

The Nature and Evolution of Capitalism in the Czech Republic

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Abstract:

The evolution of capitalism in the Czech Republic was very strongly influenced by chosen way of economic transformation which was the so called “shock therapy” instead of gradual implementation of economic reforms. In the first section the paper deals with fundamental characteristics of approaches to different varieties of capitalist economies. These varieties are presented including Central and Eastern European countries. Furthermore, authors identify building blocks of indicators of capitalist economies and create a framework for the capitalist market economy in the Czech Republic. Key part of this paper is devoted to development of institutional structures in the Czech Republic. Institutional structure is divided into six spheres: business and labour law, financial systems, industrial relations, corporate governance, creation of skills, business interrelationships and innovation. The comparative analysis that is attached in the form of a table of indicators (see Appendix 1) shows that the majority of indicators relevant to the case of the Czech Republic belong to coordinated market economy (CME) type of capitalism. This is the reason why the authors tend to place the Czech Republic among countries with CME.

Keywords: economic transformation, varieties of capitalism, indicators of capitalist economy, financial systems, corporate governance.

JEL Classification: P16

1. Introduction

The last twenty-five years the economies of Central and Eastern Europe have experienced extensive economic transformation as a result of the collapse of communism in these countries in 1989.

In the Czech Republic this fact has raised an extraordinary euphoria among the people and the country has created a rare and high unity, although negative: against something, not for anything.

When looking for a way forward, for the majority of the people, capitalism was not the outright alternative to communism but various utopian third ways were sought after. Back then the conflict about where to go and how to get there was merely among reformed Communist Party members, who were mostly struck off the register or excluded communists from the sixties, and the relatively small group of economic experts headed by Vaclav Klaus. This group of people was not afraid to say that the goal of transformation of the society is capitalism and

parliamentary democracy. The result of this effort in 1990 was a compromised *Scenario of economic reform* created by the government and enforced by the former Federal Parliament, which included the main ideas of proposed system changes.

The main pillars of this transformation were:

- economic deregulation - the liquidation of institutions of centrally controlled economy, the cancellation of hundreds of commands and interventions, opening of the free market;
- the liberalization of prices and foreign trade (convertibility of the crown);
- privatization of state enterprises;
- supervision of the macroeconomic situation (fiscal and monetary restitution) and avoidance of a high inflation.

In search of the strategic transformation the economists have utilised (simply put) two different approaches (Holman, 2000). The liberal approach was focused on the supply side of economics to create market incentives. People are adaptable and thus a several basic system changes are needed to create incentives to desirable market behaviour: to work hard, to do business, to search for new markets, to increase quality of services. Such systemic changes include the liberalization of markets and privatization. The system, which has open and free markets and a private property, automatically creates incentives for such behaviour, which is typical for a market capitalist economy. The emergence of market-based incentives is a prerequisite for the subsequent development of market institutions. Firstly, there must be free prices and free access to markets, only then there is business development and competition emerges. Under pressure from the competition the business ethic is strengthened and market institutions are formed.

The institutional approach took as a basis for the transformation the emergence of new market compliant institutions, i.e. both formal and informal rules of conduct, including penalties for non-compliance. The transformation is not considered only as a number of “system cuts” but as a complex and difficult change of entrenched patterns of behaviour, which continues slowly and cannot be significantly accelerated. People are influenced by so called path dependence on the past that works as bias to swift change of behaviour and disallows quick adaptation to new conditions. People act more under the influence of habits from the previous period rather than under the influence of individual incentives. Therefore, rapid system changes are undesirable.

It has to be said that there is some truth in both approaches. Creation of market incentives in the system of unsettled rules and immature market institutions can lead to undesirable conduct (with unpredictable effects). On the other hand, postponement of system changes slows down the emergence of market-based incentives and can lead a country to “backwaters” of stagnation. According to liberal economists lack of market incentives hampers desirable development of market institutions. But it is still not clear whether those incentives are a result of existing institutions (view of the institutionalists) or on the contrary, the development of market institutions is carried out in response to market incentives (view of the liberals).

The transformation had two fundamental stages. The first stage was the market liberalization and economic stabilization. The second stage was concerned with privatization

and restructuring of enterprises. At the beginning, economists split into two groups when it comes to choosing a transformation strategy. The dispute arose about whether to choose the shock therapy or gradualism strategy. These strategies, however, apply only to the first stage of transformation - towards liberalization and stabilization.

The shock therapy expected rapid (essentially instantaneous) liberalization of markets, i.e. deregulation of prices and wages and the opening of domestic markets to foreign competition. But such liberalization must be accompanied by tough stabilization measures that would prevent high inflation and disrupting the balance of international payments. However, the stabilization acted for companies like a "shock", to which it was hard to adapt quickly. The result was an economic downturn. Advocates of the shock therapy said that this decline was inevitable and that these were short-term transformation costs. Gradualists on the contrary, demanded that the liberalization proceeded slowly, to be spread over a longer period. They believed that in such a case, the economic downturn will not be necessary.

In such rapid and radical transformation measures advocates of the shock therapy have perceived a guarantee that the transformation will be an irreversible process, which after it had started it was not possible to reverse or stop.

Followers of gradualism most feared that the shock therapy would have too high costs in the form of a large economic downturn. The "gradualists" believed that the transformation can be accomplished without a large economic downturn, if spread over a longer period and carefully controlled by the government. If the government would have opened domestic markets to foreign competition gradually and have given domestic producers time to adapt to the new conditions, they would in turn not have been exposed to a sudden shock. Gradual and slower liberalization of markets would also not have required such a drastic stabilization measures, businesses would not have been exposed to shock in the form of fiscal and monetary constraints and there would not have been a need for such a big initial devaluation of the domestic currency. The "gradualists" believed that slower transformation strategy would not lead to economic decline. For the "shock therapists" by contrast, a temporary economic downturn was inevitable for the implementation of profound structural changes in the economy and the restructuring of the corporate sector. Yet they did not believe that the government would be able to effectively manage and control such processes.

