

Vliegenthart, Arjan

Article

Who is undermining employee involvement in postsocialist supervisory boards? National, European and international forces in the revision of Hungarian company law

Journal for East European Management Studies

Provided in Cooperation with:

Rainer Hampp Verlag

Suggested Citation: Vliegenthart, Arjan (2009) : Who is undermining employee involvement in postsocialist supervisory boards? National, European and international forces in the revision of Hungarian company law, Journal for East European Management Studies, ISSN 0949-6181, Rainer Hampp Verlag, Mering, Vol. 14, Iss. 3, pp. 265-285

This Version is available at:

<https://hdl.handle.net/10419/84009>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Who is undermining employee involvement in postsocialist supervisory boards? – National, European and international forces in the revision of Hungarian company law*

*Arjan Vliegthart***

This article explores regulatory developments with regard to employee representation in post-socialist corporate governance systems of Central Europe. It sets out to weigh the applicability of different theories on postsocialist industrial relations that focus on domestic, European and international forces. It pays special attention to the Hungarian case and studies regulatory developments in the early 2000s, with a focus on the third postsocialist Company Law of 2006. The article argues that the law reform undermines effective employee representation in postsocialist corporate governance systems. It concludes that these developments can only be adequately understood as the result of the interplay between various social forces at the national, European and international level.

Dieser Beitrag erforscht die regulativen Entwicklungen hinsichtlich der Arbeitnehmervvertretung im Kontext postsozialistischer Corporate-Governance-Systeme in Mitteleuropa. Er beginnt mit der Überprüfung der Anwendbarkeit von verschiedenen Theorien, mit Fokus auf inländische, europäische und internationale Kräfte, auf die postsozialistischen industriellen Beziehungen. Es wird speziell der ungarischen Fall untersucht, wobei die regulativen Entwicklungen zu Beginn dieses Jahrzehnts, und besonders das dritte postsozialistische Unternehmensrecht von 2006 im Zentrum der Betrachtung stehen. Es wird argumentiert, dass die Gesetzesreform eine wirksame Arbeitnehmervvertretung in postsozialistischen Corporate-Governance-Systemen unterminiert. Zusammenfassend kann festgestellt werden, dass diese Entwicklungen nur als das Ergebnis des Zusammenspiels zwischen verschiedenen sozialen Kräften auf der nationalen, europäischen und internationalen Ebenen adäquat verstanden werden können.

Key words: Corporate governance, supervisory boards, company law, Hungary, postsocialism, transnationalism

* Manuscript received: 22.12.08, accepted: 09.06.09 (2 revisions)

** Arjan Vliegthart, Lecturer, Faculty of Social Sciences, Vrije University Amsterdam, Holland. Main research areas: Political economy of corporate governance, regulation in Central and Eastern Europe. Corresponding address: a.vliegthart@fsw.vu.nl.

Introduction

In his seminal article *Round up the Usual Suspects!: Globalization, Domestic Politics and Welfare State Change*, Herman Schwartz (2001) explores the driving forces behind the assumed welfare state retrenchment in Western Europe. Plotted as a whodunit, Schwartz's article discusses different explanations in the literature behind the decline in 'covert provision of social protection for both capital and labour through service sector regulation' (Schwartz 2001:43). Schwartz proposes an elegant way of discussing rival hypotheses. He juxtaposes well-known theoretical lenses on welfare retrenchment to find out how far each of these approaches travel in the light of concrete empirical evidence.

This paper adopts the same approach to the field of labour representation in postsocialist supervisory boards. It seeks to explore how and to what extent existing theories on postsocialist industrial relations can help us to understand this under-explored field. Whereas the literature on postsocialist industrial relations is rather united in its view that organised labour is amongst the losers of the economic restructuring process, there are three contradicting explanations for this phenomenon. First, there are those who relate the weakening position of organised labour to primarily domestic circumstances (Ost 2000; Crowley 2004; Crowley/Ost 2001; Avadevic 2005). Second, there are accounts that stress the importance of the European Union on postsocialist industrial relations. They argue that the European Union has had considerable leverage, both through formal and informal influence, on the emerging postsocialist institutions (Vickerstaff/Thirkell 2000; Meardi 2002). Third, there are analyses that stress the importance of transnational corporations in the formation of postsocialist social relations (Bohle/Greskovits 2006/2007). In comparison to Western Europe, labour in Central Europe is in a weak position as the comparative advantages of the region rest upon the ability to compete with other economies on wage levels, and because of the fact the Central European states are highly dependent on foreign capital for industrial upgrading and development.

Concretely, this study turns its attention to the process of deregulation of important aspects of Hungarian company law, which further undermines the position of labour in corporate decision-making (Neumann 2006; Meardi 2007). Since the collapse of state socialism, employees in Hungary –and elsewhere in Central Europe- have had a say in the corporate decision-making process because of their representation in the corporation's supervisory board. Whereas this kind of representation has never been as strong as in Western European countries such as Germany and Austria, it constituted an additional channel of workers' representation in strategic corporate choices and comprised a 'stable component of national "economic culture"' (Kluge/Wilke 2007:9). This right was institutionalised through the compulsory existence of a two-tier board system, i.e. a system that, besides a managerial board, requires the existence of a

supervisory board that controls the executive management. This system is undermined by the adoption of a new company law that paves the way for the existence of a one-tier system, i.e. a system in which the managerial board is directly responsible to the annual shareholders' meeting and which does not allow for employee control over managerial decisions. This paper seeks to find out what the causes of this development are, or to put in Schwartz' terms: who is killing employee representation in postsocialist supervisory boards? Is it domestic actors, European forces or pressure from the world economy, conveyed by foreign investors?

