticha for research assistance, as well as the various individuals who agreed to be interviewed confidentially.

Introduction

The transformation of the centrally planned economies to market principles and private property is one of the most fundamental changes in the post-war period. Although there have been comparisons to other cases of democratic transition, the simultaneous economic and political transition is unprecedented (see Offe, 1991 chapter 3; Crawford, and Lipjhart, 1995; Elster et al, 1998). The multitude of structural adjustments that Central and East European states have undertaken to modernize both polities and economies has generated a substantial literature on the effect of the institutional legacies of the past (Ekiert, 1998), the transformation strategies of the present (Stark and Bruszt, 1998), and the organizational preparations for the future (Grabbe, 2000). Though this has resulted in inter-regional comparisons of post socialist transformations in order to explain the nature and scope of reforms as well as their organizational design and impact (Elster et al 1998; Stark and Bruszt, 1998), the literature on the transition economies of Central and Eastern Europe has made little connection with that of European integration.

Where the processes of enlargement on European integration have been considered, the focus has been primarily on the effects that expansion will have on Community policies, markets and institutions (Wallace, 2001; Preston, 1997; Grabbe and Hughes, 1998; Nello and Smith, 1997). Though most analysts agree that the enlargement negotiations will be contentious, protracted, and subject to a great deal of log rolling, side payments and issue linkages, since EU member states are clearly unwilling to accept decisions that will undermine their preferred preferences in specific policy areas, there has been a tendency among EU scholars to treat the applicant states as a group without a close examination of the different policy choices and reforms they have engaged in over the past decade (cf. Pravda and Zielonka, Forthcoming). As Wallace argues, "the impacts vary greatly depending partly on the "fit" with domestic politics and preferences, and partly on the character of the receiving political environment in terms of country specific institutions and political cultures" (Wallace, 2001 p. 157).

With the concrete timetable established at the recent Nice Summit that the first wave of applicants will be admitted by 2004, Eastern Europe is now the European Union's "major preoccupation - if not obsession" (Zielonka, 1997 p.1). Yet Central and Eastern

Europe is "undergoing a plurality of transitions in a dual sense : across the region, we find not one transition but many occurring in different domains - and the temporality of these processes are often asyncronous and their articulation seldom harmonious" (Stark, 1992 p.18) The agendas of the applicants states are crowded with issues of institutional change including the creation of independent central banks, the privatization of banking and other state owned enterprises, as well as constitutional, electoral and administrative reforms. Because the economic transformation has resulted in complex developments in the economy that cannot be reduced to general trends of marketization and privatization, a major theme emerging across the Central and East European states is the high degree of institutional and organizational variety of market coordination (Chavance and Magnin, 1997 p. 196; see also Neumann and Egan, 1999; Stark and Bruszt, 1998). Such diversity also fits into the current debate about models of capitalism and governance forms that points to the historical and national variations of political economies whether in terms of industrial relations, social welfare and financial systems (Zysman, 1994; Berger and Dore, 1996; Rhodes and Apeldoorn, 1998). Although Central and Eastern European policy makers have been claiming to follow Western models as part of their strategy of modernization, there have been relatively few efforts to examine the degree to which the pressures of regional integration is shaping efforts at stabilization and structural adjustment in the CEE region (Jacoby, 2001; Grabbe, Forthcoming).

This paper assesses the impact of domestic and international influences in evaluating both the transition and consolidation process within an applicant state. It addresses a key question about the intersection of Europeanisation and domestic politics by looking at the changes in market institutions and practices in response to the requirements of European integration. The paper is structured as follows: section one provides an overview of the current economic situation in the Czech Republic. Section two focuses on the economic transition strategies in shifting from a command to market economy. Section three focuses on the domestic and international pressures pushing the accession process. Section four examines the reform undertaken in response to Europeanization by focusing on efforts to meet the acquis in the areas of competition and corporate governance.

Though the focus of the paper is on the Czech Republic as a single case study, combining both international and domestic factors in explanatory frameworks has broader relevance. Addressing this intersection, the argument made here is two-fold: 1) even though there are common goals and objectives among the applicant states such as the desire to join the European Union, the variety of national paths of transition have been glossed over in many assessment of the enlargement process, and 2) the individual paths taken in the post socialist period are more malleable and adaptive than the path-dependent view that underpins historical institutional analysis (Putnam, 1993; Eckiert, 1998; Pierson, 1996). Less attention is given to institutional change, transformation and adaptation occurring as a result of policy learning and policy failures triggering the development of new policy ideas and options. Yet change occurs at "critical junctures" when existing policies are no longer feasible, and existing institutions and routines are forced to change in response to external or internal conditions (Krasner, 1988) In practice, central European policy-makers have innovated, adapting elements of different models to fit the complex situation facing them at different points in transition process (Egan, No Date; Neumann and Egan, 1999; Grabbe 2000).

From Transition to Consolidation

Initial research in the aftermath of the collapse of communism focused on post socialist **transition,** debating the effects of the institutional legacies of the past in moving simultaneously towards democratic polities and market economies [2] (Murrell, 1992; Commisso, 1991; Bunce, 1995). The transition literature focused primarily on internal domestic reforms, with both pessimistic and optimistic prognoses about the degree to which reform efforts would promote procedural democracy, rights, and market institutions. While this does not exclude external influences, notably the financial support and policy recommendations of international institutions and foreign governments, the literature on post-socialist transformation focused primarily on institutional design in structuring domestic politics. However, as we shift to post socialist **consolidation,** the institutional infrastructure of economies and societies in CEE increasingly reflect the

[2] The literature on democratization has drawn attention to the differences between transition and consolidation, see for example Schmitter and Karl (1994)

influence of international trade agreements, and the globalization of production, capital and information regimes that impact upon the ability of nation-states to set economic rules within their borders (Remmer, 1997 p. 53). As research on the political economy of market reform strives for conceptual frameworks, the role of international institutions have emerged as important sets of explanatory variables in stabilization and adjustment (Remmer, 1997; Nicolaidis, 1991). Much can be gained by combining both the policy preferences and organizational capacity of domestic actors and institutions, with international linkages to provide important insights into the on-going processes of economic and political liberalization (Putnam, 1988; Remmer, 1997; Keohane, 1989). These interconnections allow us to consider processes of change - as well as their causes and consequences - in broader political and economic context.

This is especially appropriate as we shift to the process of consolidation of market-oriented economic reforms in CEE where the European Union is now penetrating more deeply into the economic decision-making process of applicant states. What we are now seeing is the effects of 'Europeanisation' on domestic politics, in much the same way that analysts of member states have observed, due to the growth of EU policy competences, which makes it a driving force for legislative change in CEE. Hence, the EU's influence on the reconstruction of markets in CEE is more significant than that of other international agencies (see Grabbe, 1999; Grabbe, Forthcoming). While this is important to scholars of European integration, it also enables us to look at many of the same issues that have preoccupied comparative politics and political economy in Western Europe, adding new cases for study in examining the domestic roots of foreign policy (EU membership) and the foreign roots of domestic policy (economic reform) (Gourevitch, 1978).

