

**Domestic Politics Comes First—Euro Adoption Strategies in
Central Europe:
The Cases of the Czech Republic, Hungary and Poland**

By

Assem Dandashly
License, Lebanese University, 2000
M.A., Lebanese American University, 2004

A Dissertation Submitted in Partial Fulfillment of the
Requirements for the Degree of

DOCTOR OF PHILOSOPHY

in the Department of Political Science

© Assem Dandashly, 2012
University of Victoria

All rights reserved. This dissertation may not be reproduced in whole or in part, by photocopying or other means, without the permission of the author.

Domestic Politics Comes First—Euro Adoption Strategies in Central

Europe:

The Cases of the Czech Republic, Hungary and Poland

By

Assem Dandashly

License, Lebanese University, 2000

M.A., Lebanese American University, 2004

Supervisory Committee

Professor Amy C. Verdun, Supervisor
(Department of Political Science)

Professor Colin J. Bennett, Departmental Member
(Department of Political Science)

Professor Oliver Schmidtke, Departmental Member
(Department of Political Science)

Professor Emmanuel Brunet-Jailly, Outside Member
(School of Public Administration)

Professor Mitchell P. Smith, Additional Member
(University of Oklahoma, Department of Political Science)

Supervisory Committee

Professor Amy C. Verdun, Supervisor
(Department of Political Science)

Professor Colin J. Bennett, Departmental Member
(Department of Political Science)

Professor Oliver Schmidtke, Departmental Member
(Department of Political Science)

Professor Emmanuel Brunet-Jailly, Outside Member
(School of Public Administration)

Professor Mitchell P. Smith, Additional Member
(University of Oklahoma, Department of Political Science)

ABSTRACT

In the 2003 Treaty of Accession, the signatories agreed that all New Member States (NMS) that joined the European Union (EU) in 2004, would adopt the euro, even if no timetable was provided. Why have some NMS not been able to join the euro area even if they made serious attempts at the outset? What are the circumstances and policies in these countries that have led them not yet to adopt the euro? Has it been lack of political will on the part of the government, a strong voice in the opposition, a euroskeptic president, insufficient administrative capacity, or lack of policy learning? Though there is no consensus among economists as to whether or not adopting the euro in the short run is a good idea, an economic cost-benefit analysis would suggest that in the long run euro adoption is positive for NMS. Yet, macroeconomic analyses cannot explain the change in government policies that may lead to euro adoption. Political scientists have typically focused on collective identity, policy learning, ideas and knowledge transfer among central bankers and other political elites, as well as adjustment to global pressures and Europeanization. This political science literature is unable to provide a satisfactory explanation as to why the Czech Republic, Hungary and Poland have not adopted the euro yet. I argue that the role of domestic politics is key to explaining the process of euro adoption in Czech Republic, Hungary and Poland: government policies, elections, electoral cycles as well as constitutional rules, veto points, central banks, public opinion and the media turn out to be crucial in explaining the lagging euro adoption process in these countries.

Key words: Central and Eastern Europe, comparative political institutions, domestic politics, Economic and Monetary Union, Europeanization, European Union, institutions, international political economy, macroeconomic policy, optimal currency area.

TABLE OF CONTENTS

| | |
|---|-------------|
| Supervisory Committee | ii |
| ABSTRACT | iii |
| LIST OF TABLES | vi |
| LIST OF FIGURES | vii |
| ABBREVIATIONS | viii |
| ACKNOWLEDGEMENTS | x |
| CHAPTER I: INTRODUCTION | 1 |
| 1.1 The Main Research Questions | 3 |
| 1.2 Assumptions and Arguments | 4 |
| 1.3 Selection of the Main Factors | 7 |
| 1.4 Aim of the study | 11 |
| 1.5 Chapter Outline | 14 |
| CHAPTER II: LITERATURE REVIEW | 15 |
| 2.1 Economic Literature | 16 |
| 2.1.1 Costs and Benefits of EMU | 22 |
| 2.1.1.1 The Costs of EMU..... | 23 |
| 2.1.1.2 The Benefits of EMU | 26 |
| 2.2 Peeling the Political Science Onion | 31 |
| 2.3 Euro Adoption Strategies from a Domestic Angle | 38 |
| 2.4 Conclusion and Summary of the Hypotheses Examined | 45 |
| CHAPTER III: METHODOLOGY AND CASE SELECTION | 48 |
| 3.1 Qualitative Research—The Comparative Method | 49 |
| 3.2 Case Selection | 50 |
| 3.3 Research Methodology | 56 |
| 3.3.1 Interviews—Important Method in Qualitative Research | 58 |
| 3.3.2 Why Use Interviews for this Research?..... | 60 |
| 3.3.3 Reliability of Interview Data | 61 |
| 3.4 Conclusion | 62 |
| CHAPTER IV: HISTORICAL DEVELOPMENT AND THE COMMUNIST LEGACY— DOES IT MATTER? | 64 |
| 4.1 Historical Institutionalism | 66 |
| 4.2 Half a Century of Developments in Central Europe: Learning from the East | 68 |
| 4.2.1 From Yalta to the 1956 Revolution (Hungarian Revolution)..... | 70 |
| 4.2.2 The Beginning of De-Stalinization and the Hungarian Revolution..... | 74 |
| 4.2.3 The Prague Spring and its Aftermath | 83 |
| 4.2.4 Solidarność and the Revival of Poland | 96 |
| 4.3 Conclusion and the Communist Legacy Hypothesis | 109 |
| CHAPTER V: THE CZECH REPUBLIC—THE EUROSKEPTIC LEADER OF CENTRAL AND EASTERN EUROPE | 111 |
| 5.1 Background | 111 |
| 5.2 Europeanization, Social Learning and the Early Institutional Developments | 112 |