Selection of the transformation strategy was not just a matter for economists. To realize the shock therapy politicians had to have enough political capital - they must have had broad support of the population for the drastic transformation measures. This was accomplished in those countries where the revolution was waged against the communists, as was the case in Czechoslovakia and Poland. In these countries, people have seen the transformation as the continuation and completion of the anti-communist revolution. Therefore, majority of the society also supported politicians who demanded the quick removal of the hated system of central control and planning. Shock therapy was considered as a radical accomplishment of the revolution, a "mean to cope with the past", at least in the economic sphere.

The aforementioned facts strongly influenced the nature and development of capitalism in the Czech Republic.

The goal of the paper is to characterize the development of main elements of institutional structure of the market economy that has been formed during the transformation process towards a capitalist economy in the Czech Republic.

Structure of the paper is as follows. In the second section we characterize the basic elements of approaches to different varieties of capitalist economies. In the third section, we present these varieties including the countries of Central and Eastern Europe. Before we analyse the framework of the capitalist market economy in the Czech Republic, we characterize the building blocks of indicators of capitalist economies, which is a content of the fourth section. Pivotal fifth section presents the framework of the capitalist market economy in the Czech Republic. In conclusion, we will summarize the findings and state of knowledge.

2. Basic elements of the approach to varieties of capitalist economies

The approach to varieties of capitalism developed by Hall and Soskice (2001) considers businesses as key actors in the political economy and their approach is concentrated on these businesses. The authors consider businesses as “actors that pursue endeavour for development and utilisation of key competencies or dynamic skills, considered as capacities for development, production and sales of goods for profit” (Hall and Soskice, 2001). The core of their analysis are interactions of actors. They claim that business skills of firms are fundamentally relational and that a firm has to deal with a number of coordination problems. This is the reason why firms’ successes depend on their relations with other actors.

According to the institutional economics (Mlčoch, 2005) a business is a set of contracts among their constituents, a set of contracts that unites together participants of a business coalition: owners, managers, employees but also external participants – such as suppliers, customers, creditors and a community on which territory the business operates. Within the spirit of this idea, Hall and Soskice (2001) have concentrated on “five spheres in which businesses develop their relations towards solutions of coordination problems that are crucial for their key competencies” (Hall and Soskice, 2001). These are the following spheres:

- Industrial relations, where the company faces the problem of how to coordinate bargaining on wages and working conditions with their workers, organizations representing labour unions and other employers.
- Vocational training and education, where the company faces the problem of securing of workforce with appropriate skills, while workers face the problem of deciding how much to invest in that skill.
- Corporate governance, where companies face the problem of access to financial instruments and investors seek opportunities for investment.
- Inter-firm relations, where companies face the problem of ensuring the relationships that a company generates with other companies and, in particular, its suppliers or customers with a view to guarantee stable demand for their products, adequate supply of inputs and access to technologies.
- Relations with employees, where companies face the problem of how to ensure that employees have the necessary competencies and work well with others to achieve business objectives.

Solution of these coordination problems on the side of businesses depends on the institutional frameworks of economies in which these businesses operate. Before we will

continue with own institutional frameworks, we will analyse main types of economies based on the approach to varieties of capitalist economies.

3. Varieties of capitalist economies

Approaches to varieties of capitalist economies are distinguished by different authors. There exist several main approaches based on: Hall and Soskice (2001), Rhodes and van Apeldoorn (1997), Coates (1999) and Amable (2003). These authors focus on a number of “paradigms” of capitalism according to their specific characteristics and complementarities.

The approach of Hall and Soskice is dealing with a defining factor represented by the ways in which activities of companies are coordinated. They propose two ideal types of coordination of modern capitalism: the liberal market economy (LME) and coordinated (sometimes referred to as 'organized') market economy (CME). Liberal market model is applied in Anglo-Saxon countries - USA, UK, Canada, Australia and New Zealand. In LME businesses operate through competitive markets in most areas of economic life, with price signals, supply and demand as the main economic indicators.

In the second type of economy (CME) companies are coordinated through many nonmarket relations. These include network monitoring based on exchange of private information and cooperation relations (rather than competition) among and within businesses. Examples of such systems are Germany, Denmark, France and Japan. They have a high level of employment, low level of equity capitalization, relatively low working hours and relatively low income inequality.

Rhodes & van Apeldoorn (1997) approach is based on Albert (1993) distinction between Anglo-Saxon, "Rhine (or Rhenish)" and "State" capitalism and carry out further steps towards the operationalization of these concepts. They proposed a classification into three groups: market-oriented Anglo-Saxon, German network-based (i.e. Rhine) and the Romanesque type of capitalism. They argue however, that the similarity of the latter two types is quite strong and therefore they have included Western European capitalist model into the continental unlike Anglo-Saxon type. Moreover, compared to Hall and Soskice (2001) they distinguish a third concept, namely, developing state type (i.e. state-interventionist).

There are many criticisms of these approaches by several authors, even coming from those who accepted the framework of previously described varieties of capitalism. We will focus on only two criticisms (see Morgan, Whitley and Moen 2005).

Firstly, the analyses of capitalism types are concerned only with one characteristic of capitalist economies, namely business coordination processes. It is important to be aware of the fact that based only on sole dimension of capitalism, different economies are put together in one category even if they can be distinguished by several economic measures. For example, Japan and German are included into a category of coordinated market economies, have different types of welfare state and involvement in international economy. USA, Canada and Great Britain also have significant differences in means how they create welfare and their global presence.

Secondly, the industry structure in relation to global economy, “engine” of wealth accumulation (businesses, government), types of innovation and education as well as types of ownership and mechanisms of ownership control represent criteria that result in different

combinations of countries' economic varieties. Amable (2003) enlarges the analysis by including other dimensions such as goods-market competition, institution of labour market, financial sector, corporate governance, social security and the welfare state. As well as the approach of Hall and Soskice (2001) Amable (2003) works with typology using institutional complementarities.

