

UNIVERZITA KARLOVA
FAKULTA SOCIÁLNÍCH VĚD
INSTITUT POLITOLOGICKÝCH STUDIÍ

***CZECH-GERMAN ECONOMIC TIES AFTER THE 2004
EU ENLARGEMENT: A NEOFUNCTIONALIST PERSPECTIVE***

Martin Janíčko

MAGISTERSKÁ DIPLOMOVÁ PRÁCE

Praha 2010

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Martin Janíčko
V Praze, dne 19.5. 2010

Autor práce: Martin Janíčko
Vedoucí práce: PhDr. Irah Kučerová, Ph.D.
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Poděkování

Na tomto místě bych rád vyjádřil poděkování vedoucí mé diplomové práce, PhDr. Irah Kučerové, Ph.D., za její vždy vstřícný a nápomocný přístup v celém průběhu jejího psaní.

BIBLIOGRAFICKÝ ZÁZNAM

JANÍČKO, Martin. *Czech-German Economic Ties after the 2004 EU Enlargement: A Neofunctionalist Perspective*. Praha: Univerzita Karlova, Fakulta sociálních věd, Institut politologických studií, 2010. 85 s. Vedoucí diplomové práce: PhDr. Irah Kučerová, Ph.D.

ANOTACE

Diplomová práce spadá svým zaměřením do oblasti mezinárodních ekonomických vztahů a zabývá se především intenzitou česko-německých obchodně-investičních (potažmo obecně ekonomických) vazeb po rozšíření Evropské unie v roce 2004, jehož byla ČR přímým účastníkem. Jejím primárním zájmem je otestovat hypotézu, že vlivem tzv. východního rozšíření došlo k výraznější determinaci ekonomického vývoje v ČR ekonomickým vývojem v SRN především díky tzv. pozitivním *spill-over* efektům (efektům přelévání). Tyto efekty měly v zásadě pomoci rozvíjet oblastní spolupráci mezi ČR a Německem a „příznivě“ působit na další sladování již před rozšířením podobných institucionálních vzorců. Výraznější determinace měla být tak způsobena zejména těsnější ekonomickou kooperací umožněnou uvolněním mnoha existujících bariér z předvstupního období. Zmíněné bariéry mohou být chápány mnoha způsoby, počínaje regulací kapitálových toků, přes legislativní rámec platný pro přímé zahraniční investice a konče perspektivou budoucího vývoje ČR, která se právě vstupem do Unie výrazněji konturuje.

ANNOTATION

The submitted diploma thesis deals with the issue of the Czech-German economic relations after the 2004 enlargement of the European Union. Economic relations are in more detail divided into the trade relations and the investment (financial) relations. The main aim of the thesis is to evaluate the hypothesis that the so called “Eastern Enlargement“ has led to somewhat intensified determination of the economic development in the Czech Republic by the one in Germany. The pivotal transmission mechanism in this process should have been positive *spill-over* effects that might have been in effect even before the very accession of the European Union by the Czech Republic. Such *spill-over* effects, that to an extent allowed for more significant determination of the Czech business cycle by the German one, may take form of e.g. common European Union trade framework, deregulation of capital flows, and/or perspective of the future development of the Czech economy within the European Union.

KLÍČOVÁ SLOVA

rozšíření EU; hospodářská determinace; reálná konvergence; neofunkcionalismus; hospodářské cykly; obchodní vzorec; investiční vzorec; efekty přelévání; formální a neformální instituce

KEYWORDS

EU enlargement; economic determination; real convergence; neofunctionalism; business cycles; trade pattern; investment pattern; spill-over effects; formal and informal institutions

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INTRODUCTION

The Czech-German economic relations have always been quite vigorous, although their nature has been quite significantly evolving in the course of time. Also a certain volume of the economic relations persisted even when the “political” regimes and political ideologies appeared to be “unbridgeable” or, taken to the extreme, literally “antagonistic”.

The momentum of the relations is thus somewhat exceptional compared with the economic relations of many other resembling countries, and it has to a very large extent proven its resilience towards adverse “political conditions”. The very important aspect, which has substantially contributed to the extent of the trade relations, has been *inter alia* the two countries’ economic development.

Hence, one could find out a number of good reasons for the elaboration of such a thesis. Generally speaking, Germany has always represented the type of country that could be easily regarded as one of the best economic and/or socio-economic performers in Europe as well as worldwide - at least from the beginning of its so to speak “unified” existence in 1871. At the same time the Czech Republic (or Czechoslovakia) has never been an underdeveloped country - in the economic sense - either.

Even though there still exist quite many controversies regarding interdependence, convergence and economic growth patterns, this has undoubtedly facilitated the economic ties between the two countries in a significant manner, as it was already proven several times that the economic exchange and intensity of economic relations in general increases with the socio-economic development of the countries involved. (The argument is also examined more in detail in the thesis itself.)

Further, the bilateral commercial relations are nowadays more important than ever before, in spite of the economic crisis being still somewhat present in the “real” economy, which caused a general slowdown in the trade and investment volumes across Europe. Nonetheless, a number of short-run stimulus packages implemented in Germany (for instance the so called *car scrapping scheme*) have undoubtedly improved the economic situation of many sectors in the Czech Republic, such as automotive industry, manufacturing, and semi-production.

Moreover, since the general debate on the nature of the bilateral relations is still going on in both academic and non-academic field, this diploma thesis has tried to contribute to it, particularly by answering some of the questions that might be possibly raised in this sense.

Finally, it has been already six years since the Czech Republic joined the European Union and has therefore become a member of the largest economic and political community in the world. From this reason and since Germany also takes part of the community, both countries have begun another era of the bilateral relations, this time substantially facilitated by the membership itself.

As it is demonstrated on the following pages, the new pattern of these relations has by and large started. In addition to it, this basis for the joint relations has led to some more accentuated business cycle determination of the Czech Republic by the German one than ever before.

The main method used throughout the paper is the *hypotheses testing* and the *time series analysis*. In this framework, the description of the relations is presented in the very beginning of the thesis, then statistical analysis is derived from the data extracted primarily from the EU sources (such as DG ECFIN and Eurostat) and OECD (Organization for Economic Cooperation and Development) as well as from the convergence analyses elaborated by the Czech National Bank (CNB).

For the trade and investment patterns, the time series data of quarterly real GDP (Gross Domestic Product) growth and quarterly industrial production are used. Determinations are then calculated with help of basic econometric analysis and the results are consequently interpreted.

The theoretical literature is namely taken from the “field” of the European integration process, to which a relatively significant part of it has been devoted. Even though the theories have been evolving with the integration itself primarily due to the reflection of the new challenges, threats and motivations, it would be correct to say the most important questions remain unchanged according to their general nature.

Neofunctionalists have much to say in this, since their theory is well to be used in the whole integration process in the European Union. Hence, number of neofunctionalist concepts is taken into account as they can provide some relevant theoretical basis of the Czech-German cooperation.

All-in-all, the neofunctionalists would claim the typical integration is due to the mutual benefits that it brings about. This might actually concern the Czech and German state as well; however, one of the research questions of the thesis is to find out whether the mutual benefits are to be considered as evident even before the very enlargement or whether it was really the enlargement itself that has brought them about.

There maybe exist several appropriate explanations for the economic ties’ pattern having been witnessed recently, but the aim here was to test particularly the neofunctionalist one.

Considerable economic determination might have taken place for several reasons. After the fall of so called Iron Curtain in 1990 and also the demise of the Soviet Union the new era of the bilateral relations started. Obviously, the new

commercial relations were “new” only partway, for - in some degree - they reassumed those before 1989.

Given the paper is most importantly based on hypotheses, they must be well specified. The hypotheses are generally two and they could also be regarded as complementary:

The first hypothesis defined for the thesis (1) says the Czech-German economic relations have intensified after the 2004 EU enlargement as a consequence of the enlargement itself.

The second hypothesis (2) states that the economic determination of the Czech Republic by Germany, measured by the business cycle synchronization, has even amplified since then. Clearly, there had existed many agreed aspects of the EU accession before this date, such as 1998 trade liberalization with the EU countries, sign-up of Treaty of Accession in 2003, Copenhagen Criteria fulfillment monitoring, and so forth. The 2004, nonetheless, represents a benchmark after which the EU-Czech commercial, political, cultural, social, and other relations became “intra-community” relations, with all the possible implications it could have possibly brought along.

Naturally, the paper aims at quantifying the effects of the Czech-German economic relations not only after the enlargement, but also before. This is important regarding the comparison of the two periods.

Apparently, statistical data and primary literature plays a very important role in this. This is actually not only given by the nature of the paper itself, but also by the fact there is not that much literature dedicated to this topic. Therefore the paper tries to bring about some of the new facts and analyses, which was not yet published.

The emphasis in the thesis put on the quantitative and also empirically-tested facts is logical: since the interconnections between countries now depend on a number of variables and factors, it seems necessary to try to separate them from each other.

The synopsis of the paper is as follows: the first - i.e. the following - part of the thesis is a descriptive one, in which some retrospective into the Czech-German economic relations is made and a number of important and relevant features of the bilateral economic relations are sketched out, going back basically to the foundation of Czechoslovakia in 1918. Since the relations of the two countries have a very long history, rolling over a number of historical events and, at the same time, creating many informal institutions and changing structure, intensity and determination of the relations was one of the immanent features of them.

Also, most important economic and political development is presented, as it is a very substantial factor of contemporary relations. Notwithstanding some part of the relations is to be regarded as *autonomous*, the recent economic development has played its part as well.

With the global financial and economic crisis coming in and a general mistrust that has spread in diverse investment activities, even the bilateral relations between the Czech Republic and Germany have been affected significantly, like it is well shown in the paper and it unfortunately slightly debases the analysis as it seems quasi impossible to adjust for an unexpected and virulent economic development.

This should not, however, be thought of as that grave, for the time series after 2004 - needless to say - is quite a short one and its analysis is done only in an appropriate context of the preceding years.

The following part is consecrated to the analysis of the matter, trying to quantify the effects of enlargement and the effects of pre-enlargement situation. This is made using the time series analysis, ranging back to 1993 and separating two

“periods”, i.e. from 1993 till 2004 and then from 2004 till 2008. However, the quarterly GDP data are used only from 1995 due to the methodological change in that year and subsequent impossibility to compare them with the following. Regression analysis is then made for several relevant variables, taking into account the hypothesis enunciated in the beginning and focusing on the pre-accession situation and separating it from the following one.

Third part of the thesis sums up and interprets the previous ones, supplying several possible explanations and examining the hypotheses “verbally”. At the same time, the neofunctionalist theory is tested facing empirical evidence of the bilateral relations. The synthesis is likely to be the most important part of the paper, for it includes the core of the thesis propositions.

In the conclusion part of the paper, key findings are summed up and taken up briefly, strictly sticking to the theoretical background and outlining some plausible scenarios for the years to come.

In the paper, a few difficulties had to be dealt with, while some persisting. Among these namely “loose” definition of the term *interdependence* or *dependence* could be regarded as a source of ambivalence.

The connotations of *determination* or *dependence* overlap and might be perceived as being close to each other, while the term *interdependence* is more complicated for one major reason: it suggests the determination is both ways, which is without a doubt true, however, in a very unequal manner. In other words, the German determination by the Czech economic development is not to be taken into account as it is deemed unimportant.

Another difficulty is the pre-accession period. Given the quite short time having elapsed after the enlargement, some of the effects might be ascribed to the enlargement, but there would never be total certainty which of them is related to the accession alone and which is related to the “accession expectancy”.

Further, as it always a matter of concern for such kind of papers, statistical discrepancies might also play a role, since the statistical offices of the two countries usually issue slightly different data about basically the same things (for instance brown-field investment outflow from Germany to the Czech Republic does not entirely match the brown-field investment inflow to the Czech Republic coming originally from Germany and the like).

Since some important data from the EU sources are obviously extracted from the Czech and German sources respectively, the thesis makes effort to balance them as much as possible.

Last but not least, the complexity of social phenomena is a very substantial problem when it comes to explanations. Normally, there are plenty of aspects with a possible impact, however, a simplified analysis - which is necessarily every analysis - stresses only a small number of factors, though perhaps substantial ones.

As it was touched upon already, the quantity of literature devoted strictly to the topic is not really large, and in addition, it is namely dedicated to the general questions of business cycles' harmonization in the European Union. On that account, apart from the "pure" statistical sources, the thesis is based on the literature dealing with the integration process and adjustment process in general.

Such literature is to be found namely in English, but to a certain extent also in French and in Czech. Amongst these one could single out Vintrová, R. (2004) *The CEE Countries on the Way into the EU: Adjustment Problems: Institutional Adjustment, Real and Nominal Convergence*, Monnier, A. (2004) *L'Union européenne à l'heure de l'élargissement*, European Commission composite authors (2009) *Five years of an enlarged EU: Economic achievements and challenges* or definitely a very precious textbook from Burda, M., Wyplosz, C. (2005) *Macroeconomics: A European Text*.

On the contrary, quite a large quantity of literature is devoted to the neofunctionalist theory. The founder of neofunctionalist theory is presumably Ernst B. Haas with his *The Uniting of Europe* (1958), amongst the other one could name Philippe C. Schmitter (2003) *Neo-Neo-Functionalism*, M. Harris (2004) *Neofunctionalism and the Widening vs. Deepening Dilemma*, Simmons, B., Martin, L. (2002) *International Organizations and Institutions. In: Handbook of International Relations*, Rittberger, V., Zangl, B. (2006) *International Organization: Polity, Politics and Policies*, Decaux, E. (1984) "*La Convention-Cadre Européenne sur la Coopération Transfrontalière des Collectivités ou des Autorités Locales*", Jordan A., Khanna J., (1995) "*Economic Interdependence and Challenges to the Nation-State: The Emergence of Natural Economic Territories in the Asia-Pacific*", and others.

1. CZECHOSLOVAK - GERMAN ECONOMIC RELATIONS IN RETROSPECTIVE (1918 - 1993)

“In the beginning there was nothing. God said, 'Let there be light!' And there was light. There was still nothing, but you could see it a whole lot better.”

(Ellen DeGeneres)

1.1 PRE-WAR DEVELOPMENT

Looking at the bilateral commercial relations back to 1918, when Czechoslovakia was founded and when Germany started a new period of its existence¹ (although the formal establishment of “Weimar Republic” dates to 1919), we can find their intensity having substantially varied. Between 1918 and 1938 Germany by far represented the main trading partner for Czechoslovakia, although the then volumes are much less significant compared to nowadays.

It is estimated that more than 20% of the Czechoslovak exports went every year in that period to Germany.² At the same time exports plus imports stood for - on average - approximately 66% of the then Czechoslovak production.³

Moreover, there were number of German firms present in Czechoslovakia, such as Daimler-Benz, Thyssen, Krupp, and Siemens. This is also quite logical

¹ Winkler, 1993

² http://fenrir.psp.cz/eknih/1929ns/ps/tisky/t2029_00.htm

³ Kubů, Pátek a kol., 1999

referring to the geographic positions of the countries, by-and-large the surrounding of Czechoslovakia from southern, western as well as northern direction by Germany.

Such kind of geographical position used to be - unlike nowadays - in fact the most crucial thing, accompanied by other relevant determinants. Altogether they created favourable conditions for bilateral relations, and were able to play down many of the political quarrels that also existed between the two countries.

It should, however, be noted the property structure of the economy used much more “nationalized” at that times than it is nowadays. Nevertheless, there existed several exemptions to this rule, like Yugoslavia for instance.

The significant trade pattern was, however, allowed namely by an increasing industrial structure of both countries. For sample, in 1921 already one third of the population in Czechoslovakia was employed in industrial sectors.⁴

Much of the industrial production, like it is the case nowadays, was exported given the (already) developed division of labour. And for both economies imports and exports presented vital sources of their economic growth, although obviously incomparable with the contemporary situation.

The fact that already in 1920 Czechoslovakia attributed “most-favoured-nation clause” to Germany could serve as a very persuasive proof for this.⁵ Such attribution was in fact very special, as Czechoslovakia belonged to the group of the winning countries of the World War I as opposed to Germany, which was obliged to follow the rules arising from Versailles.

The clause was therefore very exceptional and facilitated the relations for next 18 years. The most important articles traded were textile, porcelain, manufactures, and food products.⁶

⁴ Faltus, Průcha, 2003, pp. 51

⁵ Moravcová, Bělina, 1998, pp. 93

⁶ Faltus, Průcha, 2003, pp. 59

It was symptomatic for the period the trade cycle was much more amplified than the “ordinary” business cycle. Thus with the global economic crisis - known also as the “Great Depression” - the trade relations between the countries, which were both open to foreign trade above the average, shrunk considerably. It is now estimated the trade volume contracted by 70 p.p. in 1930 *vis-à-vis* 1928.⁷

Both countries were hit hard by the crisis, since the omnipresent commercial protectionism caused huge losses in export oriented industries. For illustration, comparing the years 1928 and 1932 Germany alone lost 41 p.p. from its pre-crisis period, while its overall share in the global volume decreased by 4 p.p. from 14.6% to 10.6%.⁸ The same held true for Czechoslovakia, i.e. it also lost over proportional share of its traded volume.

It might seem worth noting the overall stance of the Czechoslovak economy used to be slightly better than nowadays⁹, although it seems difficult to compare now and then production for one simple reason: the GDP, i.e. perhaps the most important macroeconomic aggregate¹⁰, did not exist at that time and is now only matter of retrospective estimates.

Comparing the industrial production, Czechoslovakia was at about 50% of the level in Germany, which kept the position of one of the most developed countries in the world together with the United Kingdom (UK), United States of America (USA), Australia and New Zealand.¹¹

Czechoslovak economic performance was basically accelerating from 1918 to 1929, but afterwards, as the crisis had a very detrimental impact on the overall

⁷ http://fenrir.psp.cz/eknih/1929ns/ps/tisky/t2029_00.htm

⁸ Moravcová, Bělina, 1998, pp. 93

⁹ In terms of relative performance.

¹⁰ Or at least the most often cited one.

¹¹ Faltus, Průcha, 2003, pp. 59

economic conditions, it decelerated significantly, and the country almost lost its positions gained in the first decade of its existence.

For sample, if 1929 is taken as a benchmark (= 100%), approximated GDP of Czechoslovakia slid down to 81.7% in 1935 (i.e. in the gloomiest “crisis” year) and it relatively recovered not earlier than in 1937, reaching 98% of the 1929 output volume.