This study explores the political debates surrounding the 2006 revision of Hungarian company law. It digs into the policy-making process surrounding this law and traces the different forces that have impacted upon this revision. Moreover, it discusses the interplay between these various forces, allowing for an in-depth scrutiny of the three 'suspects' discussed above. Whereas the empirical analysis is restricted to the Hungarian case, its findings contribute to two bodies of literature. First, it enriches our knowledge of the position of (organised) labour in postsocialist Europe, both empirically and theoretically. Empirically, it adds a new policy field to the debate. While most of the existing studies on the position of labour in postsocialist Europe turn their attention to issues such as wage bargaining and social provisions such as sick pay and safety regulation (Deacon 2000; Kovács 2002), little research has been done on the position of labour in corporate governance and company law issues. This is surprising because these latter issues involve pressing socio-economic questions, i.e. the ability of labour to influence strategic long-term decision-making in a firm (Jackson 2005), and constitute a policy field that is closely connected to 'pure' industrial relations (Höpner 2005). Therefore this paper theoretically adds to our understanding of the dynamics of postsocialist decision-making, in the sense that it enhances our knowledge of how far the existing research paradigms travel in explaining an empirically neglected area of employee involvement in socio-economic decision-making.

Second, the paper also contributes to the field of comparative capitalisms (Jackson/Deeg 2008). The last years we have seen an increased application of a comparative capitalism or a Varieties of Capitalism approach to postsocialist socio-economic institutions (Drahokoupil 2009 for an overview of some of the most relevant contributions to this field). Central to this strand of literature is the idea that institutional complementarities between the different socio-economic institutions give certain countries their own comparative advantage (Hall/Soskice 2001). Moreover, coherent institutional set-ups lead to national business systems that can remain remarkably different from each other even in times when forces of globalisation are widely considered to lead to institutional convergence (Whitley 1999). This paper captures the changing nature of two crucial socio-economic institutions and provides us with insights into the type of

postsocialist capitalism. It highlights the interactions between the fields of corporate governance and industrial relations. These two policy areas are vital in any socio-economic system because of their important repercussions for the division of power amongst the various social actors within society. At the same time, the added value of this paper lies in the discussion of how institutional changes are actually shaped. It complements the more static institutionalist accounts of postsocialist capitalism with a historical dimension while stressing the fact that they continue to be modified incrementally in order to capture the dynamics of postsocialist development.

The remainder of this paper is structured as follows. First, I will review the existing theories on the industrial relations in the context of postsocialist Europe. Based on this review I will derive the kind of developments these theories would expect with regard to company law (section 2). Subsequently, I will deal with the evolution of postsocialist company law in Hungary (section 3), before turning to the emergence of the third postsocialist Company Code in 2006 (section 4). In the final section, I will then discuss the extent to which these theories hold with regard to these developments and how we could enhance our theoretical understanding of the postsocialist socio-economic development.

2. Domestic, European and Transnational forces and the stability of the Hungarian two-tier corporate governance system

In recent years there has been increasing scholarly attention on the position of (organised) labour in postsocialist Europe. The majority of studies have pointed out that the position of labour in postsocialist Europe is weak, especially compared to the position of labour in Western Europe.¹ But whereas the majority of studies point to an overall weakness of organised labour in the region, the reasons for this weakness tend to vary from study to study. Broadly, we can discern three kinds of accounts: domestic, European and transnational accounts. In this section, I will discuss these three theories and give hypotheses of what they have to say about the sustainability of the two-tier corporate governance model in Hungary and the stability of employee representation in Hungarian supervisory boards.

The first theoretical perspective focuses on the domestic reasons for the weak position of labour in postsocialist Europe. The so-called ‘illusionary

1 There is a limited number of studies that argue that a substantial form of postsocialist corporatism has emerged in the 1990s (Iankova 1998). The most ‘widespread view, however, was that tripartite institutions are far from being vehicles for corporatist policy making, and that they have been used by governments mostly to legitimize their already-decided policy choices rooted in neoliberal economic principles’ (Avdagic 2005:28).

corporatism' theory (Ost 2000) points at the role of trade unions and other representatives of the worker states during the socialist era and their subsequent discreditation at the end of the 1980s, early 1990s. It draws heavily upon a path dependency approach and aims to demonstrate that the emerging corporatist arrangements are symbolic rather than substantive. Postsocialist elites have only included labour into their socio-economic institutions in order to share the costs of the economic restructuring programmes and in order to gain legitimacy amongst the population. Therefore this strand of literature concludes that the 'establishment of tripartite bodies was a means to control labor, not to empower it' (Ost 2000:523).

How does such an argument relate to employee representation in supervisory boards? In Western Europe social solidarity is institutionally constituted in various ways of which employee representation in supervisory boards is but one instance (Egan 1999:4-5). In this respect, illusionary employee representation would fit in a system where 'neocorporatist forms are being used to generate neoliberal outcomes' (Ost 2000:504). As I will point out in the next section, illusionary employee representation adequately fits the emerged two-tier system. Since its introduction in the early 1990s employee representation in postsocialist Europe has never reached the same status as in Western Europe. Since the second half of the 1990s, Ost (2000:511) argues in the Hungarian case, corporatist arrangements have gone into further decline. With the general impression that the rules of economic game were adequately locked in, the government 'sought to dismantle the few ways in which labor could still articulate its interests in public forums.' Along similar lines such an account would hypothesise that in the field of corporate governance, neoliberal national elites will seek to undermine employee representation in the supervisory boards because such arrangements would no longer be needed to maintain social peace within the corporation. At the same time, we expect that organised labour, lacking authoritative representatives and the ability to command organisational loyalty (Ost 2000:525), is unable to counter such attempts effectively.

A second strand of literature focuses on the role of the European Union (EU) on postsocialist industrial relations. Most studies find that the postsocialist institutions resemble those that are already existing in the EU and that this resemblance is the result of 'both imitation and imposition' (Vickerstaff/Thirkell 2000:239). But in postsocialist Europe, these institutions work out differently than in Western Europe. In this respect, it is important to stress the mismatch between economic and social concerns that have been put forward by the EU since the collapse of state socialism. Whereas economic issues received tremendous attention, European attention on social issues resembled more a kind of 'lip service' (Rys 2001:187; Bohle 2004; Scharpf 2002). As a result, the central argument in this strand of literature is that the European Social Model has only half-heartedly been introduced in the postsocialist context. The

institutional similarities in the socio-economic field are only superficial as they are hardly backed up by substantial EU policies.