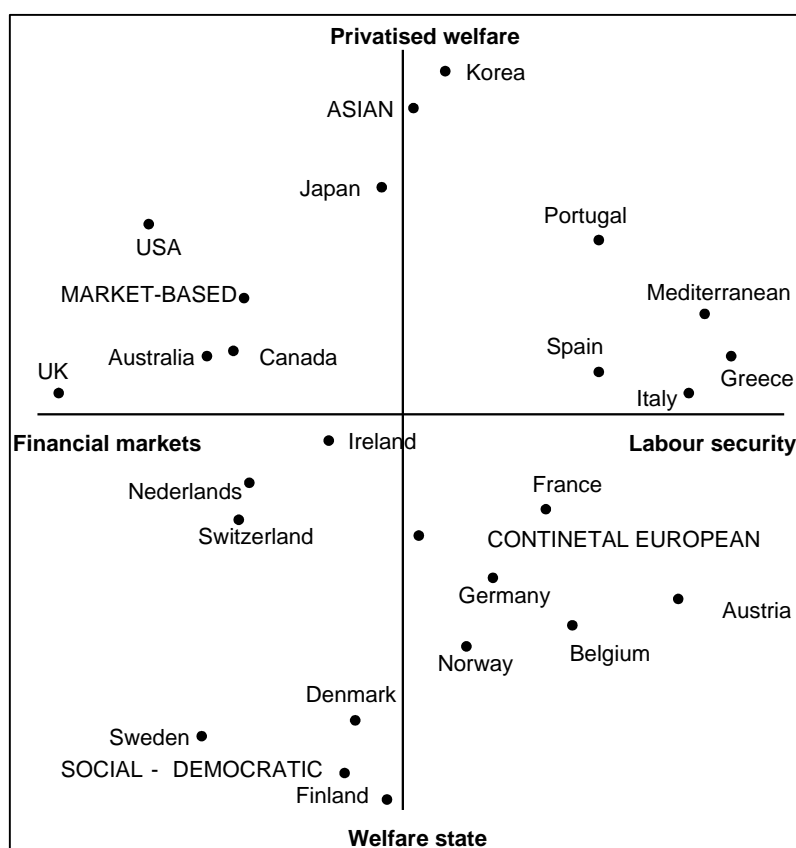
These criticisms imply a greater variety of variants of capitalism. From this perspective the approach developed by Amable (2003) is more interesting because it suggests five type of capitalism. The market-based capitalism is similar to a liberal market economy by Hall and Soskice (2001). Distinguishing features of the social democratic model are reasonable assurance of employment, high level of social welfare, an extensive system of retraining and coordinated system of wage bargaining. The Continental European system is similar to the social-democratic model, but the welfare state is less developed, the financial system facilitates long-term corporate strategy, wage bargaining is coordinated and job retention is less intense than in the social-democratic system. The Mediterranean model has greater protection of employment and lower level of social security than in continental European model: labour force with limited skills and education does not allow for high wages and high level of skill in the industrial strategy. The Asian model (a variety of Coates "state (or dirigisme)" capitalism model) is "largely dependent on corporate strategies of large corporations in cooperation with the State and centralized financial system" (Amable, 2003). Employment security is realized by retraining opportunities and career advancement within corporations. There is no system of social security, as well as sophisticated financial markets; stability is ensured by large corporations. Approach by Amable (2003) is summarized in Table 1. and Figure 1.

Table 1. Five types of modern capitalism

| Type | Country |
|-------------------------|-----------------------------------------------------------------|
| Market-based | Australia, Canada, UK, USA |
| Asian | Japan, Korea |
| Continental-European | Switzerland, Holland, Belgium, Norway, Germany, France, Austria |
| Social-democratic | Denmark, Finland, Sweden |
| Mediterranean | Greece, Italy, Portugal, Spain |
| Criteria | |
| Product markets | regulated, unregulated |
| Labour markets: | flexible, regulated |
| Financial institutions: | stock markets, banks |
| Welfare: | the extent and type of welfare state |
| Education: | the extent and type of public versus private education |

Source: elaborated based on Amable (2003)

Figure 1. Five models according to Amable (2003)



Source: elaborated based on Amable (2003).

Despite the aforementioned various approaches to capitalism varieties and proposals of various types of capitalism, the practice shows that the level of similarity of some varieties suggests that for further analysis we can ultimately follow two types of economies consistent with the approach of Hall and Soskice (2001). Their approach is more widely accepted in the related literature thus it will be a backbone of our research too. Our goal is to develop more detailed characteristics of both varieties of capitalism, which allows us to further specify the institutional environment that one or another variety of capitalism creates for businesses. In association with this, we will analyse which variety of capitalism is close to Czech economic conditions and what institutional environment is being generated for the corporate sector in the Czech Republic.

Features shared by all aforementioned approaches are mostly related to the developed capitalist countries with high levels of progress of the markets and with a long history of capitalist development. Transformation in post-communist countries were held in conditions of advanced forms of industrial society, but with the need to create a free market, private property and functioning banking system with a convertible currency. In association with the transformation of post-communist countries quite different characteristics ownership and coordination were needed to overcome. In the absence of free markets, the main coordinator of all economic activities was the government through extensive public ownership of resources. The state had complete control of money spending and investment management. State management had fully determined the level of employment, wages and income distribution. The social basis of pluralistic democracy (middle class and private ownership of assets) was non-existent.

Therefore, there was a demand to seek ways to overcome this legacy of state-directed economy and lead the country's transformation into capitalist economy. Hence, it was necessary to understand not only the type of capitalism that was going to be created, but also the extent to which capitalism was to be established.

A model of capitalist economy for the countries of Central and Eastern Europe (CEE) was examined by Farkas (2011) that chose a similar approach to Amable (2003) and focused only on the EU member states after enlargement. Then the CEE countries were compared with existing models. This research showed that the CEE countries are eligible for the existence of another kind of capitalism as independent of the previously mentioned models. The cluster analysis shows that the distinction between the CEE countries from the old member countries is more significant than the differences among them (see Table 2).

Table 2. Cluster analysis results by Farkas (2011)

| Clusters in EU 25 | | Types of capitalism (Amable, 2003) |
|-------------------|--------------------------------------------------------------------------------------------------------|------------------------------------|
| Cluster 1 | Austria, Belgium, Denmark, France, Germany, Ireland, The Netherlands, UK | Continental-European |
| Cluster 2 | Greece, Italy, Portugal, Spain | Mediterranean |
| Cluster 3 | Finland, Luxembourg, Sweden | Social-Democratic |
| Cluster 4 | Bulgaria, the Czech Republic, Estonia, Poland, Hungary, Lithuania, Latvia, Romania, Slovakia, Slovenia | Transition |

Source: Farkas (2011).