In more general, the economic stance was broadly comparable with such countries like Finland and Austria, being worth noting the Finnish economy used to be much weaker than it is actually nowadays. In 1948 it was estimated that before the WW2 Czechoslovakia occupied 14th position in terms of national product in Europe, and approximately 18th position worldwide.¹²

Similar situation could be observed in the German economy. However, the recovery was somewhat faster as its first signs appeared already in 1935.¹³ The effects of Nazi economic policy, which was based essentially on military expenditures and subsequent indebtedness¹⁴, seemed to work out for the moment. In 1939 output per head was already much above the crisis level.¹⁵

¹² Faltus, Průcha, 2003, pp. 61

¹³<http://www.wirtschaftsgeschichte.vwl.uni-mainz.de/downloads/Lehrveranstaltungen/WS0607/Vorlesung/Wirtschaft%20und%20Politik%20in%20der%20Weimarer%20Republik%20Abbildungen.pdf>

¹⁴ In case the economy is devoting significant part of its production factors to military industry, the questions of paying-off is usually raised. In most cases, however, the redemption is deemed to take place through a booty.

¹⁵ <http://www.wirtschaftsgeschichte.vwl.uni-mainz.de/downloads/Lehrveranstaltungen/WS0607/Vorlesung/Wirtschaft%20und%20Politik%20in%20der%20Weimarer%20Republik%20Abbildungen.pdf>

All-in-all, the United Nations (UN) retrospective estimates suggest that Germany placed 7th in global ranking concerning output per head, while it “ended up” 3rd in the same ranking, but concerning total volume of output (both for 1939).¹⁶

At the same time the dynamism of its economy was extremely elevated, exceeding among others also the Soviet Union in which the room for extensive growth was enormous at those times.

This fed through into the lowest continental rate of unemployment (within the capitalist states) amounting to 1.5% of the working population.¹⁷ In 1938 the number of people unemployed was almost the same one as in then Czechoslovakia as it equaled to 430,000 (the rate of unemployment equaled to as low as 1.5%).¹⁸ At the very moment, however, Czechoslovakia (409,000 unemployed; i.e. 5.5%) was approximately five-fold less populated than Germany: 15 mil inhabitants in (in which almost 3 mil Sudeten Germans included), compared to 78 mil in the “inland” Germany.¹⁹

Apparently (although we have to pay attention to the demonstrative ability of the measure, namely bearing in mind Hitler’s economic policy) and against most of the *clichés* still existing in some literature, Germany was a very developed country when it started the Second World War (WW2) broke out.

With the substantial change in political regime in 1930s and the simultaneous change in the exerted economic policy, Germany strived to become a military and self-sufficient country in order to create a well-functioning war economy. This resulted in the efforts to become almost an autarky (at least in the short term) which

¹⁶ Milanovic, 2002, pp. 16

¹⁷ Spoerer, 2005, pp. 30

¹⁸ Spoerer, 2005, pp. 30

¹⁹ <http://www.feldgrau.com/stats.html>

provoked hikes in tariff and also non-tariff barriers of all kinds.²⁰ This started to be reflected by the export-import figures, clearly demonstrating stagnation and impossibility to pick up from the low early post-crisis volumes (e.g. in 1939 German export volume was at about 67% from of that in 1929).²¹

In the similar way Milanovic (2002) adds that *“It is important to stress that autarky was not viewed by the new Fascist ideologies as a reaction to other countries’ unfriendly policies as it was regarded by the democracies when they engaged in competitive devaluations and tariff rises or even by the Soviet planners who faced the enmity of the capitalist powers. Autarky was viewed as a desirable attribute of a nation - the best economic policy one could pursue.”*²²

Thus, with a “slow” start of the “centrally administrated economy” the room for the recovery of the bilateral commercial relations was reduced to almost nothing.

²⁰ Milanovic, 2002, pp. 8

²¹ <http://www.wirtschaftsgeschichte.vwl.uni-mainz.de/downloads/Lehrveranstaltungen/WS0607/Vorlesung/Wirtschaft%20und%20Politik%20in%20der%20Weimarer%20Republik%20Abbildungen.pdf>

²² Milanovic, 2002, pp. 55

1.2 A NEW “DIMENSION” FOR THE “BILATERAL ECONOMIC RELATIONS”: THE PROTECTORATE

No wonder the attenuated bilateral relations changed further with the Munich Pact adoption in 1938, after which the Czech economy became largely dependent on the German one. Most of the industrial goods started to be imported as many of the factories in the borderland were taken over by the Germans.²³

It is estimated that altogether 40% of the industrial capacities were annexed by the Germans and started to be regarded as the inner part of the “Third Reich economy”. The situation finally crystallized into the total occupation of the Czech lands starting in 1939 and the complete subordination and exploitation of the Czech economic area by the Third Reich.

Even though not all of the factories were confiscated (this concerned namely Jewish ones), in reality almost all of them were producing for the German military purposes. Unlike Slovakia, “Czech lands” became a very useful area for Germany as there was situated a very significant industrial potential. This was true notably for military factories, heavy industry and chemical industry facilities, coal mines and coal mining industry, machinery as well as some important army equipment.

During the whole occupation, economy in the Protectorate was directly managed by Germany. Indeed, it was the inner part of the so called *Third Reich* (alongside with the *General Gouvernement* and later also with the area called Białystok it was legally an “autonomous” part of the Reich itself²⁴).

²³ Needless to mention that many of them were already owned by the Germans at the very moment of the seizure.

²⁴ See also Spoerer, 2005, pp. 15.

This happened hand-in-hand with the overall “germanization” of the economy, taking place by several means: personal interventions (key positions in the economy were given to Germans), annexing land of the Czech farmers, closing down of many Czech professions, German capital expansion and confiscation of the ownership.²⁵

Subsequently, extension of the German capital shares in a number of Czech firms thus led to almost perfect control over the Czech economy in its totality. The process was commonly called the “internal aryization” and “germanization” and it affected nearly all of the Jewish businesses and business institutions - such as the Commodity and Stock Exchange in Prague.²⁶ What is more, in the most important (or even strategic) domestic business Germans took over the total control regardless of nature of their ownership structure.

Since 40% of the industrial production was directed to Germany and “exports” highly exceeded “imports”²⁷, Third Reich was on top of it provided with a “zero-interest” credit.²⁸ Such situation was very common in the then European context as most of the occupied countries were forced to do the same.²⁹ Seemingly, the bilateral commercial relations between 1939 and 1945 still existed, but in a very unequal manner, taking form of “subordination - superiority”.

All-in-all the methods of Czech economy exploitation were very diverse, but it is not the aim of this paper to analyze them more in depth. The Czech experience from this era did not, nevertheless, harm the future prospect of the relations too significantly.

²⁵ Faltus, Průcha, 2003, pp. 77

²⁶ Novotný, Šouša, 2008, pp. 78

²⁷ Even though *exports* and *imports* did not exist in their “proper” form; namely due the bilateral trade patterns deformation.

²⁸ Novotný, Šouša, 2008, pp. 78

²⁹ For further details see Spoerer, 2005.

Concerning the references, here I do refer to a large quantity of literature to some extent dealing with the economic and “social” conditions and environment in the Protectorate Bohemia-Moravia, e.g. Kuklík, J., Gebhart, J. (1995) *Dramatické a všední dny protektorátu*, Brandles, D. (2000) *Češi pod německým protektorátem* or Uhlíř, J. B. (2002) *Ve stínu říšské orlice*. A very good insight into the functioning of the German war economy gives, for example, Spoerer, M. (2005) *Nucené práce pod hákovým křížem* which offers a very useful and complementary overview, analyzing principles of the human capital exploitation in the Third Reich.

However, it must be unfortunately admitted quantity of literature devoted directly to the economic relations between the Protectorate and the Reich is rather limited, as it might be found difficult to collect the indispensable economic data on this matter.

1.3 PATTERN OF THE BILATERAL ECONOMIC RELATIONS BETWEEN 1945 AND 1993

With the end of the War there was obviously some room for general normalization of the relations. Losses resulting from the war were considerable on both sides: besides the human casualties³⁰, the material losses were huge as well. While Czechoslovakian material damage amounted to 4.7 bill pre-war U.S. dollars, German economic losses were several times higher.³¹ On top of this Germany had to carry the burden of war reparations which was - given the overall losses caused for the most part by the collapsed Third Reich - a very unfortunate factor for its development.

Although the reparations from the German part were paid regularly for several years, certain part of them was “violently” taken right after the war or even during the last moments of it. It was namely the USSR that took part of the fixed capital in order to get compensated for the material losses made by Germany at the Eastern front.

All-in-all the two countries needed to undertake vigorous restructuring, although for different reasons: Germany ended up as a much damaged country, occupied essentially by four winning nations and basically unable to start with economic activity “on its own”. Czechoslovakia had to namely reorient its economy

³⁰ Czechoslovakia was estimated losing up to 360 thousand inhabitants, mostly Jews, but also political prisoners, intellectuals or members of resistance. Majority of them killed /gasified or executed in extermination camps, prisons or in battles. Germany lost more than 6 million inhabitants, most of which died in the battles in the Eastern front. However, this was partially moderated by the return of approximately 9.6 mil ethnic Germans, being displaced from the countries they had lived in before. Casualties of the WW2 are listed for example at <http://www.worldwar-2.net/casualties/world-war-2-casualties-index.htm>.

³¹ Faltus, Průcha, 2003, pp. 81-82

from the arm industry to satisfying of “ordinary” needs of population and at the same time rearrange the property rights of the businesses that had been subject to germanization.

Indeed, since capitalism and - maybe more precisely - right-wing parties started to be considered as the greatest “culprit(s)” of the war as well as of the Munich Pact³², the economies in Europe (for the most part) headed to an increased nationalization and “socialization”.

Government started to be deemed as the very entity whose interventions were *indispensable* in the economy in order to keep it stable and resistant to fascist and nationalist pressures.³³ Hence the role of government and the position of government interventionism increased considerably even in the peacetimes.

The bilateral economic relations were relatively subdued when the room for their recovery was substantially reduced by many factors playing role in parallel. Perhaps the most important one (regardless of the specific ones inherently weighting on the two countries relations) rested in the general focus on the domestic economic activities and overall reconstruction of economies. In both countries export activity was marginalized; by contrast, imports represented quite a substantial aid for restructuring.

The main reason for this was the shortage of consumption goods and raw materials. Both were supplied in a very insufficient manner in whole Europe and this held certainly true for Germany as well as for Czechoslovakia, despite number of differences the countries were experiencing.

³² They were blamed for the policy that had led to it.

³³ Such pressures were feared to gain importance once economy falls into recession and involuntary unemployment increases. In fact, such argument is consistent with what John Maynard Keynes underlined in his *General Theory of Employment, Interest, and Money* from 1936 stating that the government involvement should keep the nationalist and revolutionary pressures attenuated.

Also, the famous U.S. plan called *European Recovery Program* (dubbed as the so called “Marshall Plan”) had a significant impact on both economies: while Czechoslovakia and eastern part of Germany was not authorized to accept it (because of the Soviet Union early “interventions”), western part of Germany was obviously authorized to accept it.

Soon it began to be relatively apparent that the German state would not stay unchanged and geographically unaffected and that it would be divided into two separate entities: the one governed by the “Westerners” and the one governed by the Soviet Union.

This led, among other things, to the increase in demand for the U.S. goods and net import position of Germany, while Czechoslovakia was - notably in raw materials - fully dependent on the Soviet Union. The trade between the two countries being described in the paper was in fact almost inexistent, as the whole European economy was sluggish and was suffering from the post-war recession.

Germany found itself in a very disadvantageous position for many reasons: as it was already touched upon earlier it had to pay the reparations to the winning countries; it had to let the winning countries a free access to its innovation and research program, its marine and warships and other military equipment was confiscated, and decartelization and demonopolization took place primarily in chemical industry and number of heavy industry sectors (although its implementation largely varied, basically depending on the occupation area).³⁴

Ultimately, with Germany being divided to the Eastern and Western part (since then called Eastern and Western Germany) and with series of communist *coups d’Etat* in Eastern Europe, the frontiers were quite clearly defined.

³⁴ Faltus, Průcha, 2003, pp. 83

Beginning from 1945-1946, the main focus in Czechoslovakia was put on the trade with the Eastern Germany, having the pattern of the economic relations to a very large extent pre-set by the production plans. Although there was still not much to trade with³⁵, for the economies were ruined and experiencing difficulties with basic needs provision.

As Czechoslovakia was becoming more and more obeisant to the USSR, the trade relations between Czechoslovakia and West Germany started to be pretty much subdued, while main focus was to be put on the relations with its eastern neighbour. German Democratic Republic (GDR) and Czechoslovakia were both members of the Comecon³⁶ (from 1949 and 1950, respectively), in which most of the relations were under the control of the Soviet Union that also became the Czechoslovak biggest trading partner in volume (already during the very first 5-year production plan).³⁷

However, from 1970s (at the latest), the economic situation in most of the socialist countries was progressively deteriorating, which finally significantly contributed to the collapse of the concerned regimes.

Based on dynamic average numbers, the trade relations with Western Germany stood for - approximately - mere 1% of the Czechoslovak exports and imports, which was around 5% of the trade relations with capitalist countries overall.³⁸ Finally, at the end of the “socialist regime” in 1989, the overall volume of trade with both German states ended up on 16% from total exports and 18.5% from total imports.³⁹ Assuming the trade with West Germany accounted for less than 1% then more than 96% of the trade with “Germany” was made with the GDR.

³⁵ Perhaps except of natural resources whose endowment is relatively poor in both regions.

³⁶ *Council for Mutual Economic Assistance* (also referred to as CMEA).

³⁷ Faltus, Průcha, 2003, pp. 172

³⁸ Weber, 2003, pp. 119

³⁹ Sojka, Konečný, 2006, pp. 176-177

Therefore the FRG had exerted practically no the Czechoslovak economy whatsoever. One of the reasons why the bilateral trade relations decreased⁴⁰ was also change in role that the foreign trade actually played.

To some extent paradoxically, because Marx alone had been one of the proponents of the international division of labour (unless it leads to exploitation and impoverishment of the countries involved), international economic relations were regarded differently. For sample, the retrospective estimates showed the share of exports on the total output increased only to approximately 25%, while the same held true for imports.

All-in-all the trade volume accounted for only about 50% of total output. Compared to Czechoslovakia in 1929, trade turnover accounted for more than 60% of the then output, i.e. it was - relatively - by more than 10 p.p. higher.⁴¹ This too clearly shows international trade had lost much of its importance in Czechoslovakia and elsewhere, being to a large extent “replaced” by the efforts to achieve at least a partial autarky.

The main target of the trade relations was not to shift the production possibility frontier, but more importantly to import the goods necessary for day-to-day functioning of the state, while such goods were not available in the domestic economy, or were almost prohibitively expensive to produce.⁴²

On top of this, the territorial structure of the trade was increasingly influenced by the Soviet Union which led to an artificial orientation on the Comecon countries. The relations within the Comecon group were generally based on clearing mechanisms, but the main problem lied in the inability of the managed prices to

⁴⁰ Yet FRG remained in Czechoslovakian “top ten” countries regarding trade volumes.

⁴¹ Although one has to add that in 1937, i.e. just after the worst economic slackdown was essentially overcome, the respective share stood only for around 33%; Kubů, Pátek, 1999.

⁴² Kubišta, 1999, pp. 232

reflect scarcity and information needed for the exchange. Nevertheless, it is naturally incorrect to regard the relations in Comecon through the “free-to-choose” perspective, as most linkages within the community were controlled by the Soviet Union.

It was estimated, however, that if there had been a market economy in Czechoslovakia (instead of the centrally administrated socialism) in 1980s, it would have had more than 50% of the commercial exchange with the non-Comecon countries.⁴³ This was, in fact, one of the primary causes for the territorial reorientation after the regime collapsed.

In the same way and as the Comecon could be regarded as a much closed community (given the clearing system and specificities in the commercial structure), interdependence between the members was much higher than the interdependence between them and the capitalist countries.

The extent to which the community was closed is very eloquently demonstrated by the trade between the West and East Germany that accounted - on average - only for some 2% of the total countries’ turnover.⁴⁴

Such an indication is quite “impressive” given the fact the two economies had been totally “integrated” in only one for so many years before the separation. Even this number, however, stood for 50% of the whole FRG trade turnover with the Comecon countries, amounting totally to approximately 4%.⁴⁵

This also suggests, according to what is mentioned on page 19, the GDR realized more than 30% out of the total foreign trade turnover with the Comecon

⁴³ Jonáš, 1997, pp. 112

⁴⁴ Calculation based on Schumacher, 2006, pp. 1.

⁴⁵ *Ibid*

countries with Czechoslovakia, as its total exchange volume with the community accounted for approximately 66%.⁴⁶

However, given the different starting points for individual economies as well as different role for the foreign trade in general, the level of interdependence was much lower than for the developed capitalist countries.

The incapacity of Comecon countries to compete with the European Community members ended up in the need for consumer goods to be imported. This was perceived as one of the big defeats of the socialist community from the part of the Westerners.

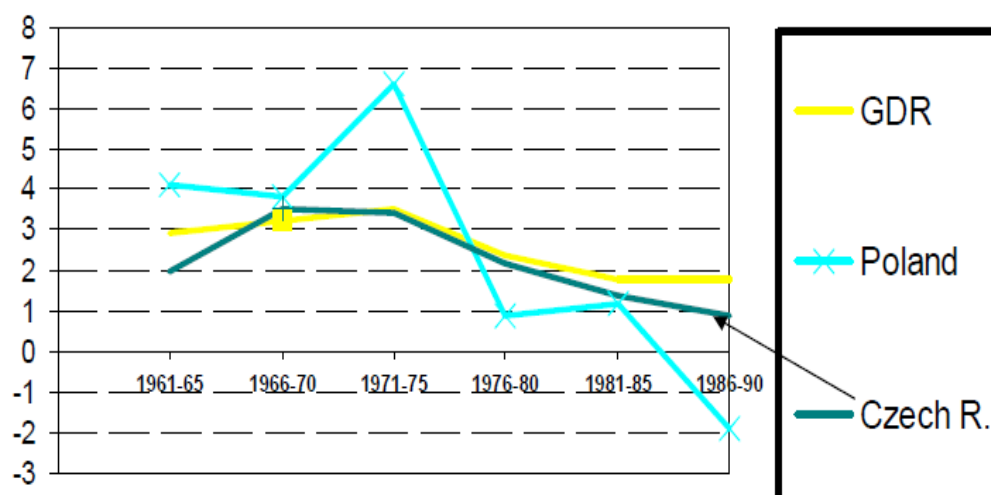
Already in 1976 O. Mayer noted that *“Regarding the alternative either to reduce the urgently required imports from western countries or at least to fully exhaust the chances for an improved access to the markets of the western countries, one apparently tries to take the second road. Whether, however, this second road will lead to success may be doubted in view of the lacking competitiveness of the East’s products.”*⁴⁷

Following graph clearly demonstrates the deceleration of economic growth in selected Comecon countries in which Czechoslovakia (denoted as the “Czech R.”) is characterized by similar growth rates as the Eastern Germany.