Furthermore, the issue of enlargement also links to the policy and institutional transfer debate (Majone, 1991; Rose, 1994; Jacoby and Locke, 1997). A consistent theme in the literature on economic transformation is the "bricolage" of institutions where old institutional legacies of partial reforms under socialism exist with new mechanisms of market governance and economic relationships (Stark, 1992). The notion that there are previous "sunk costs" that affect subsequent policy options should not preclude the possibility that policy borrowing or imitation is feasible. Existing research in the causes

and effects of policy transfer has drawn attention to how both discourse as well as actual policies can be utilized in different political settings (see Walker, 1969; Dolowitz, 1997; Rutland, 1992; Orenstein, 1998).[3] But as most observers acknowledge, policy outcome is usually more heterogeneous or variable due to the existing institutional, social, political and economic contexts into which the transfer takes place (Jacoby and Locke, 1997). Moreover, those policies that are transferred, imitated or borrowed are themselves often the subject of an intense and highly politicized struggle (Hooghe and Marks, 1997). This is especially appropriate in the EU case where the deepening of the market has resulted in differing conceptions about the governance of that market (Hooghe and Marks, 1997; Egan, 2001).

Czech reforms -based on EU norms and practices - are taking place against this background of continued disagreements among political actors about how to organize state-society-market relations in Europe (See for example, Goldstein, 1993; Pollack, 2001). The Céska cesta (Czech way) through its desire to return to Europe, is constructing a post communist political identity that rejects the legacies of the past, embraces the current economic identity of Western capitalism in terms of fiscal policies, privatization policies, and competition policies, and promotes the future as a community of European states (Gould and Appel, 2000). This process of identity formation is embedded in a framework of institutions, ideas and practices about market governance and polity building that draws upon those different models that characterize the collective identity of the European integration project (see Lykke and Friis, 2001).

I. Current Economic Situation

Beginning in 1996, the Czech economy has been contending with severe economic problems. Plagued by stock market scams, bank failures and trade deficits that have hindered economic growth, hampered investment, and paralyzed the political and economic system, the situation has now begun to change. Previously, the much vaunted "model" for post Communist transition economies in Europe, the Czech "miracle" of low inflation, low unemployment, and a growing economy became illusory (Buch and

[3] Václav Klaus has given a number of speeches outlining his neo-liberal economic philosophy, based on broad-based gains that were tempered by the need to maintain existing social policies and safety nets.

Heinrich, 1997; EBRD, 1995; Financial Times, Washington Post, December 7, 1997 p. A31; New York Times, December 1, 1997 A1 and A8; Financial Times, December 2, 1997; Financial Times, January 19, 1999). Once set apart from other countries in the region because it to suffered virtually no unemployment during the transition, the Czech Republic has faced key challenges in economic restructuring, including debt write-offs for many companies to attract investors, substantial job cuts and productivity decreases in many heavy industry sectors, and the unraveling of an opaque system of cross-shareholding among banks, government and investment companies from the mass privatization program undertaken in the early transition period (Buch and Heinrich, 1997). While exports and investments have increased, driven by a new range of tax incentives[4] that have attracted companies interested in both purchasing of privatized companies and greenfield investment, significant challenges remain.[5]

After declining growth in the economy through 1999, the GDP growth reached 2.5 % in 2000 and inflation fell to 4%. Though significantly improved during the past fifteen months, the economic situation lags behind other neighboring countries (see CERGE-EI, 2000; Financial Times, September 26, 2000). After a speculative attack on the currency in 1997, and a growing current account deficit, equivalent to 7.4 % in 1996, the government responded by introducing a strict fiscal and monetary program (EBRD, 1999). Though greater fiscal discipline is still needed -especially with regard to off-budget activities, the weakness of the economy was demonstrated by the collapse of one of the biggest banks, IPB, in June 2000, causing a major political crisis, as the bank was put under forced administration after a run on deposits (Financial Times, June 23, 2000). Sold off to another large bank, CSOB, the situation represents a continuing problem in terms of the lack of market opacity in the financial sector. The continued bail-out by the government, taking over non performing assets represents a constant drain on government finances. This last crisis, involving Kc180bn ($4.8bn) in debt write-offs has contributed to the soaring government deficit that could hit 10.8 per cent of GDP in 2001 (Financial Times,

[4] National Investment Incentive Package (72/2000)

[5] FDI has risen steadily since 1993 from 654 million dollars to 5, 108 million in 1999 surpassing those of other Central and East European neighbors. In total, the Czech Republic has attracted USD 17.142

February 1, 2001). After the recent recession, in which some estimates put the number of non performing loans as high as 32% of processed loans, amounting to a debt of around 30% of GDP, the repercussions of such prolific loans in the transition period has weakened Czech recovery as banks are considered undercapitalised, loss making enterprises with mounting bad debts that stifle their ability to provide new loans to companies that need injections of capital to undertake restructuring and modernization (Financial Times, June 1, 2000; Borish, Ding and Noel, 1997).

Coupled with the rapidly increasing levels of off budget programs, state guarantees and public liabilities, the need for further restructuring in the enterprise and financial sectors is crucial for the Czech Republic to credibly commit to the remaining challenges of its transition. With a burgeoning trade deficit, stemming from a considerable slow down in exports to the EU after 1996, the Czech Republic has geographically shifted its export market orientation with the EU replacing the CMEA as the main trading partner. With rapid growth in exports to the EU from 1992 until 1997, at around 25% on average, the initial exports focused on heavy manufacturing such as transport and machinery equipment (European Commission, 1999). Unemployment continues to rise, from about 3% in mid 1990s to around 9% per cent currently, although this is considered to be misleading since many enterprises have yet engaged in massive restructuring necessary for long term productivity and efficiency (Dyker, 2000; Stiglitz, 1997; cf Mejstrik, 1999).

The recent report in March 2001 commissioning the World Bank to study the budget expenditure of the Czech Republic highlighted the need to cut government spending and reduce the budget deficit. Because of the sizable off-budget loans that have further exacerbated the fiscal problem, the Czech Republic is under tremendous strain to cut social transfers. Government spending is currently 46% of GDP, a figure that is far higher than other EU candidates, as well as some of the poorer member states such as Portugal and Ireland (European Commission, Prague 2001). However, the rising levels of mandatory spending in healthcare, education and pensions are putting increased strain on economic recovery. The World Bank, recognizing the fact that the fixing the problem

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million between 1989-1999. Source, CERGE EI and Statistická Rocenka Ceské Republiky (Scientia, 1999)

involves some hard political choices, has suggested moving towards more market-based models in all three areas. Healthcare reforms should expand the use of consumer co-payments; educational reforms should include the introduction of tuition fees for universities and promote private universities; and pension reforms should include raising retirement age (World Bank, 1999). Undermining social protections will be politically contentious since the initial reform process generated a "social-liberal policy mix" that included the creation of a corporatist system of labor relations, continued universal social and family benefits, and introduction of single-payer universal health-insurance system that played a major role in avoiding the anti-reform backlash that occurred in Hungary and Poland (Orenstein, 1998).