4. Building Blocks and Indicators of capitalist economies

Before we describe two varieties of capitalism and the ensuing institutional environment, we will give a list of building blocks of institutional spheres and indicators by which we determine detailed characteristics of both varieties. In doing so, we assume various comparative studies see, e.g. Jackson and Deeg (2006), Hall and Soskice (2001), Black (2006), Rhodes, van Apeldoorn (1997). An important finding here is that the literature on capitalism varieties is not referring to the criteria for allocating an economy into a fixed number of institutional spheres, nor it has specified which spheres should be included in constructing a typology of capitalism.

To summarize the main approaches of the authors, we can establish the following institutional spheres, covering most areas of economic activities:

- business and labour law,
- financial systems,
- industrial relations,
- corporate governance,
- creation of skills,
- intercorporate relationships and innovation.

Business and labour law

This institutional sphere includes the issue of regulations of business structures and administrative processes, the interests of the company and shareholders, shareholder protection,

protection of workers and trade unions, labour relationships of employees with management, labour contracts, insider trading, employee participation in the corporate governance and the remuneration of employees and management.

According to Cioffi (2000) we can distinguish three types of economies in terms of business and labour law. The *neoliberal economic model* (corresponding to the type of market-based capitalism by Hall and Soskice, 2001), widespread in the USA and the UK, is characterized by liberal business law with a few mandatory rules and general freedom to contract rules and the business code with defined structure and processes of corporate governance. The market for corporate control is highly developed and strengthened by fiduciary duties and rules of disclosure.

Concerning the labour law, labour relations and management companies are strongly separated (sharp distinction between commercial law and labour law). There is no form of participation (co-decision) of employees in the Board of Directors. In these economies trade union organization are fragmented without sector or top-level bargaining between employers and unions. Protection of trade unions is weak and even in the UK there are strict restrictions on strikes.

The second type of economy, the *neo-corporatist* (corresponding to the type of coordinated market economy, according to Hall and Soskice, 2001) is widespread in Germany and German speaking countries. In this type of economy there are obligatory rules in the commercial law and administrative structure of the business processes. Corporate interests are legally superior to the interests of shareholders; the company is accountable to the employees. Privately enforceable legal rights of shareholders are not very effective. There are networks of enterprises supported by the mutual holding of shares including interconnection of directors and powerful employers' associations and sectoral businesses. The market for corporate control is weak.

As far as the labour law is concerned the intersection of labour relations and the management of the company through the Supervisory Board and employee participation is strongly supported (Works Committees). The boundaries between commercial law and labour law are vague. There are centralized trade unions and employers' associations, which provide bargaining on the sector or on industry level supported by law. Trade unions and their bargaining power are strongly protected.

The third type of economy, *etatist*, particularly widespread in France and Japan, represents a combination of both types. In the commercial law, there are more obligatory rules than in the neoliberal system, but regulatory and inter-firm relationships have the greatest impact on the structure of corporate governance. Shareholders' interests are subordinated to "the interests of the company" and state politics. There is a little legal support for autonomous organization and representation of the interests of shareholders or for the effective protection of shareholders. There are hierarchical, vertically structured business network relationships with major banks, major industrial companies and suppliers (e.g. Keiretsu in Japan). The market for corporate control basically does not exist and the state has a significant role in the industrial and sectoral organization through administrative authority and supervision over its finances.

Concerning the labour law, there is a separation of labour and strategic management of the company and certain paternalism towards employees of the company, replacing formal

consultation of workers and the right of veto. State-controlled labour and wage policy is more important than collective bargaining that is partially realised by centralized employee unions. While workers' rights are strongly protected by law, independent trade unions and collective bargaining are protected rather weakly.

Financial systems

The financial system converts household savings into investments in the sphere of production. There are two basic forms of finance flows between savings and investors. The first form is mediated through institutions (usually banks), which collect savings, combine the maturity of savings and investments in order to minimize liquidity risk and value and monitor investment risks. The second form ensures direct transfer from savers to borrowers through securities markets. This fundamental distinction between banks and markets remains a fundamental question in comparative studies. Indeed, the simplest (and most used) typology of financial systems is divided into bank oriented and market-oriented depending on prevalence of each type (Jackson and Deeg, 2006).

Bank-oriented financial systems are prevalent type in the coordinated market economy. In these systems, the capital market is poorly developed and illiquid and in the process of the capital market regulation prevail moderate rules on transparency and disclosure. Enterprises gain the necessary investment capital through bank loans. Conversion of savings to investment is mainly done through banks.

Market-oriented financial systems are prevalent type in the liberal type of market economy. In these systems, the capital market is highly developed and liquid and the regulation of the capital market is subjugated to strong rules on transparency and disclosure. Businesses gain the necessary investment capital using share offerings on the capital market and also the conversion of savings to investment is mainly provided by capital market. Orientation of investors is usually portfolio based.

Industrial relations

Industrial relations are characterized by the role of employers, trade unions, employees and state and their relationship with respect to the employment policies. Employment relationships can be operated at different hierarchical levels: companies, industry sectors, national or international level. The literature identifies a number of comparable patterns of country-specific diversity and a variety of dimensions stemming from the structure of trade unions, employers, institutions of collective bargaining through the degree of state intervention up to the extent as well as forms of worker participation in management (Jackson and Deeg, 2006).

As a result of intense political discussions in recent years and labour market reform in Europe, the differences between systems of industrial relations are concentrated into two distinct approaches: regulated, centralized systems and deregulated, decentralized systems.

Regulated, centralized systems prevail in the coordinated market economy. They are generally characterized by higher levels of employment protection, higher levels of support for the unemployed, labour participation on the board (usually by trade unions) and collective bargaining institutions that are functioning at the sectoral, regional or national level, and

reducing inequality of wages across sectors and skill levels. Bargaining power of a dense network of trade unions is high.