Based on the notion of imitation, we would expect Hungarian policy makers to focus on European developments in the field of company law to imitate these European initiatives. In this respect we expect that the current EU strategy of marketisation and strengthening the role of shareholders vis-à-vis other stakeholders in the corporation (Van Apeldoorn/Horn 2007) will be reflected in Hungarian policies. Such policy initiatives will undermine employee representation in corporate decision-making and will cause a shift from formal prescriptions of how companies should be organised to more flexible arrangements in which benchmarking, codes of conduct and soft regulation will play an important role.

A third strand of literature stresses the role of transnational capital on the establishment of postsocialist socio-economic institutions. Industrial relations are 'much more thoroughly shaped by the influence of transnational factors than in the case of Western liberal market and coordinated market economies' (Bohle/Greskovits 2007:464). With foreign investors occupying the commanding heights of the Hungarian economy (Hanley et al. 2004:159), the imperatives of international competitiveness have influenced the national corporate governance debates. During the 1990s, the transnational business community has pushed for corporate governance reforms that would safeguard transnational investments. A transnationally oriented service sector, consisting of law and consultancy agencies has supported these demands and has effectively shaped the national debates, especially after the mid 1990s (Drahokoupil forthcoming).

The results of this process are socio-economic institutions that integrate labour in socio-economic decision-making in order to maintain the social peace that is necessary for effective international competition for foreign investments, in which labour however only has a subordinate role. Based on this theoretical outlook, we could expect a two-tier system that is only sustainable if it would not hinder the interests of foreign capital. The demands of foreign capital will be the driving force behind institutional reforms. In this respect, we can expect the decay of the two-tier corporate governance system to be primarily caused by foreign capital pushing national policy makers to do away with hindering influences of employees. National policy makers on the other hand feel the necessity to introduce institutions that keep their economies attractive to foreign investors.

3. Investigating the crime scene: the politics of corporate governance and company law since the early 1990s

To what extent did these three different predictions materialise in the 2006 revision of the Hungarian Company Law? Before answering this question, I will briefly outline the developments in company law that preceded the 2006 revision and characterise the Hungarian corporate governance model. The first postsocialist company law was mostly inspired by the Hungarian presocialist legal tradition and was supplemented by provisions that were taken over from the German legal system. The 1988 Company Act that was to regulate the post-socialist order but which was introduced before the first post-socialist democratic elections (Dobák/Steger 2003:225 - 227) introduced a two-tier board system for all companies with more than 200 employees. However, Hungarian law differed on one substantial issue from the German model; 'it did not grant strong co-determination rights to the planned work councils, but conceptualised only a rather weak, consultative works council' (Galgóczy 2003:28).

With regard to the composition of the supervisory board the Code stipulated that one third of its seats were to be attributed to representatives of the employees. The 1992 Labour Code subsequently provided the rules of how employee representatives were to be elected. A crucial role in this respect has been attributed to the company's works council. They are to select the employee representative, taking into account the opinions of the trade unions. The general shareholder meeting is then to accept these candidates upon the condition that they fulfil the legal criteria.

As the first years of economic transformation passed by, it became clear that the 1988 Company Act displayed some important weaknesses, especially with regard to the protection of creditors and minority shareholders. According to the preamble of the 1997 revision, it had explicitly neglected the rights of creditors in order to facilitate the aims of the Hungarian government to let off the state enterprises. The strict protection of creditors would have only hindered the emergence of active entrepreneurs and without their involvement the transformation towards a capitalist economy would have been impossible (Czajlik/Vincze 2004:7).

This perfectly matched the EU's demands with regard to the implementation of the *Acquis Communautaire*. In its 1995 White Paper the European Commission (EC) had laid down a reform framework that needed to be implemented before the Central European countries could seriously negotiate EU membership. Amongst these demands, corporate legislation took an important place; almost a complete chapter in the Association Agreements was dedicated to it (Arlt et al. 2003:247). This included the implementation of some of the EU Company Law Directives that stressed the importance of adequate institutional provision for the various stakeholders. The 1997 revision transposed these directives into the

Hungarian context, while simultaneously strengthening the rights of the minority shareholders and creditors (Arlt et al. 2003:255).

These developments reflect a broader trend in postsocialist institution making. During the early 1990s many of the new socio-economic institutions were a combination of mimicking mostly the German model and drawing on a presocialist heritage. However, as time passed by these institutions were incrementally modified with the aim of creating an institutional system that would lead to a distinct comparative advantage. As a consequence, the kind of capitalism that emerged in postsocialist Europe is qualitatively different from the models of Western Europe and the US. Nölke and Vliegenthart (2009) have called this postsocialist system of Central Europe a Dependent Market Economy. Its institutional arrangements are structured in such a manner that they enhance the production of durable consumer goods. Conversely, the comparative advantage of Coordinated Market Economies (CMEs) such as Germany rests upon the incremental innovation of capital goods, whereas Liberal Market Economies (LMEs) such as the UK and the US are particularly competitive in radical innovation in technology and in the service sector. In the field of corporate governance, the postsocialist system is characterised by the importance of foreign headquarters in corporate decision-making of their subsidiaries in the region. Major corporate decisions are not negotiated between managers and shareholders, but rather between managers of the ECE subsidiary and Western headquarters. In contrast, insider control through so-called Hausbanks characterises the CME model whereas a system of outside control through stock markets is characteristic for LMEs[0]. With regard to industrial relations the Dependent Market Economy is distinct from other kinds of capitalism as it has appeased labour through collective agreements at company level whereas collective agreements at sector-wide or national level are typical for CMEs. At the same time, the pluralist system of LMEs hardly employs collective agreements (Hall/Soskice 2001). This institutional feature reflects both the heavy competition for the attraction of foreign direct investments and the lingering threat of company relocation further eastwards, as well as the fact that transnational corporations that have invested strongly in the region have developed a vested interest in keeping workers fairly satisfied.

Thus, the key determinant in understanding this model is the dominance of foreign capital as primary means of raising investments. Consequently, the distinctive coordination mechanism rests upon the intra-firm hierarchies within transnational firms. The comparative advantage of this model, the production of durable consumer goods, rests upon the combination of a relatively highly skilled labour force and relatively low wages, which makes the region very attractive for transnational corporations that export especially to Western Europe and the US. It is here that we see the interaction between the structural position of the region in the world economy and the active attempts from the side of

national policy makers to attract as much foreign capital as possible in order to strengthen economic development that have mutually reinforced each other since the mid 1990s.