II. Economic Transition Strategies: From Plan to Market

Labeled by the Financial Times in 2000 as "the reluctant reformer", the Czech Republic found itself stung into action by criticism from the World Bank, the EBRD, and the European Commission[6] that it had slipped from the ranks of front runner for European accession. While the current situation briefly highlights the problems to be overcome, the position that the Czech Republic found itself in after a decade of economic transition is best understood by examining the path taken in shifting from a command to market economy (see Husák, Kinkor, 1996). Though initially viewed as choosing innovative strategies, going ahead at remarkable speed in comparison to many of its neighbors, this proved to be the foundations for the current economic problems.

Though global financial crises and turbulence in multiple markets have affected Czech economic development in mid 90s, earlier domestic policy choices and political developments are crucial in understanding the current crisis. Though the underlying problems stem from micro economic rather than macro economic conditions, the general assessment that the Czech Republic had managed the transition from plan to market was

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[6] Periodic reports are issued by the European Commission on applicant states. The first two reports on the Czech Republic In November 1998 and October 1999 were critical of Czech efforts and reported that progress was "not satisfactory" in meeting membership requirements.

based on the mass privatization program introduced in the early stages.[7] Though the privatization process transferred a large amount of property into private hands, it consisted of essentially two elements: the removal of state control and the introduction of shareholder control and governance.

Privatization was considered critical for Czech market reform (for early assessments, see Desai, 1994; Brom and Orenstein, 1994; Kotrba, 1995). The process took place in two waves, in 1992 and 1994, in which the state embarked on a massive transfer of state industries to private hands through a unique voucher distribution scheme (Mejstrik et al, 1994). The system was quite simple: an innovative voucher privatization system was introduced to allow public involvement, increasing the number of stakeholders in the economy. Such widespread distribution of vouchers posed problems of fragmented control, so efforts were made to enhance corporate governance through the introduction of investment funds that consolidated investment by collecting voucher points from the public, thus leading to concentrated ownership by investment funds and strategic investors (Buch and Heinrich, 1997; Buch, 1996)[8]. Although they were either privately owned or established by state-owned banks or joint stock companies, the investment funds performed poorly and are considered one of the key problems in the transition process (Palda, 1997; Švejnar, 1995). Not only were fund managers relatively inexperienced, many were also perceived as acting in their own interests, with limited efforts at disclosure and transparency, often hiding assets as well as failures. Fund managers often held down market value so that poor dividends would allow banks and allied brokerage firms to buy out the small shareholders at advantageous prices (Mloch, No Date; Financial Times, 26 April, 1996). As a result, the system resulted in poor standards of disclosure, limited concern for shareholders' rights, and considerable neglect of minority shareholders , despite the introduction of new regulations to tackle these issues.[9] The weak regulatory oversight of the relationship between banks, companies and investment funds distorted the

[7] As the World Bank noted most initial assessments , including their own analysis, were extremely positive about the Czech transition process.

[8] Of the 842 companies which offered more than 50% of their shares to voucher privatization in the first wave, investment funds held 50% or greater share in more than 334 firms, or roughly 40% of all voucher-privatized companies. See LaŠtovicka (1993) for patterns of investment behavior.

governance of some firms, allowing banks that controlled investment funds to cross-subsidize companies through preferential loans. Additional problems arose from these non-transparent cross-ownerships because the non-banking financial institutions - namely insurance companies, investment funds and pensions funds that were the decisive domestic investors - were weakly regulated and supervised.[10]

Privatization failed to create large independent banks that would restructure non viable firms. The Banking Act in 1991 envisaged a German style universal banking system that would enable them to play both a debt and equity monitoring role (Simonson, 2000; Neumann and Egan, 1999). Although the bank-based, cross-shareholding model appeared to emulate the Germanic model of capitalism, it did not operate the same way since the companies continued to be dominated by state banks that did not become active shareholders to improve the productivity and efficiency of companies, some of which were persistent loss makers. The banks -with diversified portfolios - through their investment funds did not promote economic restructuring, leading to a distorted environment in which the bank-industry relationship provided domestic banks with a monopoly over financing, which kept the costs of capital high, raising loan payments, reducing corporate profits and inhibiting outside investors.[11] Though investment funds were trying to manage industrial enterprises that have tremendous financial problems including long term debts, the regulatory and supervisory framework lagged behind the development of the equity market, resulting in a number of problems including insider trading, price manipulation, asset stripping and investment fraud. The term "tunneling" has recently been used to describe this kind of abuse, with extensive tunneling occurring in banks, funds and other companies (Machacek, 1997).

The dominance of banks in providing credit to companies undermined the development of capital markets in promoting economic growth. The Prague stock market

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[9] The Amendment to the Czech Commercial Code, effective in July 1996, was designed to increase the rights of minority shareholders and strengthen ownership obligations and disclosure requirements.

[10] Although Investment funds were initially restricted by two rules: they could not hold more than 20% of a privatized firm; and individual investors had priority in purchasing stocks in high demand, enforcement of these rules led to consolidation after first wave of top 14 funds owning 77.6 % of total points and 60.1 % after second wave (see Mejstrik, 1999 pp 248-249; Desai, 1994 pp 14-16).

emerged a few months after the end of privatization in April 1993. Though an emerging stock market should provide firms with access to surplus capital and fuel economic growth through new securities, the Czech stock market remains underdeveloped. While the stock market should be a good indicator of public confidence in the financial practices of listed companies, facilitating investment decisions for both companies and individuals, the Prague Stock Exchange has experienced shortcomings in terms of transparency and oversight that have undermined confidence in capital market institutions in general. Apart from the listed market which allows trading in a small number of enterprises, two competing over the counter (OTC) markets have emerged - the PSE OTC and RM-S. This secondary trading market is often conducted in a non-transparent way, involving fraudulent transactions by fund and enterprise managers, reflected in low prices of funds shares in terms of market value. In addition, many large deals are made by strategic partners off the exchange which accounts for the low liquidity and trading (Pistor and Spicer, 1996).