On the contrary, regulated, decentralized systems as the predominant type in liberal market economies (market-based) provide weak protection of employment, less generous unemployment benefits and individual employment contracts. Institutions that guarantee participation of workers in boards do not exist, and the institution of collective bargaining at the company level are weak. Trade unions are fragmented and there is a lack of sectoral or top management negotiations. The bargaining power of trade unions is weak.

Corporate governance

Corporate governance is the central part of the institutional sphere. There are several views on this issue. The theoretical area of corporate governance is concerned mainly by study of how shareholders control over company's management, so that it is acting according to their interests. The existing comparative analysis assumed two basic approaches to ownership control: in the first approach, markets for corporate control play the central role; in the second approach a system of internal control with direct supervision of the management through a combination of debt and equity shares (Shleifer and Vishny, 1997). Other studies differentiate countries according to whether the corporate property was concentrated among larger shareholders such as wealthy families, banks or companies (holders of blocks of shares), or distributed among small shareholders and institutional investors within a liquid capital markets. Another aspect used in the typology, are the specific differences among countries in the corporate governance domain including stakeholders such as: employees, banks, customers, etc., and countries with exclusively shareholder's oriented form of capitalism.

In economic literature, the aforementioned approaches are specified in two categories: systems with external control (Anglo-Saxon model) based on the markets for corporate control and systems with internal control (Continental-European model) based on banks. Although such typology has its conceptual limitations, but is the most widespread. The basic differences between the two systems can be identified in the governing bodies, management and supervision of managers, ownership structure and means of financing (Hučka, Malý and Okruhlica, 2007).

The differences in the two systems of corporate governance raise the question of the possibility of their convergence. During recent years, the European Commission was active in creating a harmonized regulatory framework for European companies. Important element of this effort was to become the "europeanization" of national models of corporate governance. However, the likely political consequences remain unclear and direction of convergence in Europe is still under discussion. One of the key questions is whether a national corporate governance models across Europe will converge as a result of the European regulatory framework and, if so, what will be the type of European model of corporate governance.

Creation of skills

This institutional sector is often underestimated in the approaches of comparative studies of capitalism varieties. Yet the systems of skill creation are considered among factors of the overall system of institutional spheres, because they significantly affect other spheres such as industrial relations, corporate governance, intercompany relationships and innovation (Thelen, 2004).

Creation of employee skills is a problem at the national and sectoral level. Differences between countries in terms of the balance between high-skilled and low-skilled workforce were a major public policy in the 1980s (Jackson and Deeg, 2006). Many perceive higher skills as means to remedy to stagnating problems with the performance of liberal economies such as the USA and UK. Problems of skills creation in these countries was a matter of serious market failure, as companies gained a highly qualified workforce to compete in the labour market and can act as stowaways on such relevant skills which they have not been able to produce. In addition, direct public support in these countries is focused on general education and is failing to adapt to the changing conditions of the economy. On the contrary, Germany and Japan are among countries with the built-in institutional mechanisms creating skills that help overcome various difficulties in generating of the necessary skills, particularly regarding changes in the labour market.

Authors Jackson and Deeg (2006) distinguish between different mechanisms for generating initial vocational training and continuing education. They refer to direct state aid, free markets, networking companies, corporate associations, etc. Like in the previous institutional spheres there are also differences in skill creation between countries with liberal market economies (LME) and coordinated market economies (CME).

In countries with LME the system of skill creation follows the basic nature of the market and provides only general skills. Professional training is based on formal education, and in terms of retraining, this is general and unspecific too. In these countries, a small proportion of companies are providing continuing professional education, and companies tend to rely on recruiting people on the labour market with the necessary skills already.

By contrast, in countries where the skill creation is provided by the state or with association and so provided character of skills is specific to each company or industry. Professional training is provided in cooperation with employers and any retraining is targeted and specific. The share of businesses providing continuing professional education of employees is high.

Intercorporate relations and innovations

National innovation systems are important institutional sphere in a comparative literature, because it has turned out that the intensity of innovation in the economy depends on a strong integration of science and industry. National differences in these institutional relationships can be considered a result of various designs of knowledge diffusion and different innovation outbreaks (Deeg and Jackson, 2006). In this sense, we can distinguish different types of innovation: organizational or technical, process or product, incremental or radical.

Hall and Soskice (2001) considered as a key distinction, that we find between different countries, the distinction between the radical innovation that represents a significant shift in the product range, developing a completely new product or significant changes in the production process and on the other hand the incremental innovation characterized by continuous improvements in small scale in the existing product line and manufacturing processes.

Countries with coordinated market economies are better in generating of inputs needed to support incremental innovation within a stable organizational structure. Highly skilled manual workers, long-term capital investment, collaborative relationships between businesses

or a standard configuration across companies we can identify as factors that help to promote innovation, which depends on an incremental improvement of processes or products.

Incremental innovation is important for maintaining competitiveness in the production of capital goods, such as tools and machinery, consumer durables, engines and specialized transport equipment. Here the main objective is to maintain the high quality of the resulting product range, suggest incremental improvements to it and ensure continuous improvement in the manufacturing process. It will be easier to provide incremental innovation, in the place where the workforce is well qualified and can develop innovations. They are able to bear the risk of proposed changes to products or processes and have plenty of work autonomy that they will treat this kind of innovation activity as a part of their job.

Conversely, countries with liberal market economies are proving capable of generating labour mobility and venture capital that is necessary for radical innovation based on science. Radical innovations are particularly important in a rapidly changing technology sector, which calls for innovative design and rapid product development based on research such as biotechnology, semiconductors and software development. Those factors are also important for success in providing complex systems, such as telecommunications and defense systems, and their analogies in the service sector: air transport, advertising, business finance and entertainment industry.

5. Capitalist market economy framework of the Czech Republic

In this section, we rely on the results of empirical research conducted by Klimplová within the thesis MBA from the University of Dalarna, Falun in 2007 (Klimplová, 2007). In addition, we use our own findings referred to in (Hučka, Malý and Okruhlica, 2007).