⁴⁶ Weber, 2003, pp. 264

⁴⁷ Mayer, 1976, pp. 67

**Graph no. 1: Decelerating (approximate) output growth
for selected Comecon members
(1961-1990; annually; in %)**



Source: Mygind, 2006, pp. 4

Looking at the graph we can see the room for extensive growth shrinking in 1970s at the latest in all selected countries. Likewise, while the Polish growth surges in the early 1970s, the growth in Czechoslovakia and in East Germany remains pretty stable. The curve in 1980s reflects Poland's economic problems at those times, resulting among other things to the strengthened *Solidarność* (*Solidarity*) movement and accelerating the changes undertaken in Poland.

Also we should note a very similar development of Czechoslovak and GDR's economies. However, this is not that astonishing for many economic factors in the two countries were similar and both countries were perceived as the most developed ones within the whole Comecon.

The whole situation changed dramatically after the fall of communism and the subsequent demise of the Soviet Union. The socio-economic system of the GDR and of Czechoslovakia returned back to capitalism.⁴⁸

A need for foreign economic reorientation and a need to find and penetrate on new markets led to the new dimension of the bilateral relations. Czechoslovakia, by contrast to GDR, desperately needed to contest new markets, because the former system of foreign markets collapsed. GDR, on the contrary, was given the opportunity to penetrate on the former FRG market, while being obviously exposed to it at the very same time.⁴⁹

In addition to it, both Czechoslovakia and former GDR had to cope with the socialist “heritage” which was basically characterized by completely different way of economy coordination. From this reason many fears concerning the competitiveness of either of these countries were raised.

Certain advantage of the GDR could be seen in the fact that West Germany possessed with capacities to help it with. Thus, although many problems remained at stake (such as high structural unemployment and fixed capital wearing-out), the amount of transfers from west - east was considerable.

On the flip side of the coin, however, former West Germany was no doubt hampered by these one-off payments, which, among other things, ended up in GDP growth deceleration. Another problem resulting from the former GDR problem was the ERM fluctuations. In spite of overcoming all these difficulties in 1990s, Germany

⁴⁸ The aim of the thesis, however, is not to discuss to what extent the contemporary system could be called “capitalism”. It is worth noting, nevertheless, some economists such as Paul Samuelson call it “a mixed economy” as government intervention and state ownership are largely present in there.

⁴⁹ Nevertheless, I do not suggest that the state entities are those who actually act. Thus, by saying “was given” or “was exposed” I always mean economic agents across the respective country. This is true for the whole thesis as the author does not suggest methodological collectivism is to be employed in it.

has basically remained a *low-growth* country until nowadays, which to a large extent contrasts with the Western German performance after the WW2.

For a simple illustration, the following table offers a unique comparison of the economic development for selected countries and it demonstrates the increasing lag of the socialist countries behind the capitalist ones from 1950 to 1992.⁵⁰ However, in this table Germany is considered as only one country.

⁵⁰ Although one must be aware of the fact that the accuracy of the data is to a certain level limited, given many incremental differences in methodology and also in the data availability.

**Table no. 1: GDP per Capita in the 56 country sample
(1820-1992; 1990 International Dollars)**

	1820	1870	1900	1913	1950	1973	1992
12 Western European Countries							
Austria	1 295	1 875	2 901	3 488	3 731	11 308	17 160
Belgium	1 291	2 640	3 652	4 130	5 346	11 905	17 165
Denmark	1 225	1 927	2 902	3 764	6 683	13 416	18 293
Finland	759	1 107	1 620	2 050	4 131	10 768	14 646
France	1 218	1 858	2 849	3 452	5 221	12 940	17 959
Germany	1 112	1 913	3 134	3 833	4 281	13 152	19 351
Italy	1 092	1 467	1 746	2 507	3 425	10 409	16 229
Netherlands	1 561	2 640	3 533	3 950	5 850	12 763	16 898
Norway	1 004	1 303	1 762	2 275	4 969	10 229	17 543
Sweden	1 198	1 664	2 561	3 096	6 738	13 494	16 927
Switzerland	-	2 172	3 531	4 207	8 939	17 953	21 036
UK	1 756	3 263	4 593	5 032	6 847	11 992	15 738
Arith. Average	1 228	1 986	2 899	3 482	5 513	11 694	17 412
4 Western Offshoots							
Australia	1 528	3 801	4 299	5 505	7 218	12 485	16 237
Canada	893	1 620	2 758	4 213	7 047	13 644	18 159
New Zealand	-	3 115	4 320	5 178	8 495	12 575	13 947
USA	1 287	2 457	4 096	5 307	9 573	16 607	21 558
Arith. Average	1 236	2 748	3 868	5 051	8 083	13 828	17 475
5 South European Countries							
Greece	-	-	-	1 621	1 951	7 779	10 314
Ireland	954	1 773	2 495	2 733	3 518	7 023	11 711
Portugal	-	1 085	1 408	1 354	2 132	7 568	11 130
Spain	1 063	1 376	2 040	2 255	2 397	8 739	12 498
Turkey	-	-	-	979	1 299	2 739	4 422
Arith. Average	-	1 194*	1 676*	1 788	2 259	6 770	10 015
7 East European Countries							
Bulgaria	-	-	-	1 498	1 651	5 284	4 054
Czechoslovakia	849	1 164	1 729	2 096	3 501	7 036	6 845
Hungary	-	1 269	1 682	2 098	2 480	5 596	5 638
Poland	-	-	-	-	2 447	5 334	4 726
Romania	-	-	-	-	1 182	3 477	2 565
USSR	751	1 023	1 218	1 488	2 834	6 058	4 671
Yugoslavia	-	-	-	1 029	1 546	4 237	3 887
Arith. Average	-	876*	1 174*	1 527*	2 235	5 289	4 627

Source: Maddison, 1992, pp. 2

Manifestly, while there was significant - mostly extensive - economic growth between 1950 and 1973 (Czechoslovakia up by 100%, USSR even by 175%), we can see apparent stagnation for most Comecon countries listed in the table between 1973 and 1992. On the contrary, economic growth in Western countries was relatively steady and firmly based.

At the beginning of 1990s, Czechoslovakia found itself in an “ambiguous” position. On one hand it had to liberalize foreign trade in order to fully participate in international division of labour. On the other hand, it had to sacrifice some of the markets it was present on for decades if it had wanted to enter the other. This was a very difficult and painful situation for many companies that emerged from the privatization process with new ownership.

Amongst the new markets to enter in the first hand, these were traditionally Germany and Austria, but also Poland and France in the second rang. Nonetheless, the Czechoslovak economy reoriented very fast and overcame most of the problems caused by the completely new economic environment.

Likewise its relations with Germany became increasingly intensive as the reunification of Germany brought about an important moment in political, but also in economic sense. For example the average volume of trade (taken from the Czechoslovak perspective) stabilized at about 30% in both exports and imports and Germany

Obviously, it was not only trade between the two countries that started to soar. As there were many opportunities for the German firms to participate in Czech and Slovak privatization processes, they naturally tried to use the opportunity in this field. Similarly a number of Czech companies were bought by German entities and thus the relations were given a completely new dimension, practically inexistent in the previous history.

Like it is demonstrated in this paper, foreign companies usually behave in somewhat different manner than the domestically owned businesses. The main difference which is touched upon here is the tendency to re-export a certain part of the production as they offshore in order to use the domestic capacities more effectively and to economize on the cost of production in general.

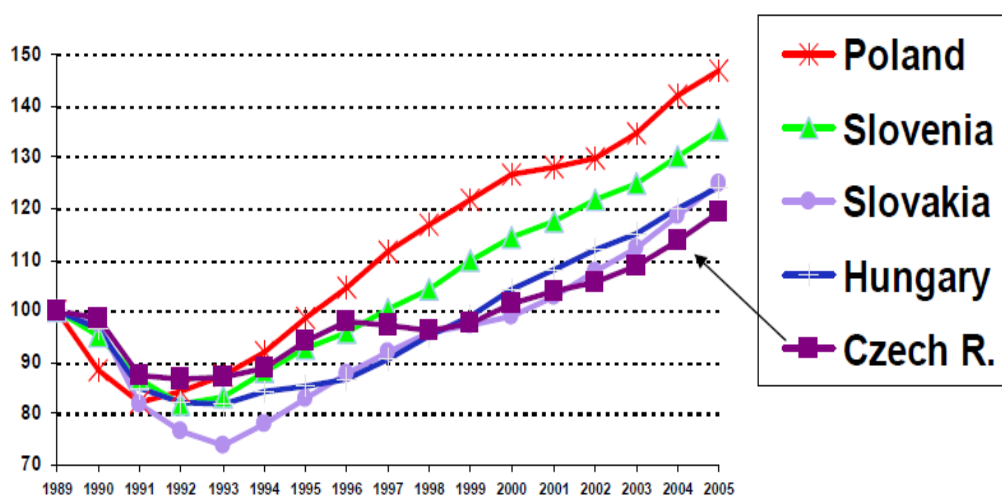
Nonetheless, neither Czechoslovakia (and consequently Czech Republic⁵¹), nor most of the other post-communist countries was not safeguarded against the typical J-Curve for the real production. This J-Curve⁵² was incidentally caused also by the need for reorientation which has been already discussed. Other explanations stress the uncertainty about ownership before the privatization process as well as the restructuring of the economy in general.⁵³

⁵¹ The two countries are purposely separated in the graph.

⁵² The problem of the J-curve is very comprehensively elaborated e.g. in Klaus, 1995. As it concerns only a limited number of countries under specified conditions, not much literature is in fact dedicated to it.

⁵³ For more details see Průcha, 2001.

Graph no. 2: “J - Curve” of the real GDP fall in post communist economies
(index in %; 1989 = 100)



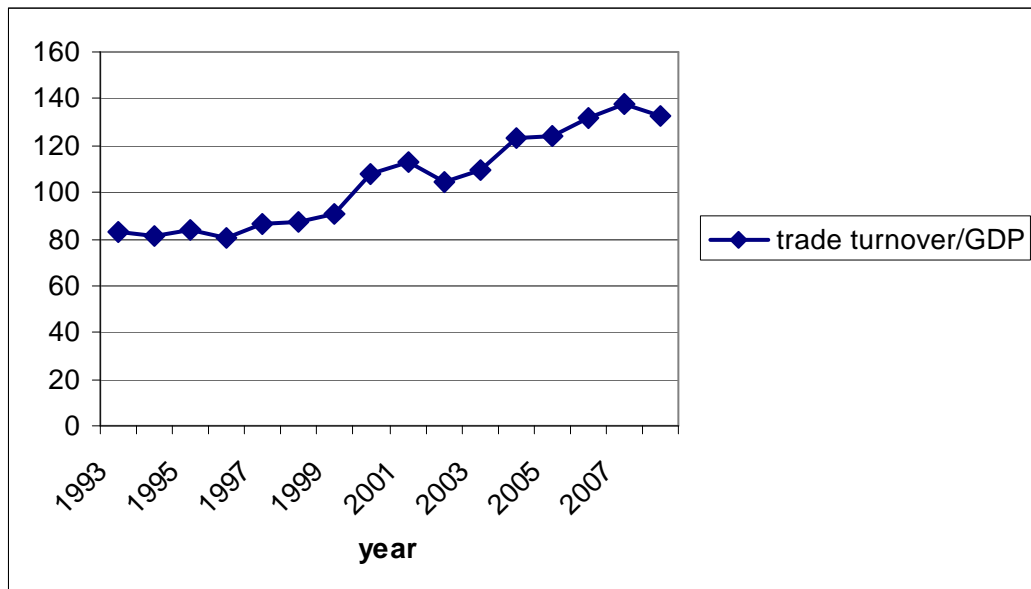
Source: Mygind, 2006, pp. 6

Czech Republic came to existence in 1993 and its typical international-economic definition states that it is “a small and a very open economy”⁵⁴. The openness of the Czech economy nowadays (2010) is huge, and it has been permanently increasing over time, recently leveling up to more than 100% (i.e. the

⁵⁴ Small open economy (SOE) is usually defined as an economy whose trade turnover exceeds total output and the economy itself is too small to have any substantial impact on other economies. Such impact could be in form of business cycle determination or interest rate determination. However, the definitions sometimes differ taking into account only export activity (usually, the respective amount of exports should reach more than 60% of the real output of the concerned country) and relative size of the economy in the global context. For more details see e.g. Krugman, Obstfeld, 2006

nominal volume of trade exceeded the nominal GDP of the country). The following graph clearly demonstrates the situation.

Graph no. 3: Openness of the Czech economy towards international trade (1993-2008; in % of trade volume in c.p. compared to nominal GDP)



Data source: Czech Statistical Office (ČSÚ)

Likewise, since the share of its exports varies around 35 to 40% of GDP, Germany is usually regarded as “big open economy”, thus an economy whose development somewhat determines the development of other countries or could have direct a direct incidence on international financial, capital, and other markets. The proportion of West German exports in its output increased steadily since the end of WW 2: from roughly 13.7% in 1950 to 19 percent in 1960, 21.2% in 1970, 26.4 % in

1980, and 32.1% in 1990. It then slumped after the reunification to approximately 22.8% in 1993 before rising again beyond its 1990 level. Clearly, Germany has integrated itself into the international division of labour with success, representing one of the global export leaders worldwide. Hence, free trade has been the vehicle by which it has managed to enhance its economic and social position worldwide as well as in the European context.

Turning back to Czechoslovakia, the somewhat liberal approach⁵⁵ towards internationalization of the economy - undoubtedly with number of exceptions notably at the beginning of the “new era” - allowed for economic relations with the countries in whole Europe without any substantial difficulties alongside with it. Number of agreements signed by the Czech authorities with the European Union and other countries improved Czech position in the exchange relations.⁵⁶

At the same time, the very intention of the Czech Republic to join the European Community (and the European Union) at some point in the future made it perhaps easier for foreign firms to place their investment, capital and financial resources in general in the country. This argument is in more detail examined later in the thesis.

Therefore, in the course of time Czechoslovakia and consequently the Czech Republic began to be a normally⁵⁷ functioning “market” (or, regardless of the various collocations it may actually have, even “capitalist”) economy in the European economic context and in the European economic environment in general.

⁵⁵ For instance, according to a (very) conservative institution called World Heritage Foundation the foreign trade policy of the Czech Republic could be classified as liberal between 1993 and 2008, much above the global average; <http://www.heritage.org/index/Country/CzechRepublic>. The same thing is usually suggested in the OECD country reviews and surveys since the it became a member of this organization (http://www.oecd.org/publicationanddocuments/0,3395,en_33873108_33873293_1_1_1_1_1,00.html).

⁵⁶ Jandová, 2006, pp. 26

⁵⁷ Apparently, the term “normal” or “normality” could be perceived in very different manners.

2. NEOFUNCTIONALISM, PACE OF REAL CONVERGENCE, AND EU ACCESSION

« Les idées sont des graines de lotus, elles ne dorment que pour mieux pousser. »
(*Fatou Diome*)

2.1 NEOFUNCTIONALIST THEORY

There are numerous sources describing and analyzing the functionalist theories within the international relations framework. Generally, there are several streams of international relations with common liberal theory “denominator”. These are essentially federalism, functionalism, neofunctionalism, transactionalism, interdependence analysis, and neo-institutionalism. Nonetheless they differ in certain characteristics and they all now basically stand for distinguished theories.⁵⁸

The common ground for liberal theories is that they see international institutions as the most crucial determinants of the international system functioning. The set of liberal theories is very wide-ranged, including those concerned namely

⁵⁸ It should be noted the *neofunctionalism* exists also in sociology, referring primarily to the work of Talcott Parsons and others. This theory, however, does not have much in common with the theory of neofunctionalism in international relations. Nevertheless, some of the aspects stressed by the two do, to a certain extent, generally overlap.

with the functioning of states and their interactions, to those focusing on preferences.⁵⁹

In a broader context, they also contribute to stability and peace-building situations as they bring about the indispensable cooperation and coordination amongst states and other - non-state - international relations actors. Moravcsik notes that they usually “(...) *include explanations stressing the causal importance of state-society relations as shaped by domestic institutions (for example, the “democratic peace”), by economic interdependence (for example, endogenous tariff theory), and by ideas about national, political, and socioeconomic public goods provision (for example, theories about the relationship between nationalism and conflict).*”⁶⁰

However, it should be underlined that the cooperation highlighted as the outcome of most liberal theories is not due to any “moral” standards of live, nor is it an act of “kindness” or a nice altruistic behaviour towards others. The cooperation occurs purely because it is found generally beneficial (in a more pragmatic understanding of the expression⁶¹) for all the parties involved in it. From this, liberal theories are not based normatively, but rather have a very positive nature.⁶²

Similarly, the increasing need cooperation generally arises from the increased interdependence and vice versa. Thus, it is becoming to a certain extent a self-sustaining system, in which one aspect fosters and keeps the other. Such virtuous cycle leads to the foundation of formerly - i.e. before the interdependence has taken its place - unknown formal and informal institutions through which the states

⁵⁹ Such as Moravcsik, A. *Taking Preference Seriously*, 1997.

⁶⁰ Moravcsik, 1997, pp. 514

⁶¹ Regardless of the fact whether the benefits could be calculated or not.

⁶² This is basically that they do not state what the best solutions *should be* but only state what actually *is, exist* or how it normally functions/behaves. The positive nature of liberal theories has been viewed as controversial and liberal scholars were often accused of being unduly *idealistic*.

cooperate even in more comprehensive ways in order to deal with the problems they have started to face in recent years.

Such problems are not, for the most part, to be dealt with by the means used without the institutions themselves.⁶³ This leads to a creation of formerly unknown international institutions; for states have to cooperate even in more official way in order to tackle problems they are facing nowadays.⁶⁴

In a broad sense, the liberals consider the international institutions as important, but on the other hand, their role in the states' behaviour is rather complementary, and not of the decisive nature. Therefore, they tend to regulate their international compartments in a more cooperative way.

Even though the substance of their behaviour cannot be definitely changed from the bottom, it might be subject to modifications. Hence, the liberal theorists of international relations do not agree neither with the realists, and consequently with all the realist streams, nor do they agree with the constructivists.