| | |
|---|------------|
| 5.2.1 Political and Institutional Change..... | 113 |
| 5.2.2 Economic Development—EU Accession and the Long Way to EMU..... | 119 |
| 5.2.2.1 The Privatization Process and the 1990s Financial Crises..... | 122 |
| 5.3 Role of Domestic Politics in Understanding Euro Adoption Strategies—The Main Factors and their Interactions..... | 127 |
| 5.3.1 Macroeconomic Indicators..... | 127 |
| 5.3.2 Government, Opposition, Electoral Cycles and the Euro..... | 132 |
| 5.3.3 Central Bank vs. Government—Cooperation or Conflict about the Euro?..... | 136 |
| 5.3.4 Public Opinion and the Media..... | 140 |
| 5.4 Financial Crisis Effect on Euro Adoption Position..... | 143 |
| 5.5 Conclusion..... | 146 |
| CHAPTER VI: HUNGARY—THE FAST TRACK TO THE BOTTOM..... | 150 |
| 6.1 Background..... | 150 |
| 6.2 Europeanization, Social Learning and the Early Institutional Developments..... | 151 |
| 6.2.1 Political and Institutional Change..... | 152 |
| 6.2.2 Economic Development—Choosing the Turtle’s way (Small and Gradual Steps) ... | 159 |
| 6.2.2.1 Hungarian Privatization—Trial and Error..... | 164 |
| 6.3 Role of Domestic Politics in Understanding Euro Adoption Strategies—The Main Factors and their Interactions..... | 169 |
| 6.3.1 Macroeconomic Indicators—Irresponsible Monetary and Fiscal Policies..... | 170 |
| 6.3.2 Government, Opposition, Electoral Cycles and the Euro..... | 175 |
| 6.3.3 Central Bank vs. Government—Cooperation or Conflict about the Euro?..... | 180 |
| 6.3.4 Public Opinion and the Media..... | 183 |
| 6.4 Financial Crisis Effect on Euro Adoption Position..... | 186 |
| 6.5 Conclusion..... | 189 |
| CHAPTER VII: POLAND—KEEP CHANGING LANES..... | 194 |
| 7.1 Background..... | 194 |
| 7.2 Europeanization, Social Learning and Early Institutional Developments..... | 196 |
| 7.2.1 Political and Institutional Change..... | 199 |
| 7.2.2 Economic Development—The Big Bang Approach..... | 203 |
| 7.2.2.1 Economic Development—The Privatization Process..... | 209 |
| 7.3 Role of Domestic Politics in Understanding Euro Adoption Strategies—The Main Factors and their Interactions..... | 214 |
| 7.3.1 Macroeconomic Indicators..... | 215 |
| 7.3.2 Government, Opposition, Electoral Cycles and the Euro..... | 221 |
| 7.3.3 Central Bank vs. Government—Cooperation or Conflict about the Euro?..... | 226 |
| 7.3.4 Public Opinion and the Media..... | 229 |
| 7.4 Financial Crisis Effect on Euro Adoption Position..... | 231 |
| 7.5 Conclusion..... | 233 |
| CHAPTER VIII: CONCLUSION..... | 238 |
| 8.1 General Findings..... | 238 |
| 8.2 The Communist Legacy—Does it Matter?..... | 241 |
| 8.3 Lessons and Findings from the Three Cases..... | 245 |
| 8.4 The Aftermath of the Financial Crisis and Sovereign Debt Crisis..... | 252 |
| 8.5 Connecting the dots—The ‘So What?’ Question..... | 254 |
| REFERENCES..... | 257 |
| APPENDIX—METHODOLOGY..... | 309 |

| | |
|--|------------|
| 1. Choosing the Right Persons for the Interviews | 309 |
| 2. The Interviews | 312 |
| 3. The Questionnaire—The Rationale behind the Questions | 314 |
| 4. List of Interviewees..... | 319 |