According Mlčoch (2005), the economic transformation of the economies of "real socialism" to a standard market economy is a specific case of application of the theory of institutional change, meaning a global change, holistic, i.e. the transition from one economic system to another.

Development of institutional structure in Czechoslovakia, respectively in the Czech Republic, was influenced by the terms of economic transformation after 1990. It consisted primarily of ownership restructuring, but also of the legal side of contractual relations. During the past 20 years there have been a substantial and irreversible changes in institutional structures.

The situation, which we are analysing, is largely influenced by the late transformation process. In the next sections we summarized findings on the current situation in institutional structures in the Czech Republic in relation to the corporate sector in similar categories, as mentioned earlier (i.e. the financial system, industrial relations and employees, corporate governance, skill creation, intercorporate relations and innovation).

Financial system

Czech financial system has almost all the attributes of a coordinated market economy. Czech joint-stock companies are largely relying on a combination of equity and bank loans. Very little funding is provided through long-term securities, particularly long-term bonds and bills. Only occasionally companies used funds received through an initial public offerings

(IPO). The main causes of these phenomena, which are reflected in the company's capital structure, may be considered as following:

- the traditional close ties between non-financial companies and the banking sector;
- influence of financial decisions by banks;
- relatively little experience and strict legislation associated with the offerings of bonds;
- lack of confidence in the capital market and a small number of entities operating on it.

Banks have played an important role not only as owner, but also as a major creditor of Czech companies. This ensures that financial problems related to debt financing can be recognized and easily overcome. This led to a lower probability of bankruptcy than by financing through the equity growth. Credit burden on businesses, however, disproportionately increased and for further increase of the credit burden there was no longer much room. In the heavily indebted companies, large shifts in ownership or bankruptcies have occurred. Recently, the ownership stakes of banks in the Czech companies have declined significantly.

Voucher privatization paved the way for the market for corporate control, which contributed significantly to the concentration of ownership interests. Openness of ownership structures has increased a chance to get a capable owner for each company. However, the positive effects of open ownership structures have been weakened by the imperfections of the legal framework and weak enforcement of the law. The market for corporate control (represented by the stock exchange and RM-System) after initial entry of several hundred emissions from the first and second wave of voucher privatization in the course of a few years proved to be informationally inefficient and illiquid due to a lack of capital. Eventually, large amounts of illiquid emissions were scrapped. Currently, on the stock exchange and RM-System operate only several dozen companies. Even though the Prague Stock Exchange have developed in recent years successfully and produced and achieved revenues in 2004 close to the world leaders, we cannot expect that the Czech model of corporate governance will adopt the market-based financial system in foreseeable future and will therefore continue to be bank oriented.

Industrial relations and employees

Sphere of industrial relations and employee includes problems of coordination of wage negotiations, hiring and layoffs of employees, working conditions, etc., between employers and employees or their representatives (trade unions).

One of the basic measures of labour and an important factor, according to which a liberal market economy differs from the coordinated market economies, is the power of trade unions and their density. It can be stated that the trade unions during the transformation of the economy lost much of their political influence, membership and social base. Trade union influence is significant in large companies, while their role in small and medium enterprises is very weak. Trade union density in the Czech Republic is only 22%.

As far as the level at which it is the collective bargaining carried out, this cannot be determined unambiguously. Some experts are inclined to believe that wage negotiations are conducted centrally, while other authors consider the degree of centralization of negotiation in the Czech Republic as low and in their view company agreements prevail.

Another important indicator of coordination is the density of employers' organizations as a percentage of enterprises organized in employers' associations. The rate in the Czech Republic is 32% and is significantly below the EU-25 average, which is 58%.

Employee representation at company level again varies by company size. While in large companies with the joint-stock company legal forms the employee representation on the Supervisory Board is required by law, in the other legal forms it is not obligatory.

An additional indicator is the question of whether the wages are negotiated across sectors or whether they are determined by the market. The opinions of experts agree on that the wages of workers in similar jobs differ in companies within one industry.

Regarding labour market flexibility (problems in hiring and layoffs of employees, the predominant types of contracts), this is significantly limited by statutory regulation. Czech Labour Code strictly regulates the grounds on which an employer can dismiss an employee. This relatively strong employment protection is also reflected by the number of contracts that are usually settled for an indefinite period. Despite these regulations, most experts inclined to think that companies are very or moderately protected (by law, agreements or similar mechanisms) against dragging of their employees by other companies.

Summing up the findings related to the sphere of industrial relations and employees, we can say that some indicators suggest that the Czech Republic inclines toward liberal market economy, while others suggest a tendency towards a coordinated market economy.

Corporate governance

The subject of corporate governance in the Czech Republic is of interest to many authors. Development of a system of corporate governance was strongly influenced by privatization as one of the pillars of economic transformation after 1989.

In recent decades, Czech companies have undergone the fastest and most comprehensive privatization program of all the transition countries in the Central and Eastern Europe. Privatization itself is not sufficient instrument to improve the performance of the economy. The performance of the economy is largely dependent on the effectiveness of the model of corporate governance, which begun to develop since 1991, when it was started by large privatization. Looking at the experience of developed market economies, the development of a fully-fledged and effective system of corporate governance is a matter of decades.

Czech approach to privatization, particularly its largest component, the voucher privatization, determined the temporary primary distribution of property rights in many companies. After the completion of voucher privatization, the redistribution of property rights through private individuals and institutional investors have ensued.

Czech approach to regulation of the ownership control of the company is quite tolerant and provides plenty of freedom to implement the most appropriate model of administrative body with respect to the ownership structure of the company. The dominant model of the administrative body that was applied by the funds were Anglo-American model with the formal role of the Supervisory Board. However, companies with good performance that have already undergone restructuring and have a clear strategic orientation, are increasingly turned into a model with dual administrative body. Ownership control by the Managing Board is in fact more

expensive due to more frequent meetings of the Managing Board and have profound responsibilities in operational matters of the company in comparison to the Supervisory Board.