The constructivists think states' behaviour could be changed in its substance simply by institutions' creation and functioning. Their theory is thus compared to liberalists - simply put - more or less extended.⁶⁵

One of the most linked streams to the very neofunctionalist theory within the international theoretic framework is commercial liberalism. It happens these two theories are sometimes mixed or even regarded as the one theory of two branches, but this is not true at all. Obviously, the two theories are the liberal ones, which make them resemble in an extent.

⁶³ Rittberger, Zangl, 2006, pp. 17-18

⁶⁴ Rittberger, Zangl, 2006, pp. 20

⁶⁵ See, for instance, Simmons, Martin, 2002, pp. 195.

But their main differences rest in their usage: while commercial liberalists strive to explain the pattern of international relations in general, the neofunctionalists do it in particular with the motives of the states' integration efforts.

From this reason, the commercial liberals have definitely a lot to say when it comes to the European integration and the motives for states' cooperation, but at the same time have much less to say about the integration processes and their implications on the concerned states as such.

Notwithstanding it is still considered to be a neofunctionalist liberal theory as for instance Moravcsik argues that "... *the commercial liberal argument is broadly functionalist: Changes in the structure of the domestic and global economy alter the costs and benefits of transnational economic exchange, creating pressure on domestic governments to facilitate or block such exchanges through appropriate foreign economic and security policies.*"⁶⁶

Nonetheless, commercial liberalism should not be regarded as only "different type of neofunctionalism". One can see several reasons for this:

First, commercial liberals argue the private companies (multinational corporations included) and commerce in general are the most important and decisive variable shaping states' behaviour vis-à-vis other states.

Second, although the institutions play an important role by nature, they have most often very informal characteristics.

Further, it must be pointed out the neofunctionalist theory is much more realistic concerning the behaviour of individual agents. In commercial liberalism, as it is commonly perceived nowadays, the agents are taken as primitives maximizing their individual total utility⁶⁷, independent on any kind of binding preferences, and

⁶⁶ Moravcsik, 1997, pp. 112

⁶⁷ Regardless of the impossibility of the clear definition of the term itself.

trying to consume under the mostly favourable circumstances, not having to face any uncertainty.

This essentially means all the possible outcomes of human behaviour will occur, but it only depends on the decision-making process. Such a simplistic argument is by no means present in the neofunctionalist theory as it strives to describe not only the outcome, but also the process on somewhat more realistic assumptions.

All-in-all, neofunctionalism is a regional integration theory, based namely by Ernst B. Haas, who was a famous American political scientist. The theory itself has been already used many times, but is especially related to the European integration process and was used by Jean Monnet when he argued in favour of the integration itself. The theory suggests integration of some sectors spills over to the integration of other sectors as a result of the integration as such. More interestingly, integration progresses and accelerates with the integration in certain aspects.

Integration process is pursued in hope it will lead to further integration and harmonization elsewhere. Unlike formerly defined streams of integration, neofunctionalism was non-normative and tried to describe and explain the process of regional integration based - among other things - on empirical data.

Integration was seen as something which must appear as an inevitable process, rather than something as “desirable” state of affairs that could be introduced by the political or technocratic elites of the “involved” (i.e. finally “member”) states’ societies.

Such a straightforward approach ended up to be finally rather way too “straightforward”. The principal reason for this was that it has essentially understood that regional integration is only feasible as an incremental process, but in case any setbacks in the integration process were to occur, it started to be less satisfying.

This should not be regarded as such a huge problem given its theoretical background and namely its effort to explain the integration process in general.

Neofunctionalists basically argue that the most important determining variable in the integration processes is in form of *supranational institutions*. The theory has been several times called “Eurocentric”, namely according to its alleged incapacity to describe integration (or the nature of international relations) elsewhere.⁶⁸ However, it tried to understand how intensive should be the regional integration in real terms.

One of the main features of neofunctionalism is the marginalization or at least decline in national tendencies among the states that participate in the integration process. Instead the countries - at least to a certain measure - deliberately delegate their powers and their authority to a supranational institution that represent their vital interests.⁶⁹ Needless to add such a “deliberate delegation” takes form of certain “obsecration”, striving to play down nations’ egoist and particular interests. Hence, according to most neofunctionalists, solely international organization could overcome individual interests divergences.

Rather, and it is again worth noting that there is another common “piece of ground” with commercial liberals, the interest groups within the states lead the state and the society intuitively closer to the real integration. The whole process is thus much more natural than it is actually in other theories.

⁶⁸ However, reasons for such an argument have not been defined in much detail, nor the theory itself wanted to line up itself into those that aim to explain existing reality only in a limited geopolitical sense.

⁶⁹ This is what, for instance, Haas argues in his well known work on the integration motives called *The Uniting of Europe*. Nonetheless, Haas became sceptical after the French started to pursue their policy of so called “empty chair” and he said - allegedly - that neofunctionalism is dead. Nowadays the neofunctionalists do agree the theory is meant notably for explaining process of integration in its way forward, and not backwards, which makes the theory more vulnerable towards criticism.

In a simple descriptive analysis, we can essentially distinguish three main principles (listed below) the neofunctionalism is actually built on. These are - at the same - time the three methods upon which neofunctionalists analyze integration processes in general.

1) Firstly, there is the very well known *spill-over effects* hypothesis, stating the positive effects of integration in one sector lead to the integration of other sectors. This should, as a result and according to neofunctionalists, lead to launch of integration in other sectors, for they could simply bring about easier reaping of benefits in the original sector.

2) Further, as the domestic interest groups and socio-economic agents find out the more suitable governing institutions are the supranational ones, they redirect their concentration towards them. Since they begin to realize the supranational institutions are better equipped to satisfy their material and other interests, they tend to use them in a more intensive manner than the local.

This ultimately leads to the weakening of the nation states, because local governments are no longer perceived as the most powerful ones, nor are they perceived as the most legitimate ones (although the question of legitimacy is simply not to be resolved by the interest groups and economic agents).

3) Finally, the sketched “circle” continues in the field of the institutions themselves. Once they start to be aware of their role of the integration process, they tend to sustain it as it brings about the strengthening of their positions. Thus, they become the fierce proponents of the integration process.

Concerning the above mentioned characteristics, Haas himself argues that this is the way and reason “(...) *how and why states cease to be wholly sovereign, how and why they voluntarily mingle, merge and mix with their neighbors so as to lose the factual attributes of sovereignty while acquiring new techniques for resolving conflict between themselves.*”⁷⁰

He then adds following: “*Neo-functionalism stresses the instrumental motive of actors; it looks for the adaptability of elites in line with specialization of roles; neo-functionalism takes self-interest for granted (...) [and relies] on the primacy of incremental decision-making over grand designs.*”⁷¹ Although it could be sometimes difficult to distinguish between “incremental decision-making” and “grand designs”, the “step-by-step” approach is perhaps quite peculiar to neofunctionalist theory in general.

Also, as it has already been mentioned, neofunctionalists are now aware of the problems with the “implicit determinism”. Since there was a long debate between the neofunctionalism and intergovernmentalism about this issue, neofunctionalist theory revived in 1980s when it succeeded to indulge its critics by “softening” the deterministic approach. The renewed approach rested on the supranationalism and the transaction-based approach supported for the most part by Stone Sweet and Sandholtz and Alexander.

Even though they admitted the neofunctionalism had failed to predict future situation in Europe⁷², they stated the theory is a very useful one when analyzing the integration motives.⁷³ At the same time the theory has become one of the theories

⁷⁰ Haas, 1970, pp. 610

⁷¹ Haas, 1970, pp. 627

⁷² Being usually unable to explain political clashes within the community and reluctance of certain groups to continue in integration process.

⁷³ This is also one of the objectives of the thesis.

used most often while analyzing the integration itself. Moreover, it has not, unlike others, explicitly denied or invalidated other theories, but has played more or less a complementary role.

The reassessment of the neofunctionalism has taken place several times. One of the recent conclusions is that the political elites are forced to cooperate more closely as the economic cooperation intensifies. Therefore, one can see the mitigation of disputes and clashes is achieved in somewhat a natural way.

In this sense, Schmitter argues that *“No theory of regional integration has been as misunderstood, caricatured, pilloried, proven wrong and rejected as often as neo-functionalism. Numerous scholars have rejoiced at having “overcome” the much-decried antagonism between it and intergovernmentalism, presumably by adhering to some version or another of the latter. So much so, that with very few exceptions, virtually no one currently working on European integration openly admits to being a neo-functionalist.”*⁷⁴

Hence the theory is still alive and all of the sudden it has even begun - owing to the new “wave” of theorizing - to be once again very up-to-date. Essentially respecting the criticism there was the new name developed for it - the neo-neo-functionalism - trying to refer to the fact the neofunctionalism has been “modernized” for the “needs” of reality (although it must be certainly acknowledged this might sound somewhat inappropriate or even “eclectic”).

In another example of the vital debate the neofunctionalist theory nowadays participates in, M. Harris points out that *“Based on the past examples of successful spillover, such as the EEC (1957) and the CAP (1968), one could view further steps such as SEA, EMU and CFSP as additional spillover. Given a flexible neofunctionalism that recognizes the role of actors within and outside of institutions*

⁷⁴ Schmitter, 2003, pp. 1

and the incremental nature of change, ongoing integration can be seen as a series of spillovers, which have occurred in intermittent great leaps forward. Applying liberal intergovernmentalism, actor-centered models or multi-level governance is useful for recognizing the role of individual actors and institutions. “⁷⁵

Apparently, the author does not suggest any specific nature of the mentioned spill-over effects. Whether they are due to the supranationalist approach or intergovernmentalist approach is, however, to a large extent irrelevant.

One of the most convincing arguments in this part is perhaps that “*When trying to assess the likelihood for future deepening after the recent expansive widening of the EU, Haas’ recognition of the need for compromise given multiple state interests and the more newer variants’ emphasis on bargains, lobbying and exogenous factors all are important.*”⁷⁶

After all, she then makes the distinction between the now and then situation, having to regard them in a very different manner, particularly because of the Economic and Monetary Union existence. Following this logic she states that “*The present case differs from past expansions and incrementalism in that a significant amount of integration has occurred immediately upon the accession of the Eastern countries (ERM II participation and fixed exchange rates, participation in the common market - except for limitations on human traffic, and full participation in EU institutions) and the next stages will encompass both catching-up with the rest (EMU) and joint-integration into new areas, such as the JHA and CFSP pillars of TEU and an EU constitution.*”⁷⁷

The catching-up process is actually one of the most crucial in view of member states since they tend to see the EU accession as an opportunity to attain high GDP per

⁷⁵ Harris, 2004, pp. 21

⁷⁶ Harris, 2004, pp. 22

⁷⁷ *Ibid*

capita.⁷⁸ Therefore the motives supplied to the general public in favour of whatever regional grouping accession are sometimes mingled with such logic and contained this kind of arguments.

From this reason, neofunctionalism essentially assumes the deeper integration of member states in the community eventually leads to higher “level of convergence”.⁷⁹ Hence she then concludes as follows: „*A multi-tiered EU is probably already a reality, but with the ostensible goal of full membership for the willing and able. If this is true, the newest member states should attain the existing level of depth enjoyed by older members as an automatic extension of their membership - after they have met certain requirements. Whether and how they will move ahead to deeper areas of integration is the challenge for theory and EU proponents.*”⁸⁰

Harris also stresses, as many scholars did already, the intergovernmentalist approach remained to be relevant. “*The road to further integration may also reach a few “integrative plateaus“, which does not mean spillover has ceased. In any case, it is clear that further integration will occur in incremental stages subject to negotiations and the multi-level interactions of intergovernmentalist and supranationalist institutions and actors.*”⁸¹

The *deepening* versus *widening* of the European integration will no doubt stay the matter of discussion for many years to come (and not only with respect to the planned enlargement of the Community), but also simply because every community is

⁷⁸ Clearly, the predictions made on GDP per capita development respect changed demographic structure caused by the enlargement in 2004 as well as in 2007. The issue is taken up more in detail for instance in Monnier, 2004.

⁷⁹ In other words, the deeper the integration process of a *particular* country, the closer it gets to the development typical in the respective community.

⁸⁰ Harris, 2004, pp. 22

⁸¹ *Ibid*

driven to a certain “self-reflection”, i.e. it needs to feed back on how it is actually evolving.

Actually, neofunctionalist theory might play here a very central role, as it basically provides us with feasible explanations for what might be happening in Europe in case of e.g. Turkey joins the Union. The process behind integrating newcomers into the Community is one of primary fields of interest for neofunctionalists.⁸²

However, one can rightly argue that having a theory with mixed empirical evidence, basically unable to predict what would happen in an opposite situation (i.e. in case integration process ceased), could be slightly complicated. There are two principal reasons for this:

Firstly, every theory is normally evaluated, among other things, by its predictive capabilities.

Secondly, there may be various driving forces behind the integration and those focused on, explained and put forth by neofunctionalism are just some part of this set.

Nevertheless, this does not invalidate the theory in its totality - one just has to be aware of the complexity of social phenomena that definitely exists. Such complexity makes it more difficult for simplistic theories as they do not take into account and/or marginalize other driving forces, but on the other hand, it gives way for theories that do not have ambitions to describe all social process they would want to.

⁸² And for constructivists, whose paradigm seems to equally fit well.

Apparently, as the neofunctionalist theory refers primarily to the spill-over effects, cross-border cooperation and economic motivations in an integration process, it does not necessarily mean it attempts to nail down all variables.

It was particularly applied to the widening of the European Community in the early stages of its existence, i.e. the progress made from the European Coal and Steel Community to the European Economic Community, and also the passage from the Community to the European Union. In other words, it started to be concerned more with the *deepening* than only *widening*, as it has been demonstrated earlier in the thesis.

Thus, it shall be assumed - in line with the theory - the integration process should have accelerated after the accession of the Czech Republic and nine other mostly East European countries to the European Union. The most important reasoning behind this is obviously an effort to create relevant hypothesis based on the relevant presumptions.

The same opinion is defended, among other political analysts, by Özen, for instance. He generally stresses that “*Neo-functionalism is an international integration theory based on the initiative of European integration movement and especially on the transition from the European Coal and Steel Community (ECSC) to European Economic Community (EEC)*”.⁸³

The same kind of argument has been used several times before. And it is also the empirical evidence often raised by the proponents of neofunctionalism in general. However, such a situation does not exist anymore as the room for cooperation extended considerably since then.

In complete accordance with this reasoning, the Czech Republic started with adopting communitarian legislation as it was approached the accession. Once

⁸³ Özen, 1998, pp. 11

fulfilled, initial requirements proved to be not satisfactory and the process has basically continued by other means.

The more and more rules were adopted by the Czech institutions, the easier access to European market granted for Czech goods and services. As it will be shown later on, the integration has not ceased in the field of legislation and common administrative procedures, but it has gone much farther.

Such arguments are further stressed by Özen: *“The movement which was initiated with the European Coal and Steel Community towards an integrated Europe is not merely a simple international integration approach but also an international development whose limits go beyond a classic type of an international organization. The most important factor distinguishing this approach from other integration efforts is the consideration of political integration as the main objective at the final stage.”*⁸⁴

From all the above it might seem evident the neofunctionalism is not a theoretic stream that has been abandoned or even overcome. Nowadays, we are principally witnessing an ongoing debate between neofunctionalists and intergovernmentalists.

Nevertheless, the two theoretical approaches have very much in common and the differences between them are in fact arising from methodological issues. The apparent efforts to merge these two streams prove right arguments marginalizing their theoretical distance.

The Czech Republic has come a long way from the Velvet revolution to the EU accession. Its position at the point of joining the community was definitely much different than the position of the founding countries. The main reason - from the neofunctionalist perspective - is no doubt the level of “development” of the

⁸⁴ Özen , 1998, pp. 11

community alone: to some extent harmonized legislation, common agricultural policy, certain internal security, solidarity & subsidiarity principle, and even EMU existed already. In this context, the country has committed to stick to these principles, essentially hoping for the easier pathway to reach them.

At present the Czech Republic is firmly anchored within the EU: It has adopted vast majority of principles upon which the Community functions, it participates in the daily decision-making process (regularly sending its representatives in most of the working groups as well as diverse formations of EU institutions), having intention to join the ERM II system once it is possible, and consequently, to join the Eurozone, as it pledged itself that it would do this at such point in the future.⁸⁵

As it now acts in line with purely functional role - i.e. economic role - of the community it meets perfectly neofunctionalist assumptions. The intensity of Czech integration is still to be measured through economic variables and the more common ground for cooperation facilitates such relations with most European countries in general, having their economic importance for the Czech Republic recently increased several fold. However, the following pages are dedicated also to the distinction between this importance before the accession and after it.

To sum up, neofunctionalism would mean the *spill-over* effects create new needs and tensions that lead to a joint action elsewhere. From this, we can distinguish between several kinds of them: functional ones, i.e. when integration in one sector of economy eventuates in integration of other sectors of economy; technical one, leading to the harmonization of standards; and finally political one, which by and large depends on the latter two, and whose typical feature includes corporations, trade unions, and other organizations lobbying regional executive instead of national

⁸⁵ Regardless of the fact how difficult would it have been to attain an “opt-out”.

governments once certain competences are shifted this direction.⁸⁶ All mentioned characteristics are typical for the contemporary integration processes, either explicitly, or implicitly.

2.2 CZECH REAL ECONOMIC CONVERGENCE IN LIGHT OF THE NEOFUNCTIONALIST THEORY FRAMEWORK

The Czech Republic is said to be “converging” to the more - in the economic sense - developed countries. Despite the fact the measures of development could be very diverse and even heterogeneous⁸⁷, the most often used measure is the GDP per capita, which is also the most often used economic measures in general.

With the perspective of joining the European Union and the final accession is commonly agreed that the benchmark for the convergence is the average per capita GDP⁸⁸ in the in the Community.

The convergence is normally divided to the real convergence, i.e. within which the real variables are followed, and the nominal one, i.e. when the nominal variables, such as monetary ones, are closely followed.

The almost magical word “convergence” might seem overused⁸⁹, as there are still so called “convergence criteria” that have basically double form (at least when it

⁸⁶ Similar classification is to be found in Rosamond, 2000.

⁸⁷ Simply because a country which is developed in one field does not have to necessarily be developed in other areas.

⁸⁸ In calculation of which the so called *Purchasing Power Parity*, or the *Purchasing Power Standards* method is normally used.

⁸⁹ It may also be sometimes “misused”.

comes to the European Union functioning): the convergence criteria the states are obliged to fulfill if they want to join the Union and the convergence criteria that must be met in order to join the European Monetary Union, or to participate in the ERM II respectively.⁹⁰

Thus, it seems that everyone still must converge somewhere and that a certain extent of convergence is therefore almost inevitable.⁹¹ The real convergence of the Czech Republic is seemingly happening as it is evident from the economic data.