LIST OF TABLES

| | |
|--|-----|
| Table 1.1 Government’s Ideology and Effectiveness | 9 |
| Table 5.1 Economic Indicators (per cent): 1993-1999 | 120 |
| Table 5.2 Performance of the Czech Republic on the Convergence Criteria (per cent) (2004-2010) | 128 |
| Table 5.3 Czech Republic Public Opinion in 2009 and 2010 | 141 |
| Table 6.1 Economic Indicators (per cent)..... | 161 |
| Table 6.2 Performance of Hungary on the Convergence Criteria (per cent) (2004-2010) | 170 |
| Table 6.3 Public Opinion in Hungary in 2009 and 2010 | 184 |
| Table 7.1 Economic Indicators (per cent)..... | 207 |
| Table 7.2 Performance of Poland on the Convergence Criteria (per cent) (2004-2010) | 216 |
| Table 7.3 Public Opinion in Poland in 2009 and 2010..... | 229 |
| Table 8.1 General Findings | 252 |
| Table 8.2 Main Domestic Factors for Non-Euro Adoption in Each Case | 255 |

LIST OF FIGURES

| | |
|---|-----|
| Figure 1.1 Some Factors Influencing Euro Adoption Decision | 8 |
| Figure 5.1 Annual Average Inflation Rate in the Czech Republic..... | 130 |
| Figure 5.2 Exchange Rate—Czech Koruna/Euro (1999-2011)..... | 131 |
| Figure 6.1 Exchange Rate—Hungarian Forint/Euro (1999-2011)..... | 172 |
| Figure 6.2 Annual Average Inflation Rate in Hungary | 173 |
| Figure 6.3 Electoral Cycles and Deficit Increase (Year/Deficit as % of GDP) | 176 |
| Figure 7.1 Exchange Rate-Polish Złoty/Euro (1999-2011)..... | 218 |
| Figure 7.2 Annual Average Inflation Rate in Poland..... | 219 |

ABBREVIATIONS

| | |
|--|------------|
| Automated Teller Machines | ATMs |
| Bank for International Settlements | BIS |
| Central and East European Countries | CEECs |
| Council for Mutual Economic Assistance (Comecon) | CMEA |
| Czech National Bank | CNB |
| Czechoslovak Communist Party | CPCz |
| Česká strana sociálně demokratická (Czech Social Democratic Party) | ČSSD |
| Defining and Negotiating Fit | DNF |
| Dolgozó Ifjúság Szövetsége | DISZ |
| Economic and Monetary Union | EMU |
| Economic Currency Unit | ECU |
| European Bank for Reconstruction and Development | EBRD |
| European Central Bank | ECB |
| European Community | EC |
| European Currency Unit | ECU |
| European Financial Stability Facility | EFSF |
| European Investment Bank | EIB |
| European Monetary System | EMS |
| European System of Central Banks | ESCB |
| European Union | EU |
| Exchange Rate Mechanism | ERM |
| Foreign Direct Investments | FDI |
| Gross Domestic Product | GDP |
| Group of Seven | G7 |
| Group of Twenty-four | G24 |
| Hungarian Civic Union—Magyar Polgári Szövetség | FIDESZ-MDF |
| Instrument for Structural Policies for Pre-accession | ISPA |
| International Monetary Fund | IMF |
| Kereszténydemokrata Néppárt (Christian Democratic People's party) | KDNP |
| Klub Angažovaných Nestraníků | KAN |
| Komisji Nadzoru Bankowego (Polish Banking Supervision Commission) | KNB |
| Komitet Obrony Robotników | KOR |
| Komunistická strana Čech a Moravy | KSČM |
| Komunistická strana Československa | KSČ |
| Liga Polskich Rodzin (League of Polish Families) | LPR |
| Magyar Demokrata Fórum (Hungarian Democratic Forum) | MDF |
| Magyar Nemzeti Bank | MNB |
| Magyar Szocialista Párt | MSZP |
| Magyar Szocialista Munkáspárt (Hungarian Socialist Working Party) | MSZMP |
| Mass Privatization Program | MPP |
| Międzyzakładowy Komitet Strajkowy | MKS |
| Ministry of Finance | MoF |
| Most Different Systems Design | MDSD |
| Most Similar Systems Design | MSSD |