4. The 2006 company law: International and European arguments translated into the Hungarian context

The developments discussed in the previous section set the stage for the discussions on the 2006 revision of the Hungarian Company Law. The process of drawing up the 2006 Hungarian Company Code displays important similarities with the way in which the previous postsocialist Company Codes had been introduced. The same group of policy makers, the so-called Codification Committee, that had drawn up the first two postsocialist Company laws were assigned to draft a third version. The preparations started in 2004 when this Committee published a strategy paper, which outlined the kinds of revisions that this group considered to be appropriate. This paper constituted the basis for a draft Law that was discussed in national tri-partite National Interest Reconciliation Council, before it was put to Parliament, which accepted the Law in late 2005.

The adopted code does not make board representation completely voluntary, but it provides a starting point for further deregulation opening the door for a one-tier system and undermining of mandatory board-level representation (Neumann 2006). More concretely, article 38 of the code, which deals with the issue of employee representation of supervisory boards, regulates four issues. In the first subparagraph, it states that companies employing more than 200 people need to allow employees ‘the right to partake in the supervision of the company, unless there is an agreement between the works council and the management of the business association to the contrary.’ Whereas employee representation is still the rule, the law seems to allow for its abolishment if the parties involved agree. In the second paragraph it regulates that in the latter cases, an alternative kind employee control on the ‘company’s management shall be laid down in agreement between the board of directors and the works council.’ The third subparagraph regulates that when there is no employee representation in the supervisory board, the memorandum of association ought to be amended in order to regulate how employee participation in the supervisory boards is to be organised. Finally, in the fourth section, the law obliges the employee representatives to inform the employees of the company on their work as long as it does not infringe on business secrets. In this section, I will discuss to what extent the three approaches are able to capture these developments.

The national policy-making process

Let us first turn to the national policy discussions. Based on the ‘illusionary corporatism’-argument, we would expect internally delegitimised

representatives of labour, i.e. works councils and trade unions, vis-à-vis national policy makers who want to create company law that formally acknowledges the interests of employees but in practice leaves them with little substantial rights. To what extent are these hypotheses corroborated by the actual developments? First, it seems that leading company law experts and policy makers in the Hungarian context are indeed sceptical about the role of organised labour in corporate affairs. According to the head of the Codification Committee, Tamás Sárközy (2002:197), 'the adoption of modern European business law [in Hungary, AV] is being hindered by the unbelievable over-regulation extorted by the trade unions.' Consequently, the initial strategy paper of March 2004 questions the usefulness of employee representation in supervisory boards (Neumann 2006) and proposes the possibility of a one-tier board system. Companies themselves would then be able to decide whether they would want to merge the supervisory boards with the Executive Board. Whereas the proposal did not make it in its original form to the draft law, it set the stage for the policy discussions. Not unsurprisingly, trade unions and other employee representatives argued against the draft which in their eyes would undermine employee influence in a longer-term perspective. During the National Interest Reconciliation Council that took place prior to the parliamentary debate, the trade unions argued against the changes in article 38 and the option that work councils could withdraw from their rights on one third of the seats in the supervisory boards. Although they received the support of the government representatives in the Committee, the law was in fact not amended, nor did the parliamentary debates, which the trade unions did not try to influence, alter this specific formulation of the law (Neumann 2006).

This begs the question why the trade unions and other organisations representing labour interests have not been more active in opposing the proposed revisions. In structural terms, the reason for their passiveness is to be found in the declining membership rates since the early 1990s, which undermine the credibility of their activities. Moreover, the scattered nature of the Hungarian trade union movement compared to other countries in Central Europe hinders their organisational capabilities (Cox/Vass 2000). Frege (2001) has argued that Hungarian trade unions are co-opted by the management not because of their strengths, but rather because of their weaknesses and their inability to pose serious threats to managerial strategies. Consequently, trade unions are often not eager to take actions that could potentially spoil their relations with employers as they might undermine their position in the longer term. In addition to these structural reasons, there are two additional factors that need to be taken into account when it comes to the proposed Company Law changes of 2006. First, employee representation in supervisory boards is not an institution that is highly valued by many Hungarian employees and trade unionists. Rather, 'many view board-level representation as nothing more than an opportunity to provide local union leaders and work councilors with extra income' (Neumann 2005:14). In

this respect, it might well be that the Hungarian trade unions do not consider the issue worth a big fight. Second, the introduction of the third postsocialist company law coincided with the announcement of the introduction of a far broader institutional reform program that the Hungarian government, consisting of social-democrats and liberals, was proposing in 2005 and which would effectively get underway after the 2006 elections. These plans, with the objective to prepare the Hungarian budget for EMU membership, involved large-scale reforms in health care and pensions and strained the relations between the government and the trade unions (Greskovits 2006). In this respect, a decision to focus on these issues is understandable and has been relatively successful in terms of popular mobilisation.

In descriptive terms, the ‘illusionary corporatism’ approach has the ability to provide a rather coherent and accurate account of the developments in Hungarian Company Law. It has an adequate characterisation for the kind of employee involvement that exists in postsocialist supervisory boards. Moreover, it helps us understand the change in the position of important national lawmakers. With the fundamentals of company law being well-established, the necessity to incorporate organised labour had disappeared and in this respect employee representation in corporate decision-making no longer constituted a necessity. Moreover, the theory also provides us with insights on why the most important national actors that could have come to the rescue of the two-tier system, were not powerful enough to mobilise in favour of the existing regulatory mechanism. However, important questions remain unanswered. The objectives of illusionary corporatism were already met under the existing two-tier system. So why did these changes take place? To answer this question we need move beyond the purely national debates in order to capture some of the underlying causes of the 2006 revision.