If we took the GDP per capita in real terms in the European Union from 2004 and compare its development with the development of the GDP per capita in the Czech Republic for the same period, we can distinctively see the difference in their dynamics: while the Czech GDP has grown relatively fast, the output of the European Union as a whole has not actually grown that fast.⁹²

In general, there is no so much controversy about the convergence itself. However, one should be always concerned with its pace, for this is the most important aspect bearing the necessary predicative value.

As Özen points out, *“This integration movement, starting with strategic sectors of the economy, would spread to other sectors as well. This is referred to as the “spill-over effect” of integration by the neo-functionalists. Such a supranational*

⁹⁰ However, the thesis is not going to be concerned with such criteria namely due to their nature and lack of relevancy.

⁹¹ Even if the countries did not fulfill the conditions for real convergence, they simply “have to converge naturally“ and it is - on top of it - usually advised by the European Commission to do so in the framework of the so called Convergence Programmes. These programmes are strictly for EU members having not yet adopted the single currency; countries that take part of the EMU are assessed in Stability Programmes. And it is generally assumed the countries unable to converge should do so as soon as possible.

⁹² It is dealt with this matter in more detail later in the thesis.

*integration covering all sectors of the economy would enable nations to establish their political ties at a supranational level instead of a national one.*⁹³

From the point of view of political process it seems relevant to note that *“It has always been advocated by neo-functionalists that a successfully progressing economic integration would bring along its own political integration. Hence, they have suggested that starting with economic integration to achieve the political one is a profound method.*⁹⁴

The convergence of the Czech economy is taken namely with the relation to Germany. The European Union as a whole is a certain benchmark for the economy to converge to. Hence, the most crucial in this case is to determine whether there has been recently any significant convergence to the level attained by German economy from the part of the Czech Republic or not.⁹⁵

There have been many clashes concerning the convergence pattern. According to neofunctionalist hypotheses, the real convergence should occur quite naturally once the respective countries engage in cooperation. The problem, however, rests in the nature of economic growth which playing the key role in the determination of the convergence pattern.

One of the most striking moments was the increasing divergence in output per capita in the course of the 20th century. This was caused namely by the divergent growth rates among different states, generally separated into “northern” and “southern”, essentially referring to world hemispheres. Hence, the inequalities existing even in 19th century were aggravated, but the process itself got more complicated in principal.

⁹³ Özen, 1998, pp. 11

⁹⁴ Özen, 1998, pp. 11

⁹⁵ In this case I am only concerned with the process of convergence, and not with the final outcome - since it could last very long until Czech Republic reaches the same level of GDP per capita as Germany.

Such empirical observation contradicts to the Solow growth model prediction stating that economies finally end up in a so called *steady state*, in which the increased capital is exactly offset by the equipment of new workers as well as by the capital depreciation.

Indeed, the empirical evidence does seemingly contradict a key prediction of this standard growth theory: countries with relatively low per capita income should catch-up with richer ones.⁹⁶

Since capital is normally regarded as relatively scarce in less developed countries⁹⁷, it should have generally higher returns and put simply, such countries should catch up the rich ones, in which capital has got relatively lower returns. This whole process should end up by equalizing incomes per capita in the respective countries in the steady state, unless they have not different savings rates.⁹⁸

However, such generalization does not take into account some kind of inherent endogeneity of capital, which could be namely observed when considerable investment into human and physical capital occur.

The convergence pattern for the Czech Republic may be split into two different ways:

In the first place, real economic convergence is normally perceived in form of cyclical convergence, referring to the synchronization of business cycles in particular

⁹⁶ http://www.ecb.int/press/key/date/2007/html/sp071001_2.en.html

⁹⁷ Relatively means there is lower share of capital on stock of labour.

⁹⁸ Which is normally not assumed to be the case, for the concerned economies are supposed to attain the same level of savings rates. If they do not attain the same levels of saving rates - which is naturally much more realistic - than we analyze so called *conditional convergence*.

economic areas/regions. The cyclical convergence is the most important in terms of economic determination.⁹⁹

In the second place, one should be dealing with closing the income gap existing between Germany and the Czech Republic. Such a gap was very considerable in 1993 when Gross domestic product per capita reached 17,200 USD in Germany and 7,200 USD in the Czech Republic.¹⁰⁰ From this, the Czech output per capita was 42% of the one in Germany. However, I assume the closing of income gap in two analyzed periods - i.e. 1993-2003 and 2004-2008 - should have been simultaneous, given the initial conditions of the concerned economies as well as the “neofunctionalist” *spill-over* effects.

The second type of real economic convergence could certainly be a complementary to the first one, but only under specific conditions. Therefore, I shall treat them as separate processes, which are both to be assessed in more detail and then merged together. The key problem here is that countries that are coming closer together in terms of income per head do not have necessarily reveal the same pattern of business cycle behaviour.

Such statement holds particularly for countries that are not much linked by their bilateral trade and financial relations, but do record significant income inequalities. Examples from international economic history are abundant.¹⁰¹

In case of the 10 “newcomers”, i.e. the countries participating in the largest EU enlargement in its history, economists normally talk about “conditional

⁹⁹ Matkowski, Próchniak, 2004, pp. 21-25

¹⁰⁰ Both variables are calculated on the PPP basis;

OECD: <http://puck.sourceoecd.org/vl=1047790/cl=11/nw=1/rpsv/home.htm>.

¹⁰¹ Krugman, Obstfeld (2004) deal with this issue in an impressive detail.

convergence”.¹⁰² The same type of convergence exists in the case of Germany and the Czech Republic as the savings rate somewhat differ in the two countries.

Common framework given by the *acquis communautaire* stands for a structural factor in the convergence process. This set of principles, whose existence is broadly in line with the neofunctionalist predictions, should have allowed for faster convergence process in both ways.

The most important reason is that the structural adjustment is absolutely indispensable in order to make the economies function on similar principles. The *acquis* then resembles common legal framework on the nation-state basis.¹⁰³

In case of the Czech Republic, the structural adjustment is seen as one of the central factors.¹⁰⁴ Another important factor is the increase in *total factor productivity*. Since the post communist countries suffered from the productivity deficiencies, capital accumulation was not properly transformed into economic growth. With higher level of commercial ties to more developed countries in the community even before the 2004 enlargement, the TFP was found to increase.

In principal, *total factor productivity* in the Czech Republic has grown relatively fast before accession. This shifted Czech output closer to the average of the EU. At the same time, several questions about long-term sustainability of this growth have been raised. It started to be evident that with accomplished transition other sources of growth should be utilized, capital accumulation among them.

¹⁰² For more about conditional convergence in the context of the EU see e.g. Burda, Wyplosz,

¹⁰³ Needle less to mention regions within single states usually resemble more than across states, though even in the EU exist several exceptions, such as Italy or Poland.

¹⁰⁴ And it is accentuated in *Analýza stupně sladění České republiky s Eurozónou*, 2008.

Generally, other driving forces behind the convergence process in the trade and capital flows framework are usually distinguished: technology transfer, migration, higher level of competition, and economies of scale.¹⁰⁵

However it must be noted this kind of convergence process might lead to income divergences (Romer, 1986; Krugman, 1991). This could be generally caused by brain drain R&D activities. Since the evidence on income convergence is rather mixed, often depending on the type of countries that are analyzed, the room for discussion still remains large.

The following analysis deals with the Czech-German relations without and within the *acquis* framework. It was generally discovered the Eurozone development is to a high level correlated with the German one.¹⁰⁶ From this reason, if the Czech economy is found to be increasingly synchronized with Germany, it must be then also synchronized with the EMU.

¹⁰⁵ Matkowski, Próchniak, 2004, pp. 6

¹⁰⁶ Obviously, for the purposes of measurement, one have to exclude Germany from the Eurozone, as it accounts for approximately 24% of its total output; Darvas, Szapáry, 2004, pp. 17.

3. CZECH-GERMAN ECONOMIC RELATIONS BETWEEN 1993 AND 2008

“The strongest arguments prove nothing so long as the conclusions are not verified by experience. Experimental science is the queen of sciences and the goal of all speculation.” (Roger Bacon)

3.1 INTENSITY OF TRADE RELATIONS

Beginning from 1993 the Czech Republic and Germany have started a new era of their economic relations. These have been facilitated by several factors: First, the Czech Republic accomplished its first phase of transformation - no doubt with many problems to be tackled still ahead of it - and began functioning as a more or less standard market (capitalist/mixed) economy.

Germany after its reunification succeeded to somewhat equalize the east and west differences thanks to financial transfers aimed at manufacturing, but again, certain problems have remained. Amidst them, structural unemployment and lack in productivity compared to western part as well as compared to the EC average have been the utmost.

From this reason, Germany too could be separated into two geographical parts, presupposing their different development. But this is definitely not an intention as the analysis should be kept simple and explanatory.

For the Czech-German economic ties two periods are basically distinguished: 1993-2003 and 2004-2008¹⁰⁷. The first one is a period within which, taking quarterly data, 44 observations are to be made. The second one, however, comprises solely 24 observations. Apparently, there is certain methodological problem in that the EU enlargement took place, *stricto sensu*, on May 1, 2004. However, being guided by explanatory value of the analysis, the accession is taken to be in fact accomplished by January 1, 2004.¹⁰⁸

Further, for the purpose of all analysis, the following economic indicators and data are used:

- i) Trade volumes with goods;*
- ii) Foreign direct investment flows and stocks;*
- iii) Industrial production¹⁰⁹ for both countries over the observed period;*
- iv) Real output development for both countries over the observed period.*

While trade volumes in goods and services and foreign direct investment are taken as variables that should have accentuated due to the Czech economy getting closer to the German one because of individual production sectors' skidding, real output and industrial production are essentially regarded as being an outcome of the economic ties increased intensity.

¹⁰⁷ Although data from 2009 are already available in form of estimates, the thesis does not include them into the analysis due to the economic and financial crisis being absolutely unrelated to the EU 2004 enlargement. Therefore the analysis would have been somewhat debased since the effect of the crisis is not easy to adjust for.

¹⁰⁸ As it is demonstrated later, the simplification is - to some extent - appropriate.

¹⁰⁹ Such indicator is usually considered in the international economic literature as industrial production and manufacturers stand for relatively high shares in the bilateral trade. The reasons why this is so should be found e.g. in Krugman, Obstfeld, 2006.

As it has been proven several times (Hampl In: Pečínková, 2007, Matkowski, Próchniak, 2004, etc.), foreign direct investment (FDI), either so called *green-field* or *brown-field*¹¹⁰ often contribute to higher trade intensity. This problem is tackled later on in the thesis as it is inherently linked to bilateral trade relations and their typical behaviour.

Steady increase of trade volumes over 1993 to 2008 period could be observed. Labour specialization and needs for larger variety of production paved way to higher trade intensity. Financial and economic crisis starting basically in the last quarter of 2008 ceased the whole process as trade volumes fell sharply in the global scale, Europe included.

Before a model is developed, the reliability of the data should be checked for. In this sense what regards the economic performance data, statistical offices of both countries are the primary source.¹¹¹ In the case of bilateral commercial relations, the central banks are used, but as it has been found several times, there could be found number of discrepancies not taking into account methodological differences used in the two economies.

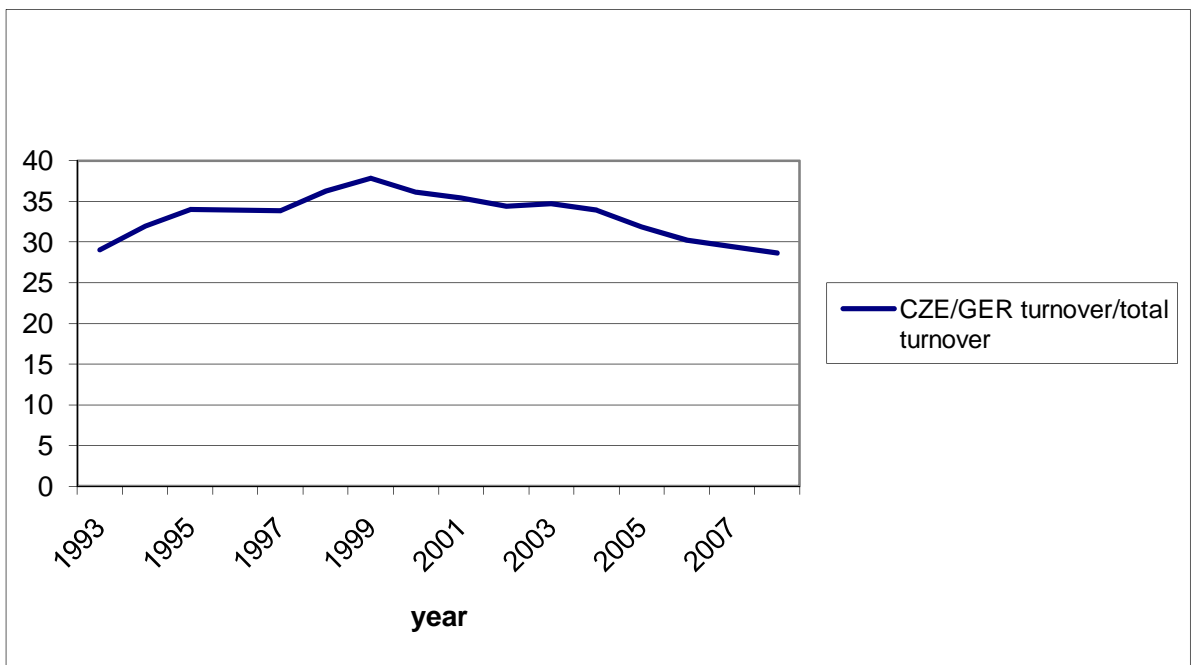
Why should one assume somewhat higher interdependence between these two countries than elsewhere? Beginning from 1993, the share of trade volume was increasing over the first few years, reaching its peak in 2007, when the trade turnover attained approximately 37% (40% of exports and broadly 32% of imports), having

¹¹⁰ *Brownfield investment* normally refer to a situation when a private company or even government purchases or leases existing production facility in order to start its own production with it. *Greenfield investment* basically refers to a situation when a company builds up its own production facility. Both types of investment are normally used in the context of foreign direct investment and not used when talking about domestic investment activities in order to prevent possible mismatches.

¹¹¹ These are the Czech statistical office (ČSÚ) and the German statistical office (Deutsches Bundesamt).

stabilized at about 30 % by 2007.¹¹² The situation is demonstrated by the following graph.

**Graph no. 4: Turnover of the bilateral trade compared to total trade turnover of the Czech Republic
(annually; shares in %)**



Data source: Czech Statistical Office (ČSÚ) and German Statistical Office (Bundesamt)

¹¹² Czech statistical office; <http://www.czso.cz>

While the share in percentage remained more or less relatively stable, the volume in absolute values was steadily increasing by the average of approximately 16% per year.¹¹³

Similarly it should be noted Germany remained the most important destination for the Czech trade¹¹⁴, the Czech Republic represented on average 12th to 15th position, when the most important trading partner is by and large France, USA and the United Kingdom, followed by the Netherlands, Italy and Belgium. Interestingly enough, given number of similarities the two countries actually share together, Austria has placed in 7th to 8th.¹¹⁵

Quod nota the trade balance between the two countries became titled “in favour” of the Czech Republic in 1998 and remained positive until nowadays.¹¹⁶ Exceptionality of this situation is underlined by the fact that German trade balance with most other countries has always been positive which put Germany into a position of the net exporter.¹¹⁷

Following graph clearly demonstrates the development of the bilateral trade relations between 1995 and 2008.

¹¹³ Czech National Bank; <http://www.cnb.cz>

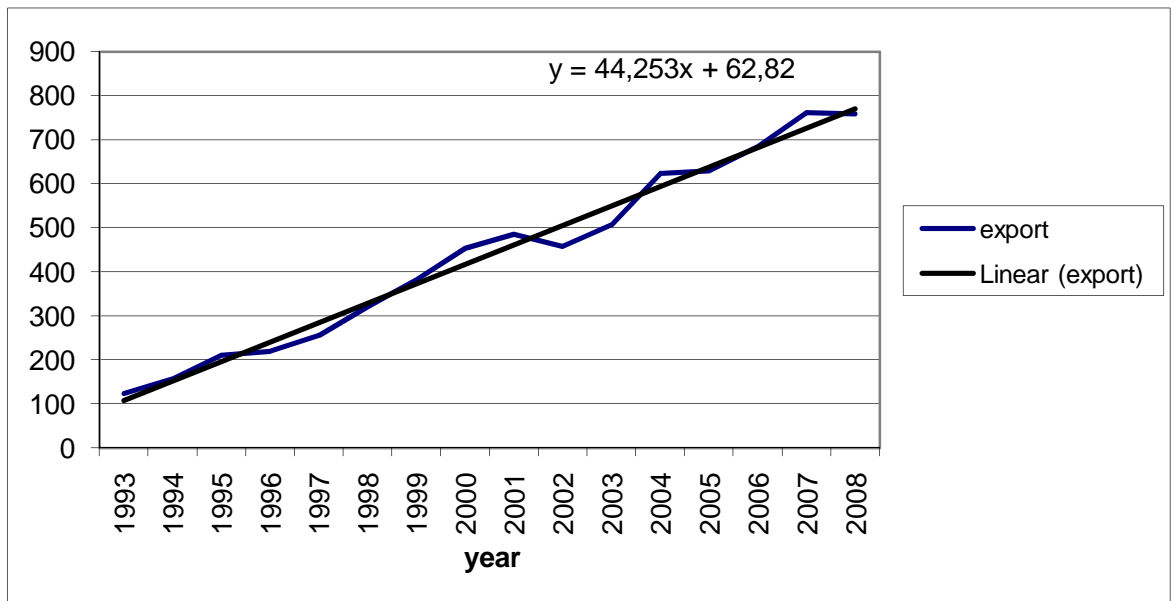
¹¹⁴ Being followed by Slovakia, Austria, Italy and France, however, with quite a significant distances between them and Germany; Czech statistical office (ČSÚ); <http://www.czso.cz>.

¹¹⁵ German statistical office (Deutsches Bundesamt); <https://www.destatis.de>

¹¹⁶ Czech National Bank; <http://www.cnb.cz>. However, one must still bear in mind trade balance is not exactly the same indicator as the goods and services balance, i.e. the respective balance within the current account, even if in the case of Germany and the Czech Republic they do overlap to a very large extent.