These problems have also contributed to weak corporate governance. The reliance on banks has not been conducive to creating a corporate culture that promotes shareholder value, since banks were mainly concerned about the fragile situation of many large conglomerates that would default if they did not continue to support these indebted corporations. Since banks were only partially privatized, and the state continued to keep a major stake in the big four banks, KB, CS, IPB, and CSOB, the focus was on providing capital rather than restructuring (World Bank, 1999; Simonson, 2000). State owned commercial banks were given a significant financial injection in the form of five year bonds that enabled banks to recapitalize, write-off non performing loans through debt for bond swaps and target credit to potentially viable firms (Desai, 1994). The first step was the creation of the Consolidation Bank, KB in 1991, a fully-owned state bank that carried out this purchasing of a large number of non-performing loans (Consolidation Program 1). The second step was to address inter-enterprise debt through the issuance of bonds funded

[11] The Czech National Bank did provide guidelines for banks on providing for loan losses in 1993. The Czech government chose to establish a consolidation bank solution, KoB to collect non-performing loans. For an analysis of KoB, see Matousek, 1995.

by the National Property Fund to help clear portfolios of large banks of bad debts, followed by a stabilization program to take over bad debts of small banks.

Despite initial intentions, this enormous restructuring of financial institutions, did not produce the expected results. Banks were allowed under the Banking Act of 1991 to establish investment companies, trade in currencies, futures and options, and underwrite new stock issues. Because the banks continued to be prone to government influence, through major or partial ownership of the largest banks, this leverage has been of the major reasons why the banks have continued to guarantee credits to poor performing enterprises and have financed large parts of the fiscal deficits (Elster, et al.1998 p. 173). Many banks did not promote improvement in productivity, or set tough conditions for new loans.

Declines in stocks, bonds and assets, as well as reduced corporate profitability in the transition period, increased the risk of a liquidity threat. Because the balance sheets of banks are not transparent, as corporate governance and disclosure laws are still somewhat limited, the scope of the fiscal problems were not readily apparent. With the collapse of a number of banks such as KrB and Banka Bohemia due to mismanagement and fraudulent lending, the costs of stabilizing the banking sector has placed huge strains on the budget. The Economist estimated that the total cost of bailout to the Czech taxpayer in 1995 was 100 kc crown or 8% of GDP (Economist; see also Mladá Frontes Dnes, 23 November 1996; Hospodarke Noviny, 15 November, 1996). Many of these bail-outs of banking losses are off budget activities incurred from bad lending decisions that are far in excess of any income derived from the privatization of the bank. [12]

In addition, poor lending decisions by banks in the post transition period have exacerbated the problem since the emergence of the banking sector was largely chaotic and unregulated. Inexperienced, and faced with the sudden pressures to act quickly, the government set minimal licensing requirements and control over lending activities. This resulted in a large number of banks having limited capital reserves, offering few services.

[12] Hidden public liabilities covering losses from the banking sector, and in transformation institutions scuh as the National Property Fund, Konsolidacni Banka (Kob), Ceska Inkansni (CS), Ceska Financni (CF) have accumulated. While various public subsidies including agricultural guarantees and transport

The loan portfolios inherited by these banks included a large number of heavily indebted firms and real estate holdings that have fallen rapidly, making the estimation of the real proportion of bad loans extremely difficult. Under the assumption that the government would eventually bail them out, the bank's main clients, the manufacturing industries, continued to sell products to each other on credit to avoid insolvency (See Svejnar, 1991 p. 130). While inter-firms debt spiraled, there was no framework in place for dealing with bankruptcies.[13] Unable to recover loans when firms are in trouble, creditors (especially international lenders) have become more cautious. The loose lending practices of the early 1990s have thus made venture capital increasingly difficult to acquire for many innovative or start up companies (Prague Post, 19 November 1998). The limited effectiveness of bankruptcy laws (adopted in 1991 and amended in 1998) meant that the situation favored the debtors rather than creditors since the legal proceedings were extremely slow, the process was not transparent to creditors, and the system suffered from low recoveries for creditors. (World Bank, 1999; p. 119; OECD February 2000). The Czech National Bank has reported that 22% of all bank loans are uncollectable, and that the amount of credits marked as non performing by the government had risen to 34.5 % of total loans in 1996 (Hospordarske Noviny, 22 August, 1996).[14] Banking privatization is thus viewed as a means to minimize the costs to the government of continued intervention that has affected the Czech economy for most of the decade.

While many of these challenges should have been addressed in the early stages of the transition to promote long term sustainable growth, they have become increasingly important in meeting EU norms and standards. Without greater fiscal discipline, the Czech Republic runs the risk of falling behind in its efforts to meet EU standards. In sum, several problems are at the heart of the Czech economic malaise:

- *slow progress in privatization of the banking sector*, resulting in continued inefficient capital allocation. Constraints on privatization are partly the result of

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subsidies will be scrutinized by the EU, the off budget guarantees represent the biggest fiscal risk and liability.

[13] Between 1989-1992 only 85 firms were liquidated despite the growing number of loss making enterprises. See Egan (No Date).

[14] This can be compared to the 1-3% of classified or non performing loans that is typical of Western banks.

mounting bad loans and debtors defaulting, increasing state liabilities and indebtedness of the public sector.

- *Inadequate restructuring of major companies*, caused in part by the privatization process that allowed individual investors to entrust their privatization vouchers to investment funds created and controlled by banks, and not responsive to shareholders - a poor model of corporate governance. The state-owned banks have propped up inefficient industries with easy loans, refusing to cut off the flow of cash or force these firms to restructure. The banks feared such restructuring would lead to large-scale bankruptcies and massive loan write-offs.
- *inefficient efforts to reform the legal system and enforce regulatory oversight*, leading to low investor confidence and lack of trust in the market. Czech capital markets are considered weakly regulated, mainly because of the lack of transparency and credibility in the banking sector. The complex ownership system has exacerbated the problem due to corporate mismanagement, investor fraud and banking failures.

III European Accession and the Céska Centa : Domestic and International Pressures

In view of its intention to be among the first applicants to join the EU in the future, the Czech Republic continues to strive towards revising its current policies to meet the acquis communautaire. Briefly, the EU signed a Europe Agreement with the Czech Republic in 1991 which established a trade agreement, and set out a more comprehensive political partnership as well as fiscal and technical assistance (see Sedelmeier and Wallace, 1996). This was followed by a reformulated policy in Copenhagen in 1993 to response to pressures for eventual membership and improved market access. Though the process by which CEE accession is taking place does not differ from previous enlargement since it involves a mapping out of a countries eligibility by the Commission, and acceptance by the Council and Parliament, the accession requirements laid out in the Copenhagen criteria are more far reaching than that provided to previous applicants (See Avery and Cameron, 1998). Thus, the prospective members have to take on the "obligations of membership" – which include the whole body of EU legislation – but they must also have a "functioning market economy" and "the capacity to cope with competitive pressure and market forces within the Union" (Copenhagen, 1993; for a fuller discussion see Grabbe, 1999).