The European context

In this respect, the two other perspectives can provide additional insights into the driving forces behind this shift in the Hungarian company law. When we look at Hungarian company law debates in the early 2000s, we often find references to the process of European integration. As we have seen in the previous section, EU requirements played an important role in Hungarian company law during the second half of the 1990s and this did not change after the European Commission concluded that Hungary abided by the demands of the Acquis in the early 2000s. Even after that, references to the European integration process remained of high importance to Hungarian company law debates. Telling in this respect are the arguments put forward by Gabor Gadó, deputy state secretary at the Justice Ministry, in defense of the subsequent changes of Company law. During a 2003 debate in the Hungarian parliament, he argued that a proposed set of company law amendments was ‘a good example of

Hungarian laws becoming more user-friendly as a result of the [EU] harmonization process' (Budapest Business Journal 2003, 30 June).

But what are the concrete EU policy initiatives that have been integrated into the 2006 Company Law? Whereas company law has been on the European policy agenda since the early 1960s and there have been fourteen European Company Law Directives up to date, there are no EU Directives that prescribe either a one-tier or a two-tier system. Whereas the 2006 law incorporates almost all Company Law Directives and states in the preamble that it has been written 'with a view to approximation with the company law of the European Union,' the regulation with regard to the discussion of one-tier and two-tier systems and the way in which employee involvement in supervisory boards has been regulated can not be directly attributed to any European legislative initiative as this is a national affair.

Still, from a European perspective, two developments are worth mentioning. First, the introduction of the European Company Statute (SE) has been of importance. In 2001 the Council of the EU issued the so-called Statute for a European Company, which offers transnational European corporations the possibility to overcome the legal and practical problems that arise from operating in more than one national jurisdiction by introducing a new legal vehicle, the European Company (SE). The issue of employee involvement in the European company was addressed in a subsequent Council Directive (2001/86/EC: 1), where it seeks to ensure 'that the establishment of an SE does not entail the disappearance or reduction of practices of employee involvement existing within the companies participating in the establishment of an SE'. The Directive establishes 'fall-back statutory provisions on information and consultation, and on board-level participation' (Rebérioux 2002: 128), a provision that goes against the Anglo-Saxon type of corporate governance arrangements. In practice however, decisions on whether an SE adopts a two-tier system including employee representation is beyond the direct influence of employees as it is negotiated by the owners of the different corporations in the 'terms of foundation' (Keller/Werner 2008:167).

Second, throughout the EU there are pressures to allow companies substantial freedom with regard to their institutional set-up. In their policy recommendations the High Level Group of Company Law Experts have advocated that all individual companies in Europe are offered the choice between a one-tier or a two-tier system, based on the individual choice which model 'best suits their particular corporate governance needs and circumstances' (High Level Group 2002:59). In its 2003 policy document *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward* the European Commission (2003) supported the idea, although it recognised 'that the implications of such a proposal should be carefully studied... The Commission therefore proposes that this

recommendation from the High Level Group should be followed up in the medium term' (EC 2003:15-16). It is however important to stress that there are no concrete Directives that would make the 2006 changes obligatory. Rather, it seems that the Hungarian policy makers themselves wholeheartedly use European developments in order to propagate de-regulation with regard to the organisational set up of corporations. Why have they done so?

International competitiveness

This brings us to the third theoretical perspective that might help us understand the driving forces behind the company law revisions of 2006. Based on the notion of 'embedded neoliberalism,' we might suspect a social pact between capital and labour as long as such a pact would serve primarily the interest of transnational capital that has entered the region since the mid 1990s. And here, we find a second clue for the de-regulation of the Hungarian corporate landscape. Hungary opened its economy for foreign investment in the early 1990s and attracted more FDI per capita during the early period of the economic transformation than other states in the region, but it was losing its attractiveness vis-à-vis the neighbouring states at the end of the 1990s (Sass 2003:20). At the same time, foreign investment remained of crucial importance as part of the Hungarian strategy of economic development, especially in the light of lacking domestic savings. The social-democratic government that reached for power in 2002 opted for regulatory reforms that would strengthen the position of foreign capital, alongside the introduction of special policies for foreign investors such as tax breaks and other forms of indirect support (Bohle 2008).

As a result of the importance of foreign capital to the Hungarian economy, foreign investors play a crucial role in the development of the Hungarian corporate governance culture (Galgoczi 2003:32), where practices that were introduced by foreign corporations to their subsidiaries subsequently spread amongst the national policy scene (Vliegthart/Overbeek 2007). In an attempt to enter the competition for foreign investments in the best shape possible, governments in the region were willing to follow the ideas introduced by (local subsidiaries of) transnational investors (Grabbe 2003:248). This changed the function and nature of corporate legislation in multiple respects. On the one hand, private actors entered the regulatory field and introduced soft regulation to complement or specify existing laws in order to further align the Hungarian system with the rules of the game elsewhere. In the Hungarian context, the Budapest Stock Exchange issued Corporate Governance Recommendations that it had developed with the help of the British Know-How Fund and Ernst and Young in 2002, following the example of other countries in the region (Collier/Zaman 2005:767-768; Hermes et al. 2007). The existence of such a corporate governance code, which the World Bank in its 2003 Report on the Observance of Standards and Codes warmly applauded as a means of strengthening the corporate governance system (World Bank 2003:15), quickly

became the guide for corporate behaviour of corporations that were listed on the Hungarian stock exchange. On the other hand, the rise of soft regulation coincided with a call for less public regulation, or formulated differently, a larger scope of organisational freedom for corporations.

The importance of foreign capital can also be traced back in the development of postsocialist company law. First, the Codification Committee consisted primarily of lawyers working for international consultancy agencies. Second, representatives of foreign capital in Hungary such as the American-Hungarian Chamber of Commerce have provided policy advice with regard to the company law reforms, which the aforementioned deputy state secretary Gado considered 'very accurate and useful' (AmCham 2001:37). On a more structural level, Hungarian politicians effectively defend their policies with explicit reference to the importance of being attractive for foreign capital. In this respect for instance Gado defended a set of company law revisions in early 2007 in the Hungarian parliament as a necessity to meet the demands of foreign investors (Vilaggazdasag, 15 January 2007). And indeed, organisational flexibility has been an important issue for foreign investors. It helps transnational corporations to restructure local subsidiaries in order to work better according to their needs (Meyer 2004; Marinov/Heiman 1998), but it also reduces the costs of dealing with strict regulation unknown to the host economy.