¹¹⁷ German statistical office (Deutsches Bundesamt); <https://www.destatis.de>

Graph no. 5: Czech export activity to Germany from 1993 to 2008
(annually; current prices; in CZK bil)



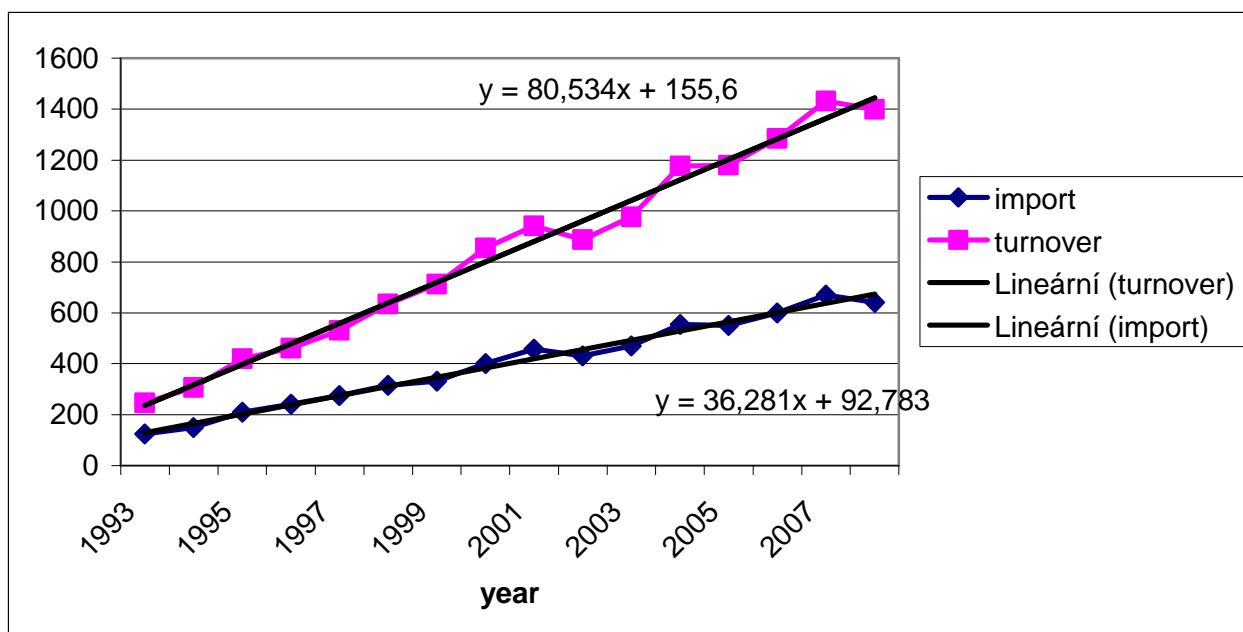
Data source: Czech National Bank (ČNB) and German Statistical Office (Bundesamt)

The data used are the yearly data, indicating apparently no significant change in the trend line. However, one could find certain acceleration after 2004, which is clear from the presented numbers. This acceleration took place namely just after the EU accession in form of a certain “jump phenomenon”, allowing to stabilize trade activity on higher levels on both sides.

Also, linear trend of the export activity is quite satisfactory. If other trend lines used, the R^2 is much lower than in this case (“power trend” is to be the second best trend-line).¹¹⁸

The following graph demonstrates an analogous situation putting together exports and imports. Linear trend lines are used in order to demonstrate their approximate (average) behaviour.

Graph no. 6: Trade volumes between Germany and the Czech Republic from 1993 to 2008 compared with German imports (annually; current prices; in CZK bil)



Data source: Czech National Bank (ČNB) and German Statistical Office (Bundesamt)

¹¹⁸ Based on calculations made with *Gretl Econometric Software*.

Again, a very similar situation could be observed to the one before. The foundation from data is not that easy to identify: while between 1993 and 2003 the trade volume was increasing by the average of 16% per year, from 2004 to 2008 it was already 17%.¹¹⁹ Moreover, according to this statistics, trade volume (in nominal prices) increased by almost 90% over the period from 1997 till 2001, slowed down afterwards and accelerated again after 2004: the volume increased by almost 50% between 2003 and 2008.¹²⁰

The consequent fall in both exports and imports in 2008 could be ascribed not only to the commencing economic crisis, but also to the Czech currency appreciation in relation to Euro. The volumes denominated in Euros slightly increased, although some of the dynamics got lost.¹²¹¹²²

This does not, however, represent any statistically significant differentiation, particularly when taking into account very short time series. Any conclusions based on this analysis would therefore be unsubstantiated and to a very significant manner statistically irrelevant.

¹¹⁹ Czech statistical office (ČSÚ); <http://www.czso.cz>

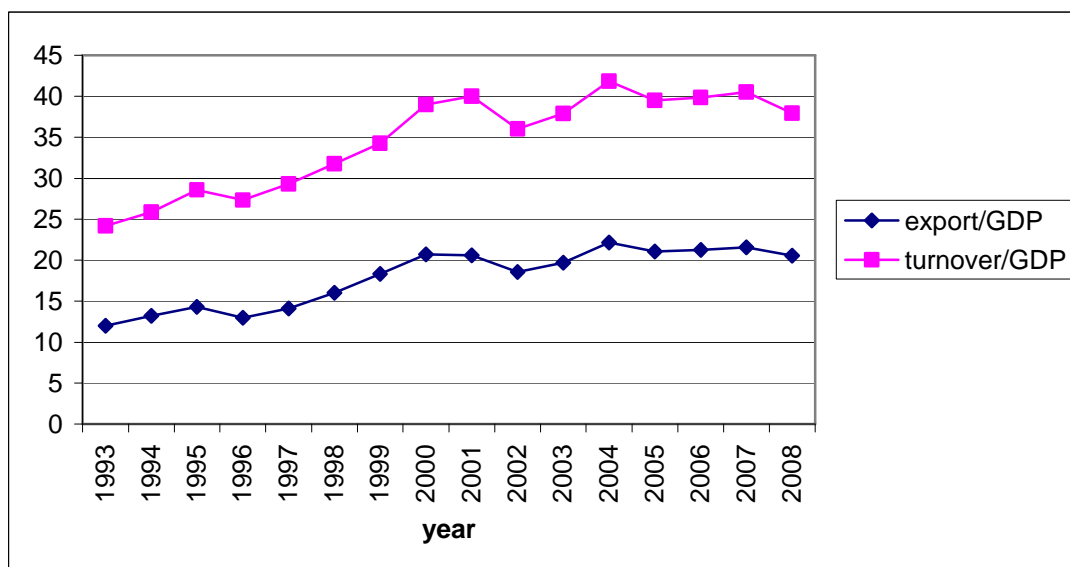
¹²⁰ Particularly, in the trade soared comparing 2003 and 2004 by incredible 22%; Czech statistical office (ČSÚ); <http://www.czso.cz>

¹²¹ Czech National Bank (ČNB); <http://www.cnb.cz>

¹²² As a pretty good illustration of how important any exchange rate development may actually be, one could find out the incidence of Euro and CZK denomination switched in the course of the financial and economic crisis in 2008 and 2009: while trade volumes denominated in Euros increased in 2008 and those denominated in CZK somewhat decreased, in 2008 they fell by approximately 5.5 p.p. more than those denominated in the CZK. Apparently, short-run exchange rates fluctuations can exert temporary detrimental effects regardless of the longer-term development.

Apparently, GDP in current prices grew at significantly slower pace than the bilateral trade. Perhaps, as it is normally the case of many similar trade patterns elsewhere, certain saturation of the bilateral trade volumes took place. Such a thing is quite usual; given the needs being “satisfied” through the foreign trade are normally somewhat limited, large part of the output is kept in form of the domestic absorption.¹²³

***Graph no. 7: Shares of Czech exports on GDP c.p. and share of total trade turnover with Germany on GDP c.p.
(annually; in %)***



Data source: Czech Statistical Office (ČSÚ) and German Statistical Office (Bundesamt)

¹²³ Similar arguments could be found for instance in Krugman, Obstfeld, 2004.

Following table complements the information. Apparently, while exports soared to 943% compared with 1992, GDP in current prices “only” to approximately 359%.

**Table no. 2: Czech export growth to Germany index vs. GDP growth index
(baseline period: 1992)**

year	$X(t+n)/t$	$GDP(t+n)/t$
1992	1.00	1,00
1993	1.52	0.99
1994	1.95	1.15
1995	2.61	1.43
1996	2.72	1.64
1997	3.18	1.76
1998	3.98	1.94
1999	4.74	2.02
2000	5.64	2.13
2001	6.02	2.29
2002	5.68	2.40
2003	6.31	2.51
2004	7.75	2.74
2005	7.82	2.90
2006	8.52	3.13
2007	9.48	3.44
2008	9.43	3.59

Data source: Czech Statistical Office (ČSÚ)

However, due to the starting economic crisis in 2008, the volume dropped substantially in 2009.¹²⁴ The very similar pattern of trade could be observed for the

¹²⁴ Czech statistical office (ČSÚ); <http://www.czso.cz>

Czech Republic in relation to the EU15. For instance, from 1993 to 2004 the share in percentage of EU15 countries on Czech trade volumes increased by 15 p.p.¹²⁵

What regards the typical structure of the bilateral trade, it stayed quite stable over the whole period. Most important shares commodity structures¹²⁶ have automotive products such as cars and automotive particles (on both sides of the balance); share of machinery is also very relevant (with automotive products equaling to almost 50%), manufactured goods play an important role as well (approximately 21%), and final consumption accounts for about 10%.¹²⁷

At the same time, the structure of Czech imports from Germany and exports to Germany is in fact very similar. The main notion that should be gained from this is the intra-industry trade plays a very important role here.

Such a thing often happens when the FDI secures a significant part of exports by re-exporting. This is typical for German FDI in the Czech Republic, namely because they produce substantial amount of the so called semi-production, being included in SITC 7 (i.e. machinery and automotive particles).¹²⁸

From this perspective, there is not any substantial difference with what can be observed in the overall Czech trade structure.

All in all, structure of the bilateral trade well reflects the development of the overall structure of the Czech foreign trade. This goes very much hand-in-hand with what we have been witnessing several years before and since the very EU accession,

¹²⁵ Jandová, 2006, pp. 14-22

¹²⁶ Based on the generally renowned Standard International Trade Classification (SITC); being normally used by the Eurostat as well as most statistical offices in the European Union.

¹²⁷ Czech statistical office (ČSÚ); <http://www.czso.cz>

¹²⁸ Similar conclusions can be found, for instance, in the Czech National Bank business cycle synchronization analysis from 2006.

i.e. increasing volume of trade volume, with - for the whole EU - even increasing relative share.

Similarly, not only the Czech trade behaves in a resembling manner with these two entities, but it also shows analogous tendencies. One of the most striking trends is a certain shift from relatively low value-added products to the products with a higher one. On the other hand, however, typical feature of the Czech-German pattern is the trade with semi production, which goes slightly against the mentioned tendency.¹²⁹

Moreover, most of the production that is either exported or imported takes form of investment and manufactured goods, and relative minority is intended for final private consumption (approximately 16% over the selected period).

From this reason, one could regard international trade as an essential source for economic growth of the Czech Republic, despite its impact is difficult to calculate in some more precise manner.

Having covered the trade issues, one could conclude by stating that the degree of openness of the Czech economy has been rising rapidly over the period. This holds true in general, but it also holds true in particular when talking solely about relations with Germany. By the end of 2008 the country placed among the most open EU Member States. Also, alongside with this development, the trade contributed positively to the economic growth.

Moreover, the growing external openness towards other countries, especially Germany, did not give any rise to macroeconomic imbalances as we could witnessed in other small open economies (such as Lithuania, Latvia, Estonia, and perhaps most importantly Hungary).

¹²⁹ Czech statistical office (ČSÚ); <http://www.czso.cz>

One of the particularly striking facts is that while the current account remained in deficit most of the time (although at a very financeable level), the trade balance with Germany stayed positive.

Surprisingly enough, even with the CZK appreciating significantly (in real as well as in nominal terms) from 2000 to 2008, when the most significant appreciation falls within 2004 and 2008, the effect on exports was relatively subdued. From this reason, further improvement of Czech exports in the European context was very likely caused not only by relative cost advantage, but also by other factors, among which quality upgrade could be mentioned in the first place.

3.2 INTENSITY OF INVESTMENT RELATIONS

In order to somewhat complete a “big picture” of the commercial relations, the foreign direct investment¹³⁰ from Germany to the Czech Republic might be playing the role of financial part of the balance of payments.

The main reason for which Czech FDI to Germany are not considered in the analysis is that they represent only a very incremental value of the set of FDI in Germany and their effect is therefore quite negligible.

¹³⁰ Naturally, there are also other types of investment, such as buying shares in companies, stock purchases, and so forth. These are, due to the limited extent of the paper, not taken into account. In addition, such investment is usually perceived as “not that productive”, in terms of their contributions to the gross domestic product or product per capita as the foreign direct ones.

Also, when compared with other countries in the region, the volume is significantly lower, standing for approximately 30% of the Austrian and 50% of the Hungarian FDI.¹³¹

Consistently with international economic intuition, their volume is perhaps going to increase with the continuation of the catch-up process which is already at work. For the time being, as the fixed capital accumulation remains relatively lower and nominal convergence is not finished, Czech FDI influx to the developed countries plays fundamental role neither in terms of the Czech economic development, nor in terms of the development of the respective countries.

The FDI stood for a very typical element of Czech economy over last several years. The Czech Republic holds a position (together with Hungary) of the most attractive destinations for the foreign direct investment in the CEE region.¹³² Primary reasons for this are normally seen as quality of labour force (namely regarding skills and education), low cost of labour force, and relatively good infrastructure.

As it is generally perceived *beneficial* to have as much foreign direct investment as possible in an economy for number of reasons (technological spillovers, managerial skills, higher productivity, new foreign markets contested relatively costlessly, and so forth), politicians usually try to attract them through so called *investment incentives*. This has been obviously also the case of the Czech Republic. Number of firms and businesses used such an opportunity, but it would not be correct this has been the main reason for their inflow.

It is apparent the common rules that were adopted by both countries has made easier for the investment activity in general. Such rules are most importantly

¹³¹ German statistical office (Deutsches Bundesamt); <https://www.destatis.de>

¹³² CEE region is conventionally referred to as *the Central and Eastern Europe*, hence comprising most post communist countries in Europe.

included in the Single market framework, which both countries are obliged to respect. Estimates say there may be roughly up to 4,000 German companies operating in the Czech Republic.¹³³

However, large number of them came in 1990s, among which Volkswagen acquisition of Škoda Car Company being probably the most notorious example. Put simply, one could distinguish two major types of German foreign direct investment in the Czech Republic: *brownfields* and *greenfields*. Typically, German *brownfield* investment took place namely in the automotive industry and in banking and financial sector, while the *greenfields* got anchored notably in energy sector and communications.

All-in-all, the average structure of the German FDI in the Czech Republic during 1993 and 2008 was as follows: automotive industry accounted for 14%, technical and trade services for 14%, natural resources processing for 13%, and financial services for 8%.¹³⁴

In the set of German firms operating in the Czech Republic one could find some of the very important, such as - except the above mentioned Volkswagen - RWE Transgas, Siemens, AEG, Continental, Linde, Deutsche Telekom, Robert Bosch, Schoeller or even E.ON.¹³⁵

There are actually several effects through which the German FDI could influence the Czech economy performance. The most important is perhaps higher

¹³³ Czech Business Web Portal (Businessinfo); <http://www.businessinfo.cz/cz/sti/nemecko-obchodni-a-ekonomicka-spoluprace-s-cr/7/1000636>

¹³⁴ Data extracted from the statistical sources of the Czech Embassy in Berlin (<http://www.mzv.cz/www/default.asp?id=32804&ido=14406&idj=1&amb=2>).

¹³⁵ Czech Business Web Portal (Businessinfo); <http://www.businessinfo.cz/cz/sti/nemecko-obchodni-a-ekonomicka-spoluprace-s-cr/7/1000636>

employment, then technological *spill-overs* and obviously the incidence on the export activity in forms of re-exports.

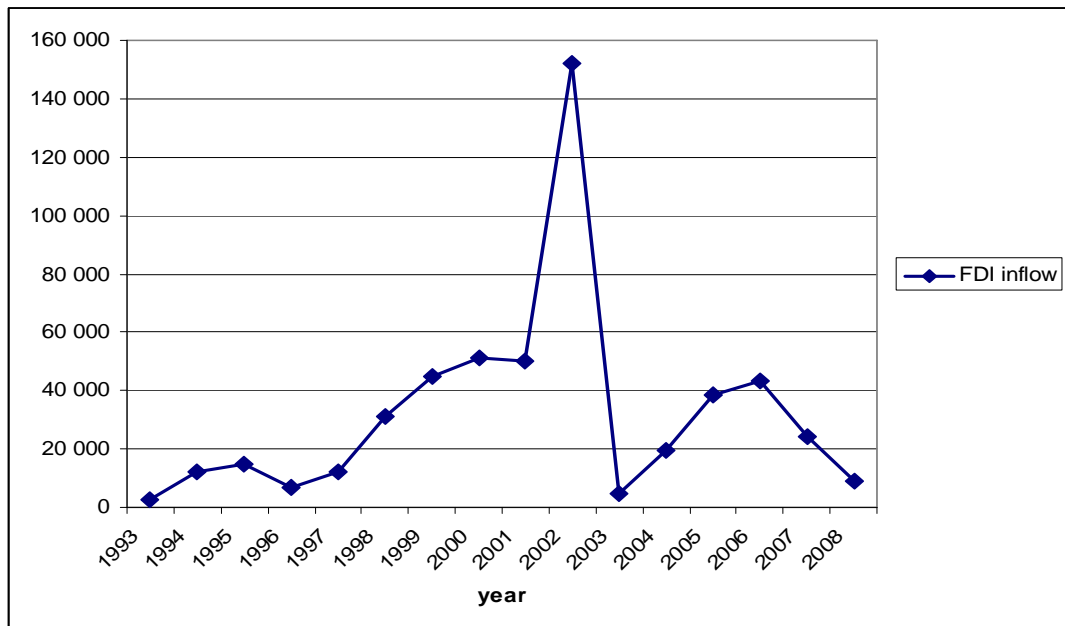
Based on the statistics, by the end of 2008 German FDI stock attained 315,918 mil CZK, from which 139,366.4 mil CZK in form of reinvested profits.¹³⁶ Germany thus placed 2nd after the Netherlands and before Austria, representing approximately 14.4% of their total amount.¹³⁷

Following graph shows the development of the German FDI flow into the Czech Republic. Considerably higher volatility of the investment compared to the bilateral trade is more or less noticeable at first sight.