After publishing a White Paper in 1995, modeled on the single market paper in relation to CEE, these concrete measures set down tangible targets in terms of regulatory convergence with the EU. Following this, the Czech Republic submitted a formal

application for membership into the EU in January 1996. In July 1997, the European Commission recommended that negotiations begin with the Czech Republic for admission to the EU. Shortly afterwards, the intensive negotiations that are presently underway for admission to "join the club" began. Essentially, the preparations for membership, the so-called Accession Partnerships, are run by the Commission's External Relations Directorate-General (RELEX). Given the complexity of the task, the Czech Republic has established different organizational structures: the Government Council for Integration (an advisory body that includes ten ministers and the prime minister), a subordinate Working Committee of the Council (which is staffed at the level of deputy ministerial chiefs), and numerous Working Groups which deal with functional issues (Jacoby, 1998).

With fifteen chapters out of thirty one chapters of the Accession agreement now currently closed, the latest assessments of their application still continues to express concern about the institutions of market governance (European Commission, Prague, April 2001). With fewer chapters closed than Slovakia, Estonia, Cyprus and Hungary, the government has insisted that they are not falling behind other applicants. Yet in spite of these criticisms, the EU is shaping economic governance and market practices to a much greater degree than that of its West European counterparts (Grabbe, 2000). The administrative, legal and regulatory environment is aided by the institutional fluidity of the market transition process on the one hand, and also by the conditionality requirements of the EU accession process on the other. Though there are transition arrangements -in terms of the free movement of labor[15] - for future member states, which are likely to be contentious on both sides, there are difficult negotiations ahead for the Czech Republic in the energy, environment and financial sector chapters. However, since there are no opt outs with regard to meeting the acquis, the Czech Republic now faces a differentiated set of political opinions between those that want to join as quickly as possible, regardless of the conditions imposed, and those that prefer admission at a later date, without those conditions (See Bugge, 2000).

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[15] See Agence France Presse, April 11, 2001; Associated press, April 11, 2001; European Report, May 12, 2001 No 2592; Financial Times, April 3, 2001. A specially-convened meeting of EU Ambassadors (Coreper) on May 10 was unable to resolve the issue, and the failure of member states to reach agreement on this issue has led to perceptions of "second class citizenship" among applicant states.

However, the impact of "Europeanization" on domestic politics is multidimensional. Following the recent surge in interest in Europeanization, it is clear that the process affects many levels of politics and governance at the national and subnational level (See Cowles, Risse and Caporaso, 2001; Kohler-Koch, 1996). First, there has been sharp clashes among the various political parties over enlargement. Though the minority Social Democratic Party took power in 1998 after the fallout from the scandals of the Conservative (ODS) government under Klaus, the ruling party has operated under a deal with the opposition that allows them to criticize the government while providing tacit support to enable the Social Democrats to govern.[16]

Yet the parties have clashed over EU accession, reflecting the distance between the long held nationalist position of Klaus about the appropriateness of EU institutions for the Czech Republic and the more willing stance of the subsequent successor Tošovský government, and later the minority Social Democrat Zeman government (Lidove noviny, 19 March 1998). The European Commission in its first two reports had pointed to the gap between policy intentions and policy output in terms of meeting the accession criteria. This is rooted in the political situation, whereby certain policies received insufficient attention from the conservative government under Klaus, and the minority status of the current government had made parliamentary approval of legislation more difficult. Complaints from the opposition Christian Democrats, Communists, Freedom Union and Conservative parties that they have not been kept apprised of negotiations, and that the entry preparation has been imposed from outside rather than reflecting national interests has contributed to concerns about the government's accession strategy.

Second, public opinion has finally begun to increase support for Czech accession. There is a growing public consensus on supporting enlargement which differs from the more lukewarm attitude several years ago. A societal consensus exists on achieving membership in broader international communities, with various opinion polls indicating strong support for both NATO and EU membership. There are fears that nationalist or populist parties could stir up resentment and backlash on specific requests that could be

[16] Known as the opposition agreement," this gives the Social Democrats (tSSD) control over day-to-day national management in exchange for political concessions to the Civic Democratic Party (ODS). Despite its political unpopularity, it was renewed after surviving for three years in Spring 2001.

difficult to accommodate. The preference for restrictions on land acquisition by EU nationals is expressed by Hungary, Poland and the Czech Republic to differing degrees is based on "deep-seated fears by central Europeans that well-heeled Germans will return to the region, inflate land prices" (Financial Times, April 3, 2001). The Czech daily newspaper, Mladá frontes Dnes, produced a poll in November 2000 that mapped public opinion towards EU accession. Strong support peaked at 58% between September 1997 and November 1998, with 21% against membership during this period. In November 2000, the number of strong supporters had fallen to 49% and the number against had risen to 25% (Mladá frontes Dnes, November 2000). There are strong signals that a referendum in the Czech Republic would strive for a 60% majority in favor of membership. In an effort to enhance public understanding about the enlargement process, the Czech Republic is working on a communication strategy to increase public support. As Foreign Minister Kavan noted in a speech at the Centre for European Policy Studies in Brussels, quoting Chirac, "le rythme de la construction européenne ne se décr te pas" (Kavan, 19 March 2001).

Third, the need for administrative reform to match the political and administrative boundaries of regional policy in the European Union has led to the abolition of district councils and their replacement by new regional systems of governance. The regional reform process has created new regional and local governance structures. Moreover, the reforms have shifted the balance from a traditional unitary fiscal model to a decentralized fiscal model where the regions are to be given percentages of certain levied taxes rather than direct state subsidies that had characterized the inter-regional transfer of funds in the past (European Commission, Prague, 2001; Cerge-EI, 2000). This decentralization was initially resisted by the Klaus government in an effort to main centralized control despite the effect that this would have on making Czech regions eligible for structural aid. The reforms were finally introduced in 1997, with the regions not following the same NUTS classification as other EU member states which would allow the Czech Republic to qualify for structural funds. As Jacoby indicates, the Klaus government agreed to allow regional bodies after insisting that the number of self-governing regions (VUSC) be roughly

equivalent to prevent any one from having a large political base.[17] With this framework in place, regional policy makers are now being forced to coordinate informally into six larger regions for the purposes of dealing with the EU The slow progress on regional restructuring has been further delayed by the Social Democrats who may find themselves undercut by regional governments dominated by the opposition parties. Though this embryonic regional structure is clearly driven by the acquis, it has not resulted in slavish imitation (Jacoby, 1998).

However, the degree to which European accession necessitates adjustment is much more expansive than in previous enlargement experiences (Brusis, 1998). The extra-territorial alignment of national competencies with European competencies is only one side of the story. The European Union has been actively promoting its political influence in many other areas including administrative and judicial reform, and protection of minorities which have traditionally been the purview of member states. In the economic sphere, the European Union has begun shaping pension, social welfare, taxation and fiscal reform. The applicant states have responded to this "penetrated sovereignty" (Wallace, 2001) through legal and administrative reforms. In the Czech case, a draft National Program of Preparation for European membership has sought to improve both the judicial and administrative process through codes of conduct for civil servants, bankruptcy laws, and economic crimes.