| | |
|---|--------|
| Narodowy Bank Polski (National Bank of Poland) | NBP |
| National Central Bank | NCB |
| National Investment Fund | NIF |
| National Property Fund (Fond Národního Majetku) | NPF |
| New Economic Mechanism | NEM |
| New Member States | NMS |
| Niezależny Samorządny Związek Zawodowy “Solidarność” | NSZZS |
| Občanská Demokratická Strana (Civic Democratic Party) | ODS |
| Office for Press and Information | OPI |
| Optimal Currency Area | OCA |
| Organization for Economic Cooperation and Development | OECD |
| Panhellenic Socialist Movement Party | PASOK |
| Państwowej Komisji Wyborcza (National Election Commission) | PKW |
| Párttörténeti Intézet Archivuma | PTIA |
| Platforma Obywatelska (Civic Platform) | PO |
| Polska Zjednoczona Partia Robotnicza | PZPR |
| Polskie Stronictwo Ludowe (Polish People’s Party) | PSL |
| Prawo i Sprawiedliwość (Law and Justice Party) | PiS |
| Prime Minister | PM |
| Private-Sector Involvement | PSI |
| Public Against Violence | PAV |
| Ruch Obrony Praw Człowieka i Obywatela | ROPCiO |
| Ruch Palikota (Paliku Movement) | RP |
| Samoobrona RP | SRP |
| Special Accession Programme for Agriculture and Rural Development | SAPARD |
| Socjaldemokracja Rzeczypospolitej Polskiej | SdRP |
| Sojusz Lewicy Demokratycznej (Democratic Left Alliance) | SLD |
| Stability and Growth Pact | SGP |
| State Property Agency | SPA |
| Szabad Demokraták Szövetsége (Alliance of Free Democrats) | SZDSZ |
| Tradice Odpovědnost Prosperita 09 | TOP 09 |
| Treaty Establishing the European Community | TEC |
| Treaty on European Union | TEU |
| Unia Pracy (Labor Union Party) | UP |
| United Kingdom | UK |
| Union of Soviet Socialist Republics | USSR |
| United States | US |
| United States Agency for International Development | USAID |
| Value Added Tax | VAT |
| Věci Veřejné (Public Affairs Party) | VV |

ACKNOWLEDGEMENTS

Thinking back to where I started from and where I ended up I find myself indebted to many people who influenced me, shaped my thinking and served—directly or indirectly—in making this work possible. Many people have been part of my PhD journey as my professors, family, friends, colleagues, and scholars. First and foremost, I would like to thank my supervisor Professor Amy C. Verdun—I am honored to be her first Ph.D. student at the University of Victoria. Over the course of the five years, I have learned from her enormous amount of knowledge, developed my thinking and research in a way that cannot be measured or valued. Her help, support and friendship were beyond imagination. I appreciate all the time she invested, her ideas, thoughts, constructive criticisms and the funding that made my PhD possible. I am thankful to her sponsoring my field trips to conduct the interviews in the Czech Republic, Hungary, Poland and Slovenia, in addition to the time spent in Poland (from September 2008-June 2009) and Hungary (June 2009-July 2009).

I am also grateful to my committee (Professors Colin J. Bennett, Oliver Schmidtke, Emmanuel Brunet-Jailly, and Mitchell P. Smith) for their feedback and support during my PhD studies. Their constructive criticisms regarding the thesis have been so helpful so I could strengthen my argument and improve the entire work. I would like to thank Professor Mitchell Smith for all his help and time I spent with him at the University of Oklahoma. His continuous support and advice have been crucial for developing my research skills. I would like to thank Professor Colin Bennett for the time he gave me during the various stages of my PhD studies at the University of Victoria. The discussions we had have been greatly important and thorough. I am thankful to Professor Schmidtke's comments on the proposal and the thesis at various stages. Professor Brunet-Jailly's comments and feedback on the proposal and on a penultimate version of the thesis were very constructive and helpful. I am appreciative to Professor Juliet Johnson who accepted to be my external examiner.