At the same time transnational corporations (TNCs) do not seem to have had a direct and decisive impact on the 2006 Revision. Already under the old Company Law, several TNCs had introduced parts of their home country labour relation regime to their subsidiaries in Central Europe (Dörrenbächer 2004; Bluhm 2007). What is important in this respect is the fact that the ideas of TNCs with regard to the 'right' institutional set up vary from one sector to another, leading to somewhat diffuse preferences with regard to the 'right' institutional set up. Rather than being pushed into a distinct direction by TNCs, Hungarian policy makers have been the primary drivers of the process and their understanding of issues of competitiveness in terms of deregulation.

5. Who is undermining employee representation in postsocialist supervisory boards?

What do we learn from these findings about the existing theories on postsocialist industrial relations, or put differently, who is undermining the two-tier system? To answer this question in the jargon of a whodunit: the world economy and the processes of European integration provided the ammunition for national policy makers that all too willingly shot a victim that was left undefended by his expected friends. Although these friends knew of the threat, they underestimated its gravity as they were seeking to protect another possibly injured party that might be hit by bullets of the same suppliers. The Committee that was assigned with drafting the 2006 company code was eager to do away with the influence of

organised labour in corporate decision-making. During the political debate on the topic, the changes that would effectuate this were backed up with references to European developments and demands from the world economy that would create the necessity to do away with over-rigid regulation in the field of the organisational set-up of corporations. Internal resistance has been not very effective. The possible damage with regard to the interests of employees was recognised in an early stage, but trade unions and other employee representatives have not been able to politicise the debate. The reasons for this are to be sought in their weak position in the national political landscape and the fact that they have been engaged in multiple social struggles at the same time.

Arguments with regard to processes of European integration and the ability to attract foreign investments have effectively depoliticised the debate on the 2006 Company Code. They have depicted the Company law revisions as changes of technical nature, rather than a change of the balance of power within the corporation. Whereas the changes of the 2006 Code have put Hungarian company law further in line with transnational demands on what constitutes 'good corporate governance', they have also strengthened some actors in the corporation – most notably shareholders- at the expense of others –most notably the employees. Consequently, while the 2006 changes have been brought to the floor as mere technical adjustments to meet the criteria of the European Union and the global economy, they have enjoyed a high level of support amongst the Hungarian political scene.

In this respect, it is essential to stress that the issues of EU involvement and foreign investments are interconnected in two ways. First, European Union agencies, especially the European Commission, have continuously pushed Central European states towards a model that would favour foreign investments as a crucial part of the economic restructuring process (Vliegthart/Horn 2007). Whereas during the early years of the economic transformation, state agencies in Hungary and elsewhere in postsocialist Europe promoted domestic accumulation strategies, the process of European enlargement has pushed policy makers in Hungary towards more FDI friendly policies (Hanley et al. 2002). With EU membership on top of their political agenda, Hungarian politicians introduced these policies without much resistance. Second, transnational corporations have kept a close eye on institutional development in postsocialist Europe. They will only enter the postsocialist economies in great numbers if there are reassured that their investments are safe (Kisfaludi 2004:708). Harmonisation with EU requirements in this respect provides such a transparent, internationally-known framework that reassures foreign investors and is therefore considered to be beneficial to the entire Hungarian economy.

Implications and research perspectives

These findings are important to our understanding of the development of industrial relations in postsocialist Europe. This study points out that postsocialist industrial relations are co-shaped by multiple factors both within and outside the region, but more importantly it casts a new light on how these various levels are interconnected. It provides us with deeper insights on how national advocates of further flexibilisation have taken up the stimuli of European and international forces and have actively re-shaped them in order to use them as convincingly as possible within the national context. Company law development in postsocialist Europe is genuinely transnational in the sense that the analysis of national forces and developments alone cannot adequately capture the process of law-making. Whereas national policy motives with regard to trade union involvement in corporate decision-making are by no means irrelevant, this study points out that this process is profoundly shaped by the desire of national policy makers to fulfil the (perceived) demands of foreign investors and transnational institutions such as the EU. The competition for foreign investments and European pressures to flexibilise national regulation set the stage in which the internal regulatory process takes place.

The shift in the Hungarian Company Law characterises a wider trend in postsocialist Europe. FDI promoting strategies have been on the rise since the mid 1990s and have been articulated by national groups closely connected to transnational capital. National policy makers, generally supported by EU officials and policy in the international financial institutions, have adapted national regulation that corresponds to these kinds of strategies. This paper points out that this process is not restricted to actions directly involving FDI, such as the promotion of investment agencies, special economic zones and strategic incentives (Meyer/Jensen 2005), but extends itself to policy fields that set the broader field in which transnational corporations operate. In this respect, it demonstrates that FDI promoting strategies have a broader impact on socio-economic institutions in Central Europe than might be expected on the basis of the existing literature.

The findings of the paper also inform us more broadly about the character of capitalism in postsocialist Europe in two ways. First, the findings demonstrate that employee representation in postsocialist Europe is less firmly established than in Continental Europe. The paper provides further evidence of how arguments with regard to international competitiveness can effectively undermine the bargaining position of organised labour. Especially in the context of Central Europe, where trade unions have been on the defence since the collapse of state socialism, forces of internationalisation can push industrial relations in the direction of less interest representation on the side of labour and more flexibility for (transnational) capital. This fits the tendency of Hungary to slowly abandon the German institutions that were introduced in the early 1990s – but that never

functioned in the same manner as they do in Germany - in order to create a system that is more flexible. Second, transnational involvement in postsocialist Europe is so deeply rooted that institutions are reconfigured in order to cater for the interests of transnational capital. This gives the region, also institutionally, an outlook that is remarkably different from other more established capitalist economies elsewhere in Europe and the US (Nölke/Vliegthart 2009). Due to the immense importance of foreign investment for economic and technological development, Hungarian corporate governance regulation first of all seeks to establish a fix between the demands of TNCs and national regulation.