The preceding section has suggested a strong role for the EU in shaping applicants movement towards accession. The final impact of "Europeanization" is on specific policy areas since this represents one of the key benchmarks by which the EU member states may decide at Laeken in the Fall which applicant states are the "front runners" for membership. Few studies have examined how the EU is shaping specific policy areas. Though this is not identical across applicant states, it is clear that the EU's impact on their political economies is likely to be much greater precisely because of their underdeveloped

[17] Interestingly in the first elections in November 2000, the opposition ODS party did extremely well despite its reservations about decentralized administration. However, regional ODS leaders have felt empowered by the institutional changes and have not always been in agreement with the central political leadership. Worth watching is the small number of independent parties that have gain a toehold in the regional political level. The regional premiers are all from opposition parties which may explain the current effort by the Social Democratic government to postpone further regional reforms.

governance frameworks that allow a degree of institutional malleability to take place. Much of the discussions on Europeanization have focused on the pressures originating from EU norms, rules, regulations and practices, so it is only appropriate to use the same "frame" to examine the degree to which specific policy areas are being transformed by processes of integration. Focusing on two areas of crucial importance to EU accession, competition and corporate governance provide good illustrations of the extent to which institutional adaptation can take place, and the degree to which modifications in institutional design are driven by domestic and international factors. Since the literature on corporate governance and competition policy in central and eastern Europe (CEE) has so far made little connection with research on European integration, it allows us to examine the extent to which the demands of the *acquis* is influencing domestic policy-making.

IV. Betwixt Two Models: Corporate Governance and Competition Policy

Although the previous sections have demonstrated the link between Europeanization and domestic politics, the EU's accession policy does contain an implicit neo-liberal policy model for CEE. Focusing on the two areas of corporate governance and competition policy, it is clear that the effort has been to promote liberalization, marketization and privatization in the economic arena. To meet EU norms, the Czech Republic has undertaken certain structural reforms to meet the acquis.

a) Competition Policy

In the competition field, article 64 of Accession Agreements sets out the rules governing competition policy.[18] Much of the evaluation in assessing competition practices in the Czech Republic is being done by the Directorate General for Competition in the European Commission. This involves two major areas: the antitrust sides (namely articles 81 and 82) which deals with agreements, abuse of dominant position and merger control, and state aids, which includes both old and new aid provisions. The Czech Republic is expected to adopt not only the treaty rules in this area but also the framework legislation that currently amounts to over a thousand pages not including the relevant court decisions.

[18] In establishing what are incompatible with the proper functioning of the agreement, the provisions of article 64 include all agreements that prevent, restrict or distort competition; abuses of dominant position; and public aid which distort competition by favoring certain undertakings or production of certain goods.

As a candidate country, the Czech Republic must undertake three tasks before the competition policy chapter is closed. First, harmonize legislation to meet the Community acquis by adopting basic treaty plus secondary legislation such as block exemptions, rules on vertical and horizontal restraints, and rules governing regional and sectoral aid into national law. Second, have in place, the administrative capacity to implement legislation. This means the creation of both an anti-trust and state aid monitoring authority which will remain important after accession especially as the EU modernizes its competition policy and decentralizes competition policy to the national level. Since current member states start from different legislative origins, there is sometimes a disjuncture in methods and process from community policies and competencies. Hence there is likely to be a greater "goodness of fit" in the Czech case as it seeks to introduce a set of institutions modeled on EU norms as a basis for its own domestic model. In the Czech case, the creation of the Office of Protection of Economic Competition (UOHS) serves as both a control unit for both state aids and anti-trust practices. This is distinctive since most EU member states do not have their own office for state aids but have instead a coordination unit between the EU and national level. This was a conscious effort on the part of the Czech Republic as the applicant states did not want the imposition of a supranational agency similar to the European Economic Area where the ESA exercises these control and oversight functions (see Devuyst, 2000). By refusing the EEA model, the applicant states wanted to retain national control of this crucial policy area and set up their own administrative structures to assess any violations of treaty rules. Third, and most importantly, specific to competition policy, there must be an enforcement record before the competition chapter is closed. The idea of a good decentralized enforcement record in both state aids and anti-trust differs from other chapters which require that the necessary directives be implemented or transposed by date of accession.

Thus, far the Czech Republic has a good implementation record, having initiated around eighty five proceedings on state aids and issuing around eighty-nine decisions on competition-related issues in 2000. The idea that public authorities and companies be well aware of how to function in a market economy has taken root, so it is likely that the

competition chapter may be provisionally closed in the latter part of 2001, with the Commission producing a report on the situation and proposing a common position.

The Czech Republic is bound under article 64 to follow basic rules of EU competition policy whenever trade is affected between EU and an applicant state. Given that the Office of Protection of Economic Competition (UOHS) has been established with relative speed, it is the sole responsible authority in this field, thus the Commission can only given technical advice. UOHS has begun an inventory of state aid projects, following on from the Commission's annual report of state aid controls that will include candidate countries in future. The key issue is ensuring comparable data and methodologies. For the Czech Republic, this means differentiating between two different types of state aids: new state aids given to attract investment through the Investment Incentives Act and reviewing old state aids for rescuing and restructuring that have to be approved by UOHS.

In the case of new investment, the competition authority must check that the new state aids meets the acquis based on the criteria of "maximum aid intensity for certain regions". Because aid for new investments need to follow community regional guidelines, state aids to regions is determined by specific criteria. All candidates in the Europe Agreement have the status of 873a regions which they were given for five years to allow certain forms of regional aid.[19] In this criteria (based on article 873a of the Treaty, those regions are considered as having GDP less than 75% of EU average. This makes them eligible for 50% maximum aid intensity for new investment, and allows the Czech republic to allot 50% state aids for regions that have been administratively reformed to meet EU guidelines (see above).[20] The entire Czech Republic qualifies for maximum aid intensity, although the income level of different regions varies.[21] In the case of existing state aids, there are detailed rules to promote restructuring, which have been used in the banking and steel sector. There are guidance notes published to ensure transparency in the criteria used to allow state aids in the steel, motor vehicles and coal sector, as well as research and

[19] There is currently a proposal in the Council to extend the 873a status since the initial five year period has lapsed, and efforts are underway to extend this for another five year period.
[20] Where the EU GDP is between 60-75% of EU average or below 60% of EU average, these regions have a different maximum aid intensity level.
[21] The Prague region is about 100% of EU average albeit it still qualifies for maximum aid.

development, small and medium companies and transport areas. Though the procedural rules are in place, there have been some difficulties in both the banking and steel sector.