The ownership structure of non-financial companies in the Czech Republic after privatization have placed Czech corporate sector as representative of the system with internal ownership control. There is obvious influence of banks and abnormal state influence, which held ownership stakes in corporations mainly through the National Property Fund. On the other hand, as a result of voucher privatization there is a relatively high percentage of the equity owned by individual investors. They represent passive investors and do not contribute to the liquidity of the capital market. It was a very diffuse ownership with a negligible share of owned companies' equity.

Ownership of Czech joint stock companies in the first years after privatization have gradually fell in the hands of banks and their investment funds, and into the hands of foreign investors. A large part ownership shares remained still in state hands. Currently, the majority of large companies is already owned by strategic investors and companies are gradually becoming more closed.

These are the findings about the development of the system of corporate governance, which is based on banks. This allows us to classify the Czech Republic clearly among coordinated market economies.

Systems for skill creation

Systems for skill creation are central to the fundamental question of whether there is the prevailing highly specialized workforce (CHP) or the general workforce skills (LTE). The answer again is not clear.

Some expert opinions suggest that the grounds of education and training are provided by the formal education institutions rather than by employers, which could point to an approach typical for LME. In education system, according to the scholars, there is little sharing of information about the needs of companies and the Czech market suffers from a lack of professionals in some special fields (welders, tailors, metal workers, construction workers).

The issue of coordination and support for the training of employees in different sectors from the employers' associations and trade unions, led to the finding that the activities of associations and trade unions in this field is very weak.

Regarding the problem of willingness of employees to invest (time, money) in acquiring specific skills according to the business or industry demand, the opinions of experts on this issue are not clear. The differences are in the size businesses. In the case of employees in a small enterprise, it is evident that they are not willing to invest in their professional training. On the other hand, employees of large companies appear to be more willing to participate in ongoing professional training with the belief that their investment in specific skills is partially protected by a collective agreement. Additionally, the amount that businesses are spending on training is less than half then it is typical in Western European firms (White Paper, 2001).

Considering the aforementioned facts in the sphere of skill creation, the experts' comments support the view that in this sphere the Czech Republic can tend to be among LMEs. Coordination of vocational training by employers' associations is quite weak and employer investment in continuing professional training of employees is rather low. It does not seem also

that employees would be willing to invest money into specific training according to the company or the industry demand. However, there is yet lack of exact statistical evidence supporting the views of experts.

The sphere of business interrelations and innovations

The sphere of business interrelations and innovation is focused on relations of businesses among themselves in particular in addressing the problem of coordination of technology and innovation diffusion. In the CME this problem is usually solved by inter-firm cooperation through companies that are focused on the transfer of science and knowledge and through them new technologies and innovations are distributed. On the other hand, in LME such cooperation is not widespread and businesses rely on flexible labour market, allowing, among other things head-hunting researchers and engineers, respectively there is a market of goods and services where are sold licenses for innovation and thus influencing technology transfer.

In the Czech Republic there is a blend of both approaches. According to a ministry report "The concept of innovation for the industry and trade sector 2005-2008" the most important partners for the development of innovative of enterprises in the Czech Republic were business clients and customers, followed by companies from the same business groups and suppliers. Much less importance is attributed to universities and research institutes. The smallest contribution to the innovative development was attributed to competing businesses. Cooperation between businesses and their customers, suppliers and other enterprises in the same business groups suggest the inclusion of the Czech Republic rather between LME.

6. Table of indicators

The table in the Appendix 1 shows a comparison of the two types capitalist economies and the Czech Republic using number of indicators related to key institutional spheres. As it is evident from the table, in some areas the Czech Republic belongs to the coordinated market economy (financial system, corporate governance, creation of skills, intercompany relationships and innovation). In the sphere of industrial relations and employees the Czech Republic is positioned by most indicators among liberal market economies. Overall, the Czech Republic is closer to a coordinated market economy, which is a different view from the opinion suggested by Klimplová (2007). We believe that this is so, because in our analysis we focused on two key institutional spheres, namely the financial system and corporate governance. According to these indicators the Czech Republic is clearly belonging to the coordinated market economy.

7. Conclusion

We have revealed that the development of advanced economies is closely linked with varieties of capitalist economies. In the current stage of development of capitalism, the most widespread concepts are liberal market capitalism (market based capitalism) and coordinated market capitalism. We have presented detailed characteristics of these two varieties of capitalism using six institutional spheres. The comparison of institutional spheres of the two varieties of capitalist economies revealed considerable differences in their institutional environment. We have analysed the capitalist framework in the Czech Republic and summarized findings on the current situation. Those findings lead us to conclude that the Czech economy is closer to a coordinated market economy. Dynamic changes in the context of

globalization do not yet reveal the convergence of both types of market economies and blurring institutional differences in various countries.

8. Acknowledgement

This article is prepared for the open research project “The Nature and Evolution of Capitalism in All World” managed by Prof. Viktor Barnatov. This paper was also supported within Operational Programme Education for Competitiveness – Project No. CZ.1.07/2.3.00/20.0296.