Perhaps needless to say, a study that focuses on the regulation of supervisory boards does not capture the practices of supervisory boards and the corporate governance system in which they function. Although there is an important link between regulation and practices, the actual translation from the first to the latter is not a one-to-one affair, especially not in postsocialist contexts where informality continues to play an important role (Böröcz 2000). In the past, especially domestically owned firms and state enterprises have often sought to 'navigate through a maze of new policies in which contradictory regulations and inconsistent enforcement produced ambiguity about which rules and which games were operating' (Stark/Vedres 2006:1371), reflecting a deeper segmentation of the Hungarian economic landscape (Martin 2008). Further research is needed to demonstrate how the different segments of the Hungarian economy have responded in practice to the regulatory reform. Whereas the 2006 Company Law opens the door for the flexibilisation of corporate structures that potentially could undermine the position of employees within the firm, the question remains whether corporate actors have actually seized the new opportunities and have entered into new kinds of industrial relations and corporate governance structures.

References

- AmCham (2001): Annual Report 2001, Budapest, American Chamber of Commerce in Hungary.
- Arlt, M-A. (ed.) (2003): The Status of the Law on Stock Companies in Central and Eastern-Europe: Facing the Challenge to Enter the European Union and Implement European Company Law, in: *European Business Organization Law Review* 4, 245-272.
- Avdagic, S. (2005): State-Labour Relations in East Central Europe: Explaining Variations in Union Effectiveness, in: *Socio-Economic Review* 2, 25-53.
- Bluhm, K. (2007): *Experimentierfeld Ostmitteleuropa? Deutsche Unternehmen in Polen und der tschechischen Republik*. VS Verlag: Wiesbaden.
- Bohle, D. (2004): The EU and Eastern Europe: Failing the test as a better power, in: Panitch, L./Leys, C. (eds.): *Socialist Register 2005: The empire reloaded*. London: The Merlin Press.

- Bohle, D./Greskovits, B. (2006): Capitalism without compromise: Strong business and weak labor in Eastern Europe's new transnational industries, in: *Studies in Comparative International Development*, 41, 1, 3-25.
- Bohle, D./Greskovits, B. (2007): Neoliberalism, Embedded Neoliberalism, and Neocorporatism: Towards Transnational Capitalism in Central-Eastern Europe, in: *West European Politics*, 30, 3, 443-466.
- Bohle, D. (2008): Race to the Bottom? Transnational Companies and Reinforced Competition in the Enlarged European Union, in: van Apeldoorn. B./Drahokoupil, J./Horn, L. (eds): *Contradictions and Limits of Neoliberal European Governance. From Lisbon to Lisbon*. Palgrave: MacMillan, 163-186
- Böröcz, J. (2000): Informality Rules East European Politics and Societies, 14, 2, 348- 380.
- Collier, P./Zaman, M. (2005): Convergence in European Corporate Governance: the audit committee concept, in: *Corporate Governance An international Review*, 13, 6, 753-768.
- Council Directive (2001): Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees.
- Cox, T./Vass, L. (2000): Government-Interest Group Relations in Hungarian Politics since 1989, in: *Europe-Asia Studies*, 52, 6, 1095-1114.
- Crowley, S./Ost, D. (2001): *Workers after Workers' States: Labor and Politics in Postcommunist Eastern Europe*. Rowman and Littlefield.
- Crowley, S. (2004): Explaining Labor Weakness in Post-Communist Europe: Historical Legacies and Comparative Perspective, in: *Eastern European Politics and Societies*, 18, 3, 394-429.
- Czajlik, I./Vincze, J. (2004): *Corporate Law and Corporate Governance- The Hungarian Experience*. Institute of Economics Hungarian Academy of Sciences, Discussion Papers 2004/11.
- Deacon, B. (2000): Eastern European welfare states: the impact of politics of globalisation, in: *Journal of European Social Policy*, 10, 2, 146-161.
- Dobák, M./Steger, T. (2003): Corporate Governance in Central and Eastern Europe – An introductory review, in: *Journal for East European Management Studies* 8, 3, 223-235.
- Dörrenbächer, C. (2004): Fleeing or exporting the German Model? The internationalization of German multinationals in the 1990s, in: *Competition and Change*, 8, 4, 443–456.
- Drahokoupil, J. (2008): Who Won the Contest for a New Property Class? Structural Transformation of Elites in the Visegrad Four Region, in: *Journal of East European Management Studies*, 13,4, 60-377.
- Drahokoupil, J. (2009): After Transition: Varieties of Political-Economic Development in Eastern Europe and the Former Soviet Union, in: *Comparative European Politics*, 7, 2, 279-298.
- Egan, M. (1999): Modes of business governance: European management styles and corporate cultures, in: *West European Politics*, 20, 2, 1-21.
- European Commission (2003): *Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*. Mimeo: Brussels.