While the banking areas has been dealt with above, the problems in the steel sector are not dissimilar to those of member states in the mid 80s, involving a large number of employees in layoffs under the Davignon restructuring plan. The Czech Republic is obligated to provide a restructuring plan for the steel sector, (currently assisted by a consultant), since there will not be an exemption for state aids under the terms of the Europe Agreement otherwise. Bringing their policies into line with the acquis, the Czech competition authority has moved rapidly. Though the competition authority is independent, there are some concerns that the recent resignation of Pavel Mertlik, the Czech finance minister, in April 2001 may significant impact this area (Prague Post, April 18, 2001). His promotion of continued privatization and opposition to large scale public spending in lieu of EU accession, may shift the balance towards his rival, Miroslav Gregr, the interventionist industry minister behind the large scale spending plan. Politically, this may create problems in closing the competition chapter if new aid is given without consideration for the legal obligations towards EU policies and practices in this area. However, the daily contact between applicant countries competition authority and EU officials serve as an important indicator of the degree to which European integration is shaping domestic policies and practices.

Aware of the enforcement issue, the Czech competition authority has exercised considerable scrutiny over aid practices to bring in line with EU standards. Often this involves tackling some of the thorniest economic problems to gauge whether violations have occurred. One of the most important examples is the recent forced administration of one of the major banks, IPB. Though this is not the first banking scandal - as Plenska Kreditini Banka (Krb) collapsed in 1996, followed by Agrobanka, and then KB in 1999 - forcing large scale bailouts and massive withdrawals from banks by citizens (Mejstrik, 1999). However, the privatization of IPB was considered a successful effort at attracting a strategic foreign investor when the Japanese bank, Nomura purchased a sizable stake in early 1998. Though there had been some disagreement over the share price after an audit by a major accounting firm had revealed huge amounts of concealed debts, the economic

situation deteriorated to such an extent that the government sold off its remaining shares to CSOB partly owned by KBC Bank, Belgium. Normura has launched a complaint about the entire sale, questioning whether the bid was open and transparent. This may result in the involvement of the Czech competition authority to asses whether state aids were involved. However, concerns that this may affect Czech accession due to the legal wrangling involved has led the Czech foreign minister to seek settlement with Nomura.

b) Corporate Governance

In contrast to the well received efforts in the competition sphere, the task of meeting the acquis in the corporate governance field is more problematic cutting across a number of chapters including industrial policy, competition policy, and capital markets. The Czech Republic has engaged in a number of reforms to address many of the difficulties resulting from previous economic policy choices that shift the emphasis towards a neo-liberal model rather than the cross-shareholding, bank-based systems.

Among the most important efforts underway are the privatization of the remaining banks and other state assets. Delays in privatization has provoked strong criticism from the European Union (European Commission, November 4, 1998). Though privatization continued at a such slower pace after the voucher method was discontinued in 1995, a large amount of assets are still state owned. Substantial stakes are still held by the state in the utility and banking sector.

While privatization has gotten embroiled in political controversies that has hampered the final sales of state assets, two banks, IPB and CSOB have already been privatized, and two banks CS and KB are scheduled to be privatized. Since these are heavily indebted banks, with KB used as a depository for bad loans accumulated in different industrial sectors, the government introduced in 1996-1998 a new bank consolidation program and stabilization program to deal with banking sector problems (World Bank, 1999 p. 38; see above). Nevertheless, the poor performance of the banking sector as a whole has forced the Czech Republic to respond by creating the Revitalization Agency in April 1999. The Agency was designed to recapitalize and restructure selected companies, clean up the loan portfolios of banks to prepare them for privatization, and seek strategic investors to provide capital and management expertise (World Bank, 1999

p. 146).[22] Interestingly, the government launched this effort with international assistance from international investment banking firms, Latona Associates in Europe and Lazard Fréres in US. The net result will restore investor confidence, improve fiscal discipline and promote greater transparency in the dealings of banks with industrial enterprises. The Revitalization Agency (RA) was abruptly terminated in late 2000 and is being integrated into the KoB, the consolidation agency after disagreements about the administration of the management of the agency by outside investment banks. The RA program had been a compromise between the industrial restructuring plan involving private creditors proposed by Finance Minister and Vice Premier, and the preference for a stronger state role by the industry minister. However, the tasks of seeking strategic investor for privatization for many of these companies in energy, transport and heavy industry continues since the Czech Republic needs to open up its markets to face EU competitors upon accession.

Oversight in the banking sector has been further strengthened by prudential lending rules that have tightened credit conditions, and thus contributed to industrial restructuring. Stricter rules for banking licenses and the need for greater capital assets are also aimed at strengthening the credibility of the banking sector. This is further enhanced by efforts to strengthen the supervision over investment funds and limiting further bank exposure in non-financial companies. Limits have been set on ownership stakes of investment funds in companies which has forced the sell-off of shares to outside investors. Recent reforms in Banking Laws in 1998 signal a shift away from bank-centered finance model. This nullifies the banks role in restructuring, reduces banks influence in industrial enterprises, and ensures that bank holdings in non bank institutions did not result in bank capital being siphoned off into a select few enterprises.

However, it is in the area of capital market reform that the Czech Republic has made significant institutional innovations that reflect a shift in economic strategy towards a more Anglo-Saxon model. The establishment of a Securities and Exchange Commission in 1998, despite substantial political opposition, has opened up the prospects of further capital market development. The goals are to prevent the abuse of insider information and

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[22] Pre-privatization clean up of KB bank is estimated at 17.7 billion Czech crowns and CS is estimated at 7 billion Czech crowns.

monitor suspect transactions. It is authorized to review licenses of brokerages, investment funds, and the alternate stock exchange system (RM-System), as well as freeze assets and fine companies suspected of wrong doing. However, the SEC still needs a stronger enforcement capacity This improved regulation of capital markets needs to be further extended into the over the counter trading system. Improvements in regulation and enforcement are still hampered by the relative inexperience of the SEC, as well as its complete lack of independence from government interference.

To further protect shareholders and increase the attractiveness of investors, the Czech Republic has begun improving the environment for corporate governance. Despite efforts to protect minority shareholder rights through the introduction of new stock market legislation in 1996, the reforms are still deemed inadequate, as demonstrated by their complaints in the IPB case. Another area that remains a concern is the poor protection of creditors, which has the dual effect of increasing the reluctance of banks to provide new loans and the difficulties they have in collecting existing loans (OCED, 1999; Neumann and Egan, 1999). Despite the Bankruptcy and Settlement Act of 1991, banks have been unable to collect collateral from loans because the law requires debtor consent (Prague Business Journal, 12 June 2000). The value of collateral pledged to Czech banks is in the hundreds of billions of crowns, one-third of them guaranteeing classified or non-performing loans which are difficult to collect. Though under immense pressure from international institutions to improve bankruptcy legislation, and enforce the decisions through the court system, the government has proposed reforms that will curtail the ability of debtors to strip assets during legal proceedings (OCED, 1999 p.6). Although the new Bankruptcy Act (105/2000) was aimed at speeding up the process by appointing a bankruptcy trustee to oversee financial affairs, it has come under strong criticism after being further amended. The law has been weakened by provisions that are not retroactive so that many existing loans subject to such foreclosures are not covered (Prague Business Journal, June 12, 2000). Currently, the bankruptcy court has thousands of cases pending, including many that have been on the docket since 1991 (Prague Business Journal, February 1-7, 1999).