¹³⁶ Czech National Bank (ČNB); <http://www.cnb.cz>

¹³⁷ *Ibid*

**Graph no. 8: German foreign direct investment inflow
to the Czech Republic between 1993 and 2008
(annually; volumes in CZK mil)**



Data source: Czech National Bank (ČNB)

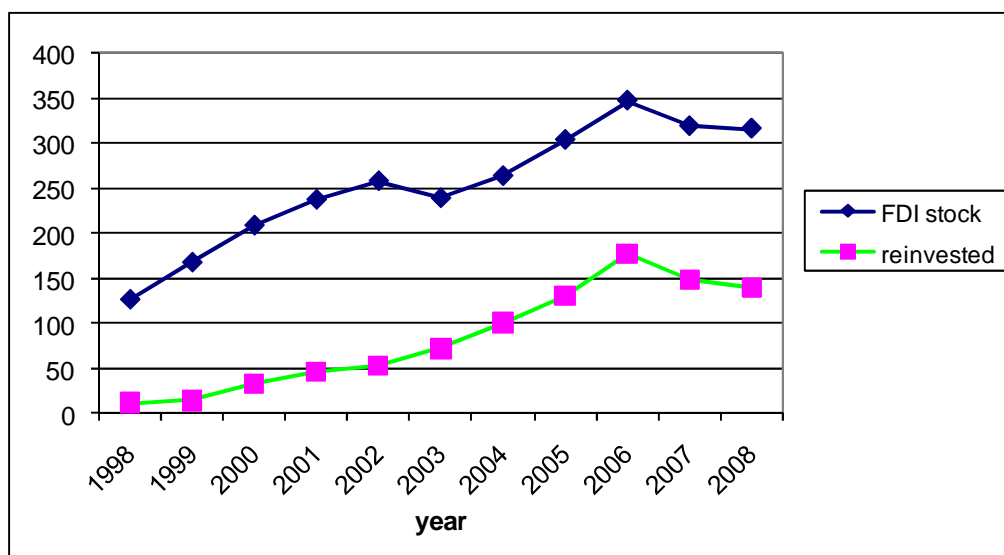
Although - like it was the case for bilateral trade - quarterly data are not available for the territorial structure, the more amplified cycle is clearly recognizable. Ruminating over the inflows as more or less discrete¹³⁸, higher non-recurring volumes make the behaviour sheer off in a more significant manner. Despite such a complication, slightly increasing FDI could be observed from 2003 on, however, the trend has chopped around quite recently as the economic crisis started to proliferate into the real economy. Therefore, there is not any clear evidence the enlargement

¹³⁸ Unlike in foreign trade, which usually deemed as infinitely continuous.

constituted change in the FDI behaviour. However, there was a significant change in the FDI source: while before the enlargement most of it took form of shareholder's capital, boom of reinvestment (or more precisely "profit reinvestment") was observed.

Apparently, while in 1998 almost none of the FDI stock came in form of reinvested profits, situation changed completely in the course of time, reaching more than 51.1% in 2006 and stabilizing around 46% since then. The most eloquent is perhaps hike in reinvested profits after in 2004 compared with 2004 (up by almost 50%).

***Graph no. 9: German foreign direct investments stock
in the Czech Republic between 1998 and 2008
(volumes in CZK mil)***



Data source: Czech National Bank (ČNB)

3.3 SYNCHRONIZATION AND DETERMINATION: INDUSTRIAL PRODUCTION

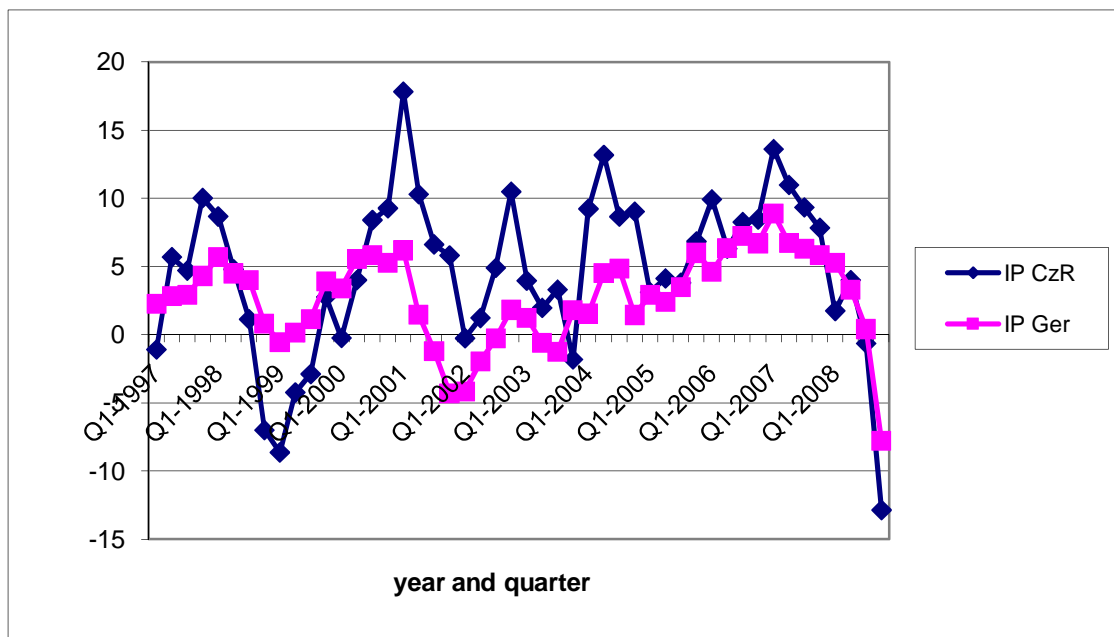
Firstly, I analyze a connection between changes in export activity and changes in German GDP. For this, yearly time series are used. Using simple regression model, in which changes in Czech exports (dependent variable) are thought of as being determined by the real GDP growth in Germany (independent variable), for period 1993 and 2003 no significant results are obtained.

Correlation coefficient is close to zero and R-Squared (taking a linear model) explains mere 0.02% of the behaviour, while standard error of estimation is a very high one. The analysis suggests that - on the annually basis - no significant relation has been found between these two variables; put simply, between 1993 and 2003 Czech exports are not to be explained by output development in Germany.

Much “better” results are found for the period from 2004 to 2008: R-Squared is now able to explain 5% of the model and correlation coefficient rises to 0.21. However, although this outcome is somewhat more persuasive, it could not be as satisfactory for any clear conclusions. All-in-all, changes in Czech exports to Germany seem to be relatively autonomous on the changes in German output.

Based on the descriptive analysis made above, I now explore industrial and business cycles synchronization. Given a need for comparability, data from 1997 to 2008 are selected. Essentially, there are some analyses (Kalous, 2003, Vintrová, 2004, CNB, 2006, 2007, etc.) suggesting relatively direct relationship between the two cycles after and even before the enlargement. According to them, the industrial production cycles are more determined than the output cycles themselves due to higher shares of manufactured goods in bilateral trade relations.

Graph no. 10: Industrial production in the Czech Republic and in Germany between 1999 and 2008
(quarterly; changes in % vis-à-vis respective quarter in of the previous year)



Data source: Eurostat

Clearly, synchronization is absolutely evident. Progressing to simple regression model, where changes in German industrial production stand for independent variable for to the changes of industrial production in the Czech Republic, I obtain following: R-Squared (linear) reaches more than 40%, while correlation coefficient offers a comfortable 63.3%, therefore a moderately strong to strong relationship.

When the time series gets split into two periods, i.e. from 1997 until 2003 and from 2004 till 2008, results change significantly: in the period 1997-2003, correlation coefficient falls to 0.43, indicating a relatively moderate relationship, and R-Squared to as little as 18.5%. Since the p-value of the model is relatively low (0.022), there is some statistically significant relationship at the 95% or higher level of confidence.

Analyzing the second period, i.e. 2004-2008, I obtain somewhat more persuasive results: correlation coefficient is at 0.817, which shows quite a strong relationship. At the same time, R-Squared equals almost to 67% which is also quite a high one. Since the p-value stays close to zero, the relationship seems to be statistically very significant (at the 99% level of confidence).

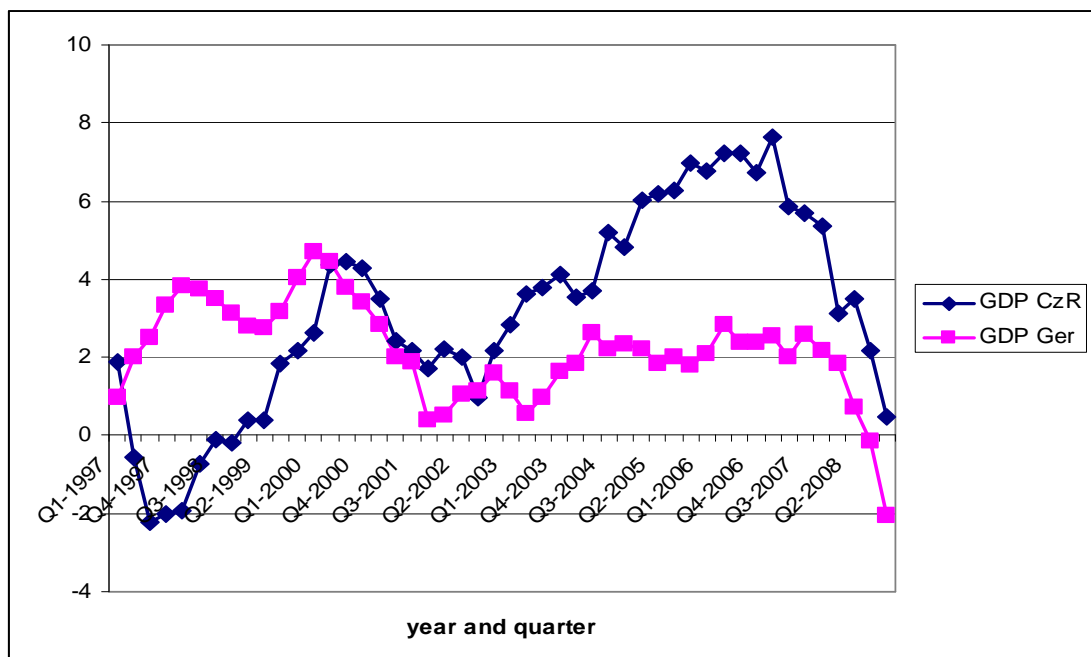
3.4 SYNCHRONIZATION AND DETERMINATION:

REAL OUTPUT

As the pattern of industrial production has been explored, I now turn to output synchronization which is perhaps the most eloquent outcome of international economic adjustment. Following graph demonstrates output behaviour both in Germany and in the Czech Republic from 1997 until 2008. For the case of simplicity and given the nature of the particular time series, trend line is not adjusted for (only seasonal adjustment is made).

**Graph no. 11: Real output in the Czech Republic and in Germany
between 1997 and 2008**

**(quarterly; changes in % vis-à-vis respective quarter in of the previous
year)**



Data source: Czech Statistical Office (ČSÚ) and German Statistical Office (Bundesamt)

Even though data not adjusted for trend, we could observe significant similarities between the two cycles. Especially, the synchronization from the EU enlargement in 2004 seems evident. However, in order to specify the analysis, I have to make another simple regression assuming Czech real output change as being

dependent (in the respective quarter) on the German one. For the whole period, R-Squared reaches only 9.7% and correlation coefficient is close to zero, signaling no relationship. If, once again, I split the whole periods into 1997-2003 and consequently 2004-2008, I obtain following: for the first period, no significant relationship is found (correlation coefficient is even slightly less than zero; p-value being at 0.41 indicates basically no relationship).

It seems, nevertheless, there could be a certain lag between the variables. Exploring this possibility, I find out the lag could have been somewhere around 9 to 7 quarters, however, the significance stays relatively low.

Taking now into consideration the second period, I get much more credible relationship: R-Squared reaches 60.36%, thus the model is essentially able to explicate 61% percent of the behaviour, and having correlation coefficient 0.77 shows moderately strong relationship. Moreover, since p-value attains only 0.0001 the described model is significant at 99% confidence level. It seems - from the analysis - the Czech economy became much more dependent on the German one since its EU accession.

Seemingly, according to the following calculations there might have been certain lag in the Czech business cycle behaviour. For the period 1997-2002 I estimate this lag up to 7 quarters (at the beginning), being reduced to some 2 quarters by 2003. This means, essentially, proliferation of external shocks into the Czech economy used to be probably much slower than it has been the case since the EU accession. Howsoever, simple linear regression model does not offer a very persuasive explanation, but rather mixed evidence, which holds especially for the late 1990s and early 2000s.

4. SYNTHESIS AND REASONING

“The opposite of a correct statement is a false statement. But the opposite of a profound truth may well be another profound truth.”

(Niels Bohr)

4.1 NEOFUNCTIONALISM AND COMMERCE

The accomplished analysis has suggested the Czech economy has been undergoing the process of adjustment which is somehow related to its EU accession. Many authors argue in the same way as I do in the thesis (Kalous, 2003, Tomšík, 2008, Jandová, 2006) although they generally concentrate on euro adoption. In other words, they regard adjustment process as the necessary condition for the ERM II admittance.

Therefore, they focus on the adjustment process as on the necessary condition, and less as on the consequence. This does not go, incidentally, against the very notion of adjustment like it is taken up by the thesis. On the contrary, the readiness of the Czech economy to adopt euro (perhaps most importantly by fulfilling the Maastricht criteria) goes with what is actually predicted by neofunctionalist hypotheses and what the analysis has actually suggested in its totality.

There have been several variables analyzed in the paper: most importantly, it has been found trade relations somewhat amplified since the EU enlargement. However, one could argue more could have been expected. This is likely to a pre-

accession harmonization, driven namely by the Copenhagen requirements and adjusting legislation in accordance with the EU standards.

A visible feature of financial relations was the increasing share of reinvested profits on total FDI, while FDI flow from Germany remained positive. The share of reinvested profits soared some time before and especially in the wake the enlargement alone, which could point to the fact the companies welcomed the accession as a certain shield against future uncertainty. Therefore, with new investment opportunities, German companies set up their own affiliated branches, generally lowering repatriated profits for the benefit of the reinvested ones.¹³⁹

Other important observation is that the Czech exports behaved relatively autonomously in relation to the German output development. There could be several relevant explanations behind this: first of all, in the early years of the bilateral trade cooperation Czech goods competed namely through their price, for they possessed certain “cost advantage”. This basically means that even at times when incomes stagnating (or even decreasing) German households and businesses could have preferred less expensive. With nominal convergence and Czech Koruna appreciation, such advantage started to be more and more limited. Therefore, the second explanation lies in the quality upgrading. As the valued added somewhat increased (perhaps also compared to the value added of goods traded elsewhere¹⁴⁰), probably certain substitution of the domestic goods took place.

Further, with the EU accession more and more quality standards fell under the scrutiny, hence the confidence in the Czech goods could have gone up. Finally, as business activity of German firms in the Czech Republic was steadily increasing, and it is generally estimated up to 50% of their production is re-exported, they behaved

¹³⁹ Obviously, exploring income transfers within the current account of balance of payments would have required additional extent that is not possible in this thesis.

¹⁴⁰ See, for instance, OECD Economic Survey of the Czech Republic, 2008.

solely in accordance with their own economic rationality, trying to spread costs of production once they happened on less costly production processes. The spill-over effects that have been so much present in the Czech Republic some time before and that accelerated after the EU accession, have definitely facilitated commercial relations in many ways.

4.2 NEOFUNCTIONALISM AND DETERMINATION

Concerning the real economy determination, it has been discovered that moderately strong determination can now exist. Stronger one has been observed for industrial production, but the so called “general” has been proven within the data analysis as well. Both determinations seem to be definitely related to the EU accession, as the coefficients for the adjusted time series are significantly more eloquent.

Hence, the determination comes in several ways: synchronization of industrial production cycles shows stronger relationship regarding tradable goods than non-tradable. Again, harmonization of product markets on the EU level (in accordance with Lisbon agenda, for example) could have had an effect on this.

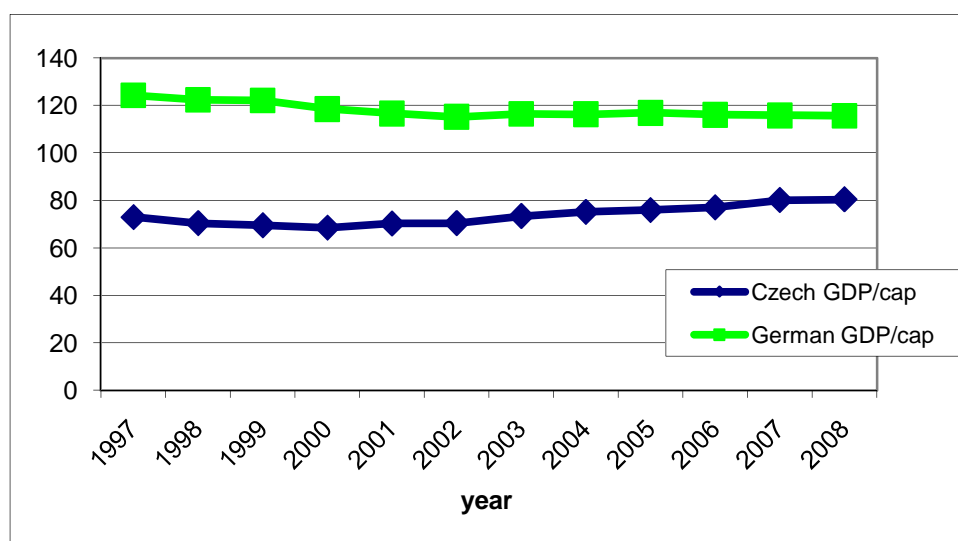
Clearly, as it was touched upon, since Germany is more or less synchronized with the Eurozone, the same would hold for the Czech Republic. The increasing synchronization leads to a persuasion that the room for deeper integration is still not much exploited, although its pace would be perhaps slowing down in the years ahead.

From this reason the similar behaviour of business cycles could thus be determined by other external factors, such as proliferation of shocks across the

Eurozone comes in form of exogenous variables for the Czech economy. Nonetheless, Czech economy seems to be increasingly synchronized with the German one, although one cannot really say it is also determined by it.¹⁴¹

However, not only economy synchronization took place, but equally real convergence. As it illustrates the following graph, the income gap between Germany and the Czech Republic decreased substantially from 1997 to 2008.