- Frege, C.M. (2001): Union Weakness and Post-Communist Identities in Eastern Europe: Evidence from the Hungarian Clothing Industry, in: *Industrial Relations Journal*, 32, 4, 295-312.
- Galgóczi, B. (2003): The Impact of Multinational Enterprises on the Corporate Culture and on Industrial Relations in Hungary, in: *South-East Europe Review*, 1, 2, 27– 44.
- Grabbe, H. (2003): ‘European Integration and Corporate Governance in Central Europe: Trajectories of Institutional Change’ In: Federocwicz, M./Aguilera, R.V. (eds.): *Corporate Governance in a Changing Economic and Political Environment. Trajectories of Institutional Change*. Basingstoke: Palgrave, 247-266.
- Greskovits, B. (2006): The first shall be the last? Hungary's road to the EMU, in: Dyson, K. (eds.): *Enlarging the euro-zone: The Euro and the transformation of East Central Europe*. Oxford: Oxford University Press, 113-128.
- Hall, P.A./Soskice, D. (2001): *Varieties of Capitalism: The institutional foundations of comparative advantage*. Oxford: University Press.
- Hanley, L./King, L./János, I.T. (2002): The State, International Agencies, and Property Transformation in Postcommunist Hungary, in: *American Journal of Sociology*, 108, 1, 129-167.
- Hermes, N./Postma, T.J.B.M./Zivkov, O. (2007): Corporate governance codes and their contents: An analysis of Eastern European codes, in: *Journal of East European Management Studies*, 12, 1, 53-74.
- High Level Group of Company Law Experts (2002). *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*. Brussels: The Commission of the European Communities.
- Höpner, M. (2005): What Connects Industrial Relations with Corporate Governance? Explaining Complementarity, in: *Socio-Economic Review* 3, 2, 331-358.
- Iankova, E. A. (1998): The Transformative Corporatism of Eastern Europe, in: *Eastern European Politics and Societies*, 12, 2, 222–264.
- Jackson, G. (2005): Employee Representation in the Board Compared: A Fuzzy Sets Analysis of Corporate Governance, Unionism, and Political Institutions, in: *Industrielle Beziehungen*, 12, 3, 1-28.
- Jackson, G./Deeg, R. (2008): Comparing capitalisms: understanding institutional diversity and its implications for international business, in: *Journal of International Business Studies*, 39, 540–561.
- Keller, B./Werner, F. (2008): The Establishment of the European Company: The First Cases from an Industrial Relations Perspective, in: *European Journal of Industrial Relations*, 14, 2, 153-175.
- Kisfaludi, A. (2004): The Harmonisation of Hungarian Company Law - A Pendular Process, in: *European Business Organization Law Review*, 5, 4, 705-727.
- Kluge, N./Wilke, P. (2007): *Board-level participation and workers’ financial participation in Europe. State of the art and development trends*, Brussels: ETUI-REHS.
- Kovács, J. (2002): Approaching the EU and Reaching the US? Rival Narratives on Transforming Welfare Regimes in East-Central Europe, in: *West European Politics*, 2, 1, 175–205.

- Marinov, B./Heiman, B. (1998): Company Law and Corporate Governance Renewal in Transition Economies: The Bulgarian Dilemma, in: *European Journal of Law and Economics* 6, 231–261.
- Martin R. (2008): Post-socialist segmented capitalism: The case of Hungary. Developing business systems theory, in: *Human Relations*, 61, 1, 131-159.
- Meardi, G.G. (2002): Trojan Horse for the Americanization of Europe? Polish Industrial Relations Toward the EU, in: *European Journal of Industrial Relations*, 8, 1, 77 - 99
- Meardi, G.G. (2007): More Voice after more Exit? Unstable Industrial Relations in Central Eastern Europe, in: *Industrial Relations Journal*, 38, 6, 503-523.
- Meyer, K. (2004): Perspectives on multinational enterprises in emerging economies, in: *Journal of International Business Studies*, 35, 4, 259-276.
- Meyer, K.E./Jensen, C. (2005): Foreign direct investment and government policy in Central and Eastern Europe, in: Grosse, R. (eds.): *International business and government relations in the 21st century*. Cambridge: University Press, 119-146.
- Neumann, L. (2005): Hungary' In: Social Development Agency absl and European Trade Union Institute for Research, Education and Health and Safety (eds): *Worker board-level representation in the new EU Member States: Country reports on the national systems and practices*. Brussels.
- Neumann, L. (2006): 'New company act reduces role of board-level employee representatives' Retrieved from <http://www.eurofound.europa.eu/eiro/2006/11/articles/hu0611039i.htm> (accessed on 31-3-2008).
- Nölke, A./Vliegenthart, A. (2009): Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East Central Europe, in: *World Politics*, 61, 4.
- Ost, D. (2000): Illusory Corporatism in Eastern Europe: Neoliberal Tripartism and Postcommunist Class Identities, in: *Politics and Society*, 28, 4: 503- 530.
- Rebérioux, A. (2002): European Style of Corporate Governance at the Crossroads: The Role of Worker Involvement, in: *Journal of Common Market Studies*, 40, 4, 111–134.
- Rys, V. (2001): Transition Countries of Central Europe Entering the European Union: Some Social Protection Issues, in: *International Social Security Review*, 54, 2-3, 177–189.
- Sárközy, T. (2002): Strategies for Developing Hungarian Business Law, in: *Begegnungen. Schriftenreihe des Europa Institutes Budapest*, Band 22, 195–205.
- Sass, M. (2003): *Competitiveness and Economic Policies Related to Foreign Direct Investment*. Hungarian Ministry of Finance, Working Paper no. 3.
- Scharpf, F.W. (2002): The European social model: coping with the challenges of diversity, in: *Journal of Common Market Studies* 40, 4, 645–670.
- Schwartz, H. (2001): Round up the Usual Suspects! Globalization, Domestic Change and Welfare State Change, in: Pierson, P. (eds). *The New Politics of the Welfare State*, Oxford: University Press, 17-44.
- Stark, D./Vedres, B. (2006): Social Times of Network Spaces: Network Sequences and Foreign Investment in Hungary, in: *American Journal of Sociology*, 111, 5, 1367-1411.

- Van Apeldoorn, B./Horn, L. (2007): The Marketisation of European Corporate Control: A Critical Political Economy Perspective, in: *New Political Economy*, 12, 2, 211-35.
- Vickerstaff, S./Thirkell, J. (2000): Instrumental Rationality and European Integration: Transference or Avoidance of Industrial Relations Institutions in Central and Eastern Europe, in: *European Journal of Industrial Relations*, 6, 2, 237-251.
- Vliegthart, A./Horn, L. (2007): The Role of the EU in the (trans)formation of Corporate Governance Regulation in Central Eastern Europe- The case of the Czech Republic, in: *Competition and Change*, 11, 2, 137-154
- Vliegthart, A./Overbeek, H.W. (2007): Corporate Governance Regulation in East Central Europe: The Role of Transnational Forces, in: Van Apeldoorn, B./Nölke, A./Overbeek, H.W. (eds) (2007): *The Political Economy of Corporate Governance Regulation*. London:Routledge, 177-198.
- Whitley, R. (1999): *Divergent capitalisms: The social structuring and change of business systems*. Oxford University Press: Oxford.
- World Bank (2003): Report on the Observance of Standards and Codes (ROSC) : Corporate governance country assessment, retrieved from: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2006/04/18/000160016_20060418123248/Rendered/PDF/358780HU0ROSC010governance01PUBLIC1.pdf (accessed on 13-10-2008)