The net effect seriously hampers the efforts of the consolidation bank, Konsolidacni, which has been trying to recover hundreds of bad loans from much of the troubled banking sector. It renders mute the Public Auctions Act which would have allowed banking houses an easier means of recovering bad loans via the sale of real-estate collateral. Though it is standard practice in EU member states for banks to sell off collateral at public auction if a loan is not repaid, the reluctance in the Czech Republic to follow this path has impeded their progress in harmonizing their policies with the EU. This is in marked contrast to both Hungary and Poland where bankruptcy laws have been used to liquidate assets, harden the budget constraints of firms and improve the fiscal discipline of both banks and firms (Gary et al, 1995; Borish and Noel, 1996).

Recognizing that the Czech Republic still has to engage in significant internal reforms to meet external requirements, the intersection of domestic and international pressures has yielded substantial regulatory changes over the past decade. Many of these reforms fit the well-known argument in the EU that although the markets are being progressively liberalized, this does not mean the absence of regulation. While markets for competition are being created, there is also recognition of the mix of regulatory styles, instruments and philosophies that govern the EU market. The transformation of the Czech economy from a command economy to a market-driven economy changed the entire ownership structure of society, altered market structures, and distribution systems, as well as witnessed a flood of new economic instruments and agents into the economy (Neumann and Egan, 1999). The existence of the market alone is not enough to provide stability. Markets not only require rules, but also economic institutions that provide a more organized pattern of interaction among economic agents to prevent market failure. No matter how strenuously the government seeks to supply the necessary institutions for market maintenance, incomplete rules, weak enforcement and the build up of trust in market transactions will need to be tackled over the long run to meet the institutional demands of EU accession (Winiecki, 1997 pp 252-253). Despite its liberal rhetoric[23], the

[23] Although Elster et al (1998) argue that the voucher privatization scheme was "clearly inspired by an Anglo-Saxon model of popular capitalism and stock market control" p. 190, the Banking Act passed in advance of mass privatization , envisaged a German style universal banking system (see Neumann and Egan, 1999; Egan, No Date, Simonson, 2000).

government -as Klaus later acknowledged - should have paid more attention to the enforcement of existing law (Mladá Frontes Dnes, April 21, 1997 p.2).

But many of the suggested reforms by various international agencies are politically difficult since they are likely to lead in the short-term to higher unemployment and slower growth (see OECD, 1999; World Bank, 1999; 2000). Stressing the external conditionality requirements in "joining the club" certainly demonstrates the regulatory reach of the EU upon the applicant states. However, recognition that domestic factors are also important in shaping the "return to Europe" can help explain the rhetoric and discourse on European integration, policy blockages and policy achievements, and circumstances under which existing policies can be redesigned.

Conclusion

The histories of capitalism are punctuated by "divides" or "critical junctures" in which economies and societies choose among a variety of viable organizing possibilities or regulatory principles. However, the process of market building in many post socialist economies has resulted in a radical change of market forms, processes and modes of coordination. As such, an analysis of Central and East European economic reforms invites us to look back at West European economic history, to consider the paths not taken, and to address the social choices, political factors and institutional conditions underlying the rise of a European "regulatory" patchwork rather than a distinctive model of economic governance in the EU. In fact, there has only been a limited convergence within the EU towards a European 'model of capitalism.' The continuing diversity of capitalisms across Western Europe has been well established in the political economy literature. (Berger and Dore, 1996; Egan, 1994; Apeldoorn and Rhodes, 1997; Zysman, 1994). The fact that the Czech Republic fits no one model neatly - blending elements of different models of capitalism - highlights the degree of institutional adaptability that the transition process can promote.

While research on path dependency has drawn attention to the institutional lock-in effects and sunk costs of particular policy choices, and points to the unintended consequences and inefficiencies of certain actions, it tends to stress the difficulties of change. Notwithstanding the political and social costs of further economic restructuring,

the persistence of certain institutional and policy choices in this context cannot be taken for granted. The accession process provides a "window of opportunity" for adaptation and change in the Czech Republic, as well as providing for new norms, rules and mechanisms to be introduced.

While the Czech Republic still has hurdles to overcome, especially in the corporate governance area, it has moved forward rapidly in the competition area. In both areas it has introduced new institutional mechanisms of governance - the securities and exchange commission and the competition authority - are both responses to pressing needs to effectively govern markets. Hence, it is important in evaluating the effects of Europeanization on domestic politics to look at different sectors to see how domestic structures have been transformed. In doing so, a focus on CEEs adds to the burgeoning literature on Europeanization, by identifying the effects of conditionality laid out by the EU accession criteria. In examining the ability of domestic institutions and policies to adapt, emulate and respond to changing circumstances, it is possible to begin tying in the work on Central and Eastern Europe to that of similar work being done on EU member states in order to assess the domestic institutional factors facilitating or prohibiting structural change. It also allows us to link both domestic and international factors. The transition literature has tended to focus on domestic factors such as the legacies of the past or imperatives of liberalization and institutional incentives to explore patterns and variations, whereas the consolidation literature has focused increasingly on the policies of new governments and the extent of external support (see Eckiert, 1998 also Eckiert, 1996; Lipjhart, 1995; Elster, 1998; Philips, 2001). Clearly international and domestic economic influences cannot be held constant for the purposes of understanding policy choices and resulting political outcomes. As the Czech case demonstrates, policy failures have triggered new efforts at policy learning and adaptation, as the pressures for accession have put pressure on CEE applicants to place alternative policy proposals on the agenda. Combining discrepant elements into what has been labeled by Stark as "bricolage," the Czech case demonstrates that the capacity for reform, adaptation and adjustment may be significantly higher than those (western) states with a deeply entrenched core of administrative and regulatory traditions (Knill and Lenschow, 1998).

As existing research moves beyond the territorial and functional boundaries set by EU research, and looks at the range of interconnected relationships that are emerging and the relationships between domestic and European politics, those countries in Eastern Europe can provide new cases (Wallace, 2001). As recent research makes clear, the conceptual framework of enlargement can move beyond historical and descriptive accounts of particular waves and groups of countries, to draw on concepts from international relations, comparative politics and political economy. Rather than compartmentalize the different strands of scholarship on Europeanization and enlargement, transition and consolidation, models of capitalism, institutional adaptation and borrowing, domestic and international factors, this paper suggests it is possible to stitch them together, to understand the evolving systems of governance in CEE. In doing so, it addresses the neglected subject of theorizing about enlargement (Wallace, 2001; Schmitter, 1996) by drawing on literature outside the general "frame" of European integration studies.

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