Graph no. 12: Real economic convergence of the Czech Republic in relation to Germany from 1997 to 2008
(GDP per capita in PPP; share in %; EU-27¹⁴² (average) = 100)



Data source: Eurostat

¹⁴¹ In order to exclude any illusory correlation, the thesis would have to go further into the detail.

¹⁴² Apparently, the “27” refers to all countries taking part of the EU since 2007.

While in 1997 Germany fetched approximately 24 p.p. (reaching 124.3% of the EU-27 average) above, while the Czech Republic 27 p.p. below (reaching 72.9% of the EU-27 average), situation changed dramatically since then. In 2008, Germany was “only” at 115.6%, the Czech Republic already at 80.4. In addition, Czech economy gained most of this after the EU accession (approx. 7 p.p.) while it gained merely 0.5 p.p. between 1997 and 2003.

From this reason it seems real convergence takes place at the same time as the business cycle synchronization. However, one should always bear in mind domestic output is not always the best indicator to use as there could be substantial leakages that are generally difficult to account for.

Nonetheless, neofunctionalist hypotheses seem to hold for both synchronization and convergence. Indeed, it is questionable to what extent sectoral integration will continue as it might be facing nation-specific barriers that are usually difficult to get over.

Once euro gets adopted in the Czech Republic, we might expect another business cycle synchronization taking place. Many analyses (for instance Gonçalves, Rodrigues and Soares, 2008) suggest higher degree of synchronization is achieved due to a common responsiveness to monetary shocks. Therefore, they generally assume euro adoption fosters the synchronization process even if certain level is achieved before the EMU accession alone.

CONCLUSION

To sum up, the thesis has explored number of relatively substantial commercial linkages between the Czech Republic and Germany, comparing namely the pre-accession period from 1993 (1997) to 2003 with the one from 2004 to 2008. Essentially, the two hypotheses that were announced at the beginning of the thesis have been - certainly with a certain degree of tolerance - met.

As it was shown and proved, most of the indicators behaved as predicted, however, due to the complexity of factors exerting their influence, we should never get excessively tempted to develop simple and/or revolutionary conclusions. Such outcomes would be neither sufficiently underpinned by any theory or model, nor would they be verified by empirical evidence.

As the Czech Republic increasingly participated in the more and more intensive trade and investment activity in Europe even before the EU accession, this has had a very significant impact on its whole economy. From the structural perspective, it has been namely the shift from labour-intensive goods to technology-intensive ones with high capital endowment. Their share in the trade relations doubled from 2000 to 2008, being undoubtedly associated with the EU enlargement and positive functional and economic *spill-over* effects that it brought about and certainly accentuated.

From this, it is not only apparent the commercial relations with Germany significantly increased in volume after the EU accession, but their ascending trend proved to be relatively stable even before 2004. This is also very much true for the direct investment pattern, whose source, nevertheless, has been more and more taking form of reinvestment activity, signaling more stable and balanced environment after the enlargement.

Regarding the determination process and the convergence process, there is clear evidence the Czech economy has become much more influenced and synchronized with the German economy. It seems, however, the industrial production pattern is somewhat determined even before 2004, while its synchronization goes up with the enlargement to a very significant level.

Similarly, the real output behaviour seems to be much less synchronized before 2004 than it is after it. Moreover, before 2004 a lag of 4 to 7 quarters in Czech business cycle behind the German one was observed, however its accuracy remains in question as the analysis has not been too persuasive.

Hence, one could probably conclude the Czech Republic has become much more linked to the German economic development since 2004 than it was ever before. Single market, *acquis communautaire*, other functional and economic *spillovers*, decrease in uncertainty and transaction costs, trade structure rectification, and plenty of other factors and aspects have considerably contributed to the increasing convergence and synchronization of the Czech economy by its western neighbour as well as by the whole Eurozone.

Looking ahead, the ability of the Czech Republic to adapt to the changing environment and requirements of the integrated European market is going to be crucial. Its primary advantage that it has disposed of compared with Germany, i.e. the lower wage level, is going to pass away namely due to the nominal convergence pattern, which already exists. Therefore, in the years to come, the Czech Republic will have to focus more on labour productivity enhancement, namely through sustaining the FDI flows, human capital creation, and domestic research and innovation activities.

This is because domestic technology development should be perceived as very important in terms of reducing the reliance on technology and skills brought about by the German (and other) FDI. Even though they have helped substantially in

switching from the lower value added goods to those with higher one, they also sometimes keep the structure of trade pattern favourable for their headquarters and domestic production, not respecting the actual “needs” of the society that have settled in. Fortunately, Czech EU accession has made it easier for the German and other foreign companies to finance their investment by dint of their own retained profits.

All in all, such sources will allow it to reap the benefits of the enlargement that it took part of yet in a more profound manner. With further diversification and external competitiveness, the more intensive convergence process could be generally expected.

Nonetheless, future development of the bilateral economic relations depends by and large on the ability of both economies to recover from the economic crisis by which both countries have been affected hard. In addition, further integration process would probably bring about other *spill-over effects* and formal and informal harmonization of number of not yet standardized norms. On the other hand, as the integration has been already quite extensive and deep for the Czech Republic itself, most of it could be transformed into the future Eurozone accession. Eurozone accession and the criteria that follow its logic constitute a certain challenge ahead of the Czech Republic’s political and economic development that could once again fit in the neofunctional theoretical framework.

Number of characters (with spaces): 131,138

Number of characters (without spaces): 110,852

Word count: 20,180

RÉSUMÉ

Práce se zabývala zejména intenzitou ekonomických vazeb mezi Českou republikou a Německem po rozšíření Evropské unie v roce 2004. Její první část postihla základní charakter těchto vazeb od vzniku samostatného Československa v roce 1918 až do vzniku samostatného českého státu v roce 1993. Druhá část práce se obšírněji věnovala zhodnocení relevance neofunkcionalismu, který představoval pro formulaci hypotéz určitý teoretický podklad. Z hlediska fungování integračního procesu tak, jak jej neofunkcionalismus přímo i nepřímo předpokládá, byly definovány dvě základní hypotézy. Tyto hypotézy prošly v následující kapitole testováním jednoduchou statistickou analýzou (komparativní metoda) a jednoduchou regresní a korelační analýzou (metoda zkoumání závislostí).

Na základě vyhodnocených a pozorovaných dat lze tvrdit, že se hypotézy potvrdily, tedy že intenzita ekonomických vazeb se mezi těmito dvěma zeměmi počínaje rokem 2004 zvýšila (ačkoli poněkud nelineárně) a zároveň se podstatně zvýšila také sladěnost hospodářského vývoje obou zemí. Toto jen ukazuje na přesvědčení, že evropská integrace vede k vyšší sladěnosti členských zemí vlivem vzájemné integrace vyššího množství aspektů ovlivňujících jejich vývoj. Tento proces se zdá být příčinou vyšší bilaterální ekonomické aktivity, v níž dochází obecně ke značnému snižování nejistoty a transakčních nákladů.

Do budoucna si lze ovšem klást bezpochyby relevantní otázku v tom, jaký rozsah bude možno v integraci dosáhnout a kde si členské státy budou chtít ponechat svá specifická ustanovení v platnosti na úkor jejich další harmonizace a synchronizace.

APPENDIX

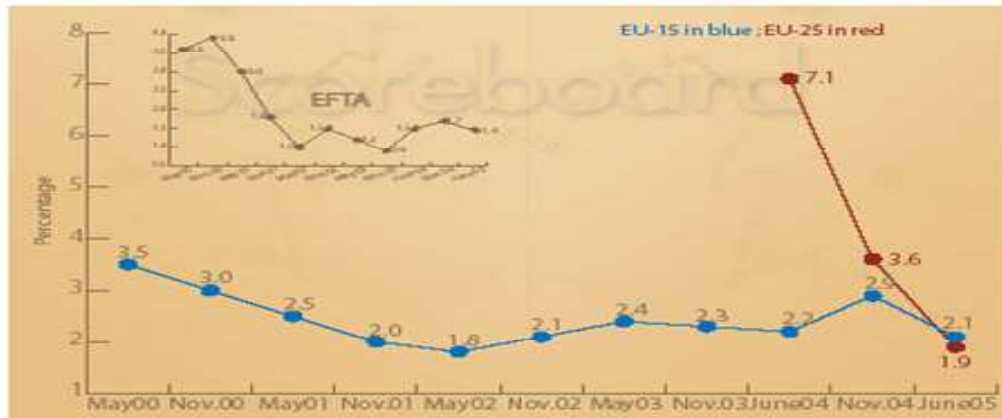
1) International Investment Positions, 1993-2002 (selected countries; percent of GDP)

	<i>Foreign Assets</i>						<i>Foreign Liabilities</i>					
	FDI		PI-stocks		PI-bonds		FDI		PI-stocks		PI-bonds	
	1993	2002	1993	2002	1993	2002	1993	2002	1993	2002	1993	2002
CEECs												
CZE	0.5	2.1	0.8	3.8	0.0	8.3	10.1	52.2	3.2	5.6	2.5	3.2
EST		9.3		0.5		10.9		58.4		8.8		10.3
HUN	0.6	3.6		0.5		0.8	15.8	38.1		5.1		22.7
LAT		0.7		0.7		9.7		31.5		0.8		4.6
LIT		0.4*		0.0*		1.0*		21.0*		0.8*		9.6*
POL	0.5+	0.7		0.1		1.0	4.1+	23.8	0.5+	2.2	8.6+	9.6
SKK	1.1+	1.8**	2.7+	0.1**	0.0+	1.6**	5.7+	22.8**	0.4+	1.3**	3.3+	13.0**
SLO	2.4+	6.2	0.1+	0.2	0.3+	1.2	9.0+	17.1	0.3+	0.5	0.3+	8.8
EMU												
AUT	4.6	14.9*	2.1	13.3	7.6	53.6	6.5	19.0*	2.1	8.6	33.3	90.2
BEL	30.3	73.9	28.7	38.4	41.7	89.5	45.6	87.4	4.0	6.6	41.3	52.8
FIN	10.8	43.6	0.4	15.7	4.4	36.2	5.0	23.2	6.2	60.9	57.1	47.4
FRA	13.0	54.8	4.2	11.9	6.4	42.4	11.0	34.3	8.5	21.9	21.5	42.2
GER	8.4	29.6	6.1	19.9	8.8	29.2	3.8	23.1	5.0	9.7	21.0	46.8
IRE		25.6		110.7		306.4		136.2		256.9		61.6
ITA	8.9	14.7	1.3	18.8	13.0	26.4	5.9	9.6	1.2	2.2	16.3	51.1
NDL	38.5	83.4	19.1	46.7	15.0	75.7	23.9	75.7	29.6	56.3	23.2	82.7
POR		23.6		6.2		38.2		32.4		12.8		42.4
SPA	5.6	29.7	0.5	10.4	2.9	27.1	18.7	29.9	5.3	11.6	18.8	32.8
Control group												
DEN	11.9	44.3*	6.0	29.7*	7.4	22.9*	11.0	41.8*	2.4	14.5*	60.8	56.6*
SWE	23.9	57.4*	8.1	46.9*	1.4	18.9*	6.9	43.4*	11.7	36.0*	13.6	61.8*
SWI	38.7	97.7	37.6	72.5	77.0	100.5	21.0	43.7	58.8	104.7	9.8	11.8
UK_	26.9	59.9	30.2	32.0	42.9	51.0	21.2	38.1	20.8	41.6	27.0	46.5
NOR	4.6				5.2		3.5				20.3	
JAP	6.0	7.3		5.1		28.4	0.4	1.9	3.9	8.1	8.6	6.5
USA	16.0	19.5	8.2	12.9	4.7	4.8	11.6	19.2	5.6	11.7	14.5	29.8
RUS	1.7	13.9		0.0	0.4	0.7	0.1	15.0	0.1	9.0	0.2	8.9

Source: Darvas, Szapáry, 2004

2) Single Market Scoreboard 2005: general transposition of directives

Figure 1: Positive momentum after Lisbon is back



The transposition deficit shows the percentage of Internal Market directives not yet communicated as having been transposed, in relation to the total number of Internal Market directives which should have been transposed by the deadline. As at 30 April 2005, 1604 directives and 514 regulations relate to the Internal Market as defined in the EC Treaty

Source: European Commission, 2005

3) Most important German investors to the Czech Republic by 2005 (values in USD)

INVESTOR	BEREICH	GESAMTINVESTITION	JAHR	Tschechische Niederlassung / Partner
RWE Gas AG	Gas	USD 3650 million	2002	
Volkswagen	Automobilindustrie	USD1199 million +	1991-1998	Škoda Automobilová a.s.
E.ON Energie AG	Energieversorgung	USD 750 million	1996	
T Mobil	Telekommunikation (GSM)	USD 183 million	1996	RadioMobil a.s.
Siemens AG	Elektronik	USD 373 million +	1994-1998	Siemens Elektromotory
Continental AG	Gummiindustrie	USD 150 million	1992	Barum Continental a.s.
MD Elektronik	Elektronik	USD 150 million	1991-2002	MD Elmont Chotěšov
Linde AG	Energieindustrie	USD 150 million +	1991-1998	Linde Technoplyn a.s.
Dyckerhoff	Bauindustrie	USD 104 million	1997	Cement Hranice a.s.
Messe Düsseldorf	Handel (Messe)	USD 80 million	1998	BVV Brno
Ruhrgas	Energieindustrie	USD 76.4 million	1999	SPP Bohemia (Východočeská, Severomoravská, Jihomoravská plynárenská)

Source: Botschaft der Tschechischen Republik in Berlin (Czech Embassy in Berlin), 2006

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PROJEKT DIPLOMOVÉ PRÁCE

Název DP:¹⁴³

CZECH-GERMAN ECONOMIC TIES AFTER THE 2004 EU ENLARGEMENT: A NEOFUNCTIONALIST PERSPECTIVE

Institut a katedra: *IPS; KMV*

Vedoucí práce: *PhDr. Irah Kučerová, Ph.D.*

Předp. termín odevzdání: *květen 2010*

1. úvodní část

Diplomová práce spadá do oblasti mezinárodních ekonomických vztahů a zabývá se především intenzitou česko-německých obchodně-investičních (potažmo obecně ekonomických) vazeb po rozšíření Evropské unie v roce 2004, jehož byla ČR přímým účastníkem. Jejím primárním zájmem je otestovat hypotézu, že vlivem tzv. východního rozšíření došlo k výraznější determinaci ekonomického vývoje v ČR ekonomickým vývojem v SRN především díky tzv. pozitivním *spill-over* efektům (efektům přelévání). Tyto efekty měly v zásadě pomoci rozvíjet oblastní spolupráci mezi ČR a Německem a „příznivě“ působit na další sladování již před rozšířením podobných institucionálních vzorců. Výraznější determinace měla být tak způsobena zejména těsnější ekonomickou kooperací umožněnou

¹⁴³ Jazykem této diplomové práce je angličtina.

uvolněním mnoha existujících bariér z předvstupního období. Zmíněné bariéry mohou být chápány mnoha způsoby, počínaje regulací kapitálových toků, přes legislativní rámec platný pro přímé zahraniční investice a konče (do určité míry nejistou) perspektivou budoucího vývoje ČR, která se právě vstupem do Unie výrazněji konturuje.

Téma bylo zvoleno ze tří základních důvodů: prvním je fakt, že se jedná o problematiku poměrně aktuální a zároveň podstatnou, o níž v České republice probíhá poměrně živá (ačkoliv prozatím poněkud povrchní) diskuze, a to jak u laické tak i u odborné veřejnosti. Druhým je pak snaha navázat na iniciativu „5 let poté“, která měla v roce 2009 pod záštitou českého předsednictví zhodnotit první viditelné přínosy a náklady tohoto největšího rozšíření Evropské unie (alespoň z hlediska počtu přistupujících zemí, jejich rozlohy a jejich počtu obyvatel) pro nově vstupující i pro tzv. staré členské státy. Posledním důvodem je kontext současné finanční a ekonomické krize, díky níž se otázka interdependence jednotlivých ekonomik dostává ještě více do popředí. Hlavním přínosem práce by mělo být tedy alespoň částečné poznání toho, zda vlivem zmíněného rozšíření došlo ke zintenzivnění ekonomických vazeb mezi ČR a Spolkovou republikou Německo a potažmo tedy ke zvýraznění determinace českého hospodářského cyklu hospodářským cyklem německým. Dalším přínosem práce bude taktéž upozornění na konsekvence, které mohou z analyzovaného vztahu těchto integrovaných ekonomik případně (pro ČR) v dlouhodobějším horizontu plynout.

Hlavním cílem práce je ověřit hypotézu, zda vlivem probíhajících transmisních mechanismů způsobených vstupem ČR do Evropské unie v roce 2004 došlo ke zvýraznění ekonomické závislosti české ekonomiky na ekonomice německé, případně pak jakým způsobem (tj., zda např. existují určitá zpoždění v hospodářském vývoji, jaký je jejich charakter a jak jsou významná). Další výzkumnou otázkou zůstává, zda a taktéž jakým tempem se zvyšovala intenzita bilaterálních obchodních a investičních vztahů právě v důsledku rozšíření a nastínění

toho, jakou by šlo v tomto ohledu očekávat situaci, pokud by k rozšíření EU hypoteticky nedošlo.

Základní použitou metodou je testování hypotéz a kvantitativní výzkum, a to především ve formě analýzy nestacionárních časových řad. V práci bude provedena deskripce a statistická analýza ekonomických vazeb těchto států a budou vyvozeny relevantní závěry hypotézy potvrzující či vyvracející. Primárním zdrojem analýzy budou statistická data čerpaná ze statistických úřadů obou zemí a z databáze OECD, jakož i analýzy sladění české ekonomiky s ekonomikou eurozóny.

V případě obchodních a investičních vztahů budou použity roční časové řady, v případě ukazatelů reálné produkce (HDP s.c. a průmyslová výroba) budou použity časové řady čtvrtletní, které vykazují lepší možnost interpretace. Závislosti budou zkoumány na očištěných časových řadách pomocí jednorozměrné a tam, kde to bude relevantní, vícerozměrné regresní analýzy.

2. předpokládaná osnova práce

Úvod

- 1) *Nástin historické geneze česko-německých ekonomických vztahů*
- 2) *Neofunkcionalismus a formulace hypotéz*
- 3) *Česko-německé obchodní a investiční vztahy 1993-2003*
- 4) *Analýza intenzity obchodně-investičních vztahů 2004-2009*
- 5) *Analýza sladění hospodářského cyklu v české a německé ekonomice*
- 6) *Interpretace výsledků*

Závěr

3. seznam literatury - strukturovaný

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Martin Janíčko