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| KEY INSTITUTIONAL SPHERES AND INDICATORS IN MARKET ECONOMIES AND IN THE CZECH REPUBLIC | | | | | | Sheet: 1/3 |
|----------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|------------|----------------------------------------------------------|
| INSTITUTIONAL SPHERE | INDICATOR | THE LIBERAL MARKET ECONOMY | THE COORDINATED MARKET ECONOMY | CZECH REPUBLIC | CATEGORY | SOURCE |
| FINANCIAL SYSTEM | <ul style="list-style-type: none"> The basic character Capital market | <ul style="list-style-type: none"> market-oriented strongly developed and liquid | <ul style="list-style-type: none"> bank-oriented weakly developed and little liquid | <ul style="list-style-type: none"> bank-oriented weakly developed and little liquid | CME CME | Hučka, Malý and Okruhlica (2007) |
| | <ul style="list-style-type: none"> The regulation of the capital market | <ul style="list-style-type: none"> strong rules of transparency and disclosure | <ul style="list-style-type: none"> moderately strong to weak rules of transparency and disclosure | <ul style="list-style-type: none"> medium strong rules of transparency and disclosure | CME | |
| | <ul style="list-style-type: none"> The acquisition of the necessary investment capital | <ul style="list-style-type: none"> public offerings of shares | <ul style="list-style-type: none"> bank loans | <ul style="list-style-type: none"> bank loans | CME | |
| | <ul style="list-style-type: none"> The conversion of savings for investment | <ul style="list-style-type: none"> through the capital market | <ul style="list-style-type: none"> through banks | <ul style="list-style-type: none"> through banks | CME | |
| | <ul style="list-style-type: none"> The number of listed companies | <ul style="list-style-type: none"> big | <ul style="list-style-type: none"> small | <ul style="list-style-type: none"> small | CME | |
| | <ul style="list-style-type: none"> The orientation of the investors | <ul style="list-style-type: none"> portfolio | <ul style="list-style-type: none"> strategic | <ul style="list-style-type: none"> cannot be accurately determined | | |
| INDUSTRIAL RELATIONS AND EMPLOYEES | <ul style="list-style-type: none"> The power of the trade unions Trade Union density Trade Union Organization | <ul style="list-style-type: none"> weak low fragmented sectoral negotiations without employees or management | <ul style="list-style-type: none"> strong high centralized legal accessibility negotiation at sectoral or industry level | <ul style="list-style-type: none"> weak low cannot be accurately determined | LME LME | Klimplová (2007) Hučka, Malý and Okruhlica (2007) |
| | <ul style="list-style-type: none"> The density of the employers' organizations | <ul style="list-style-type: none"> low | <ul style="list-style-type: none"> high | <ul style="list-style-type: none"> low | LME | |
| | <ul style="list-style-type: none"> Collective bargaining | <ul style="list-style-type: none"> limited | <ul style="list-style-type: none"> significant | <ul style="list-style-type: none"> limited | LME | |
| | <ul style="list-style-type: none"> Degree of centralization of negotiations | <ul style="list-style-type: none"> low | <ul style="list-style-type: none"> high | <ul style="list-style-type: none"> low | LME | |
| | <ul style="list-style-type: none"> The prevailing level of collective bargaining | <ul style="list-style-type: none"> corporate | <ul style="list-style-type: none"> national or sectoral | <ul style="list-style-type: none"> depends on the size of the company | LME | |
| | <ul style="list-style-type: none"> Working relationships and management Participation of employees in the company | <ul style="list-style-type: none"> sharp division of labour relations and management weak to non-existent, no form of co-decision | <ul style="list-style-type: none"> the intersection of labor relations and management significant through the co-decision | <ul style="list-style-type: none"> cannot be accurately determined significant through the co-decision | CME | |

| KEY INSTITUTIONAL SPHERES AND INDICATORS IN MARKET ECONOMIES AND IN THE CZECH REPUBLIC | | | | | | Sheet: 2/3 |
|----------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------|----------------------------------|
| INSTITUTIONAL SPHERE | INDICATOR | THE LIBERAL MARKET ECONOMY | THE COORDINATED MARKET ECONOMY | CZECH REPUBLIC | CATEGORY | SOURCE |
| INDUSTRIAL RELATIONS AND EMPLOYEES | <ul style="list-style-type: none"> Wages in companies in one sector Institutional mechanisms to protect labour force Contract of employment | <ul style="list-style-type: none"> various weak short-term | <ul style="list-style-type: none"> similar to the significant long-term | <ul style="list-style-type: none"> various significant long-term | LME CME CME | Klimplová (2007) |
| CORPORATE GOVERNANCE | <ul style="list-style-type: none"> The basic character Means of corporate control Valuation of the company The role of hostile takeover The existence of a speculative capital Capital allocation The Board Stakeholders Employee participation in corporate bodies Ownership structure Ownership of institutional investors Representation of banks in corporate bodies | <ul style="list-style-type: none"> system with external control market for corporate control stock market course important frequent effective one-level shareholders undesirable diffuse portfolio inadmissible | <ul style="list-style-type: none"> internal control system direct supervision by the owners non-market through the owners limited rarely occurs potentially inefficient two-level all interested parties mandatory concentrated strategic strong | <ul style="list-style-type: none"> the internal control system direct supervision by the owners non-market through the owners limited cannot be accurately determined potentially inefficient two-level shareholders and other interested parties mandatory cannot be accurately determined cannot be accurately determined strong | CME CME CME CME CME CME CME CME | Hučka, Malý and Okruhlica (2007) |
| CREATION OF SKILLS | <ul style="list-style-type: none"> Basic characteristic Character skills Professional training Type of retraining | <ul style="list-style-type: none"> market general formal education General, nonspecific | <ul style="list-style-type: none"> the state, associations specific (business, industry) in cooperation with the employer targeted, specific | <ul style="list-style-type: none"> state and social cannot be accurately determined formal education targeted, specific | CME LME CME | Klimplová (2007) |

| KEY INSTITUTIONAL SPHERES AND INDICATORS IN MARKET ECONOMIES AND IN THE CZECH REPUBLIC | | | | | | Sheet: 3/3 |
|----------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------|------------------|
| INSTITUTIONAL SPHERE | INDICATOR | THE LIBERAL MARKET ECONOMY | THE COORDINATED MARKET ECONOMY | CZECH REPUBLIC | CATEGORY | SOURCE |
| | <ul style="list-style-type: none"> The proportion of enterprises providing further professional education Recruiting people with the required skills | <ul style="list-style-type: none"> low high | <ul style="list-style-type: none"> high low | <ul style="list-style-type: none"> high low | <p>CME</p> <p>CME</p> | |
| INTERCORPORATE RELATIONS AND INNOVATION | <ul style="list-style-type: none"> The basic nature of intercorporate relations Alliances of banks and industrial capital Mutual holding of shares Basic character of the innovation Diffusion of new technologies The share of corporate investment in science and research | <ul style="list-style-type: none"> from the body inadmissible legally limited radical innovation the free market high | <ul style="list-style-type: none"> mandatory relationships very tight supported networks of enterprises incremental innovation cooperation low | <ul style="list-style-type: none"> cannot be accurately determined very tight cannot be accurately determined incremental innovation both methods are in use relatively high | <p>CME</p> <p>CME</p> <p>LME; CME</p> <p>LME</p> | Klimplová (2007) |