I am grateful to Professor Aleksander Surdej who hosted me as a visiting researcher at the Department of European Studies of the Economic University of Krakow for the 2008-2009 academic year. The discussions we had, in addition to the teaching and presentations' opportunities Professor Surdej provided me with, were invaluable. I am also thankful to my colleagues there: Jan Brzozowski, Katarzyna Cira and Olga Davydenko. Our conversations and discussions made my stay in Poland very fruitful and enabled me to learn a lot about the Polish politics, economics, society and culture. I am also thankful to those in charge of the SSHRC Cluster Europe-Canada Transatlantic Dialogue PhD Mentorship Program that provided the opportunity and funding to spend two months at the Munk Centre at the University of Toronto (September-October 2009). I had very fruitful time there and thorough discussions and feedback on my research from Professors Louis Pauly and Jeffrey Kopstein. Finally, I would like to thank Professor Gerda Falkner Professor at the University of Vienna and Director of the Institute for

European Integration Research of the Austrian Academy of Sciences for reading an early version of the thesis and providing constructive criticisms and comments.

Moreover, I would like to thank my colleagues at the University of Victoria—Sinéad Costelloe, Graeme Crouch, Valerie D’Erman, Ivan Dumka, and Tania Shaban—for all their support and encouragement, especially during the last stages of the PhD. Special thanks to Mark Jarvis for his helpful feedback and comments during various stages of the writing process.

Last but not least, I would like to thank my parents for all their love and encouragement and for supporting me in all my pursuits. Special thanks to all my family and friends who stood by my side during the various stages of the PhD. I am grateful to my partner Anastassiya Wiese who was there for me always. Anastassiya’s love, support, encouragement, patience and advice cannot be measured. Unfortunately she was taken too early from me during the last stages of the thesis. It is so unfortunate she cannot share this moment with me physically, but her spirit and soul are always here. It is to her memory that the entire work is dedicated.

Assem Dandashly
January 2012

To the Memory of my Princess who was taken too early

To the Memory of my Guarding Angel

Anastasiya Wiese

CHAPTER I: INTRODUCTION

This study focuses on one of the major challenges in European integration following the 2004 enlargement of the European Union (EU): euro adoption in Central and Eastern Europe. Following their accession to the EU on May 1st, 2004, ten New Member States (NMS)¹, and two other states² that joined in 2007, are expected to fulfill the so-called convergence criteria³ as spelled out in the Maastricht Treaty⁴ and enter the last stage of Economic and Monetary Union (EMU) by irrevocably fixing the exchange rate and adopting the euro. In so doing, the NMS will follow other euro area members by giving up part of their sovereignty. The ability to set monetary policy will be transferred to the European Central Bank (ECB) and their formal involvement in the setting of monetary policy will be limited to having one vote on its Governing Council.

Only three EU member states that are Central and East European Countries (CEECs) have adopted the euro. Slovenia and Slovakia joined the euro area in 2007 and 2009 respectively. Lithuania and Estonia tried to meet the entry criteria by 2006, but failed. Estonia only entered the euro area in January 2011. The rest of CEECs are not

¹ Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

² Bulgaria and Romania.

³ Maastricht convergence criteria are: Inflation rate should not exceed 1.5 percentage point of the average of the best performing members (EU members with the lowest inflation); public debt cannot be more than 60 per cent of the Gross Domestic Product (GDP); public deficit to GDP must not exceed 3 per cent; the nominal long-term interest rate cannot be more than 2 percentage point of the average of the best performing members (with lowest interest rate); and regarding the exchange rate, a member has to stay in the Exchange Rate Mechanism (ERM-2) for at least two consecutive years in which the currency can fluctuate within ± 15 per cent against the euro.

⁴ The Maastricht Treaty or Treaty on European Union (TEU) was signed on February 7, 1992 in Maastricht, The Netherlands. It entered into force on November 1, 1993 during Jacques Delors' Commission Presidency (1985-1994).

putting in much effort into adopting the euro soon.⁵ The Czech Republic, Hungary and Poland planned to adopt the euro soon after joining the EU in May 2004. The Czech Republic projected to join the Exchange Rate Mechanism (ERM-2)⁶ soon after EU accession and adopt the euro before 2010. Hungary planned to join the euro area by 2007 or 2008, which meant joining ERM-2 in 2005. Poland intended to join ERM-2 for the shortest time needed, and adopt the euro some time before July 1, 2009. This commitment leads us to expect an early euro adoption. Yet none of the three countries has adopted the euro. What might explain this sluggish process? If one examines the effect of geography and location of the NMS regarding euro adoption, one does not find an easy explanation: all NMS are geographically in close proximity to western Europe and those who joined fall within the same region. Also note that of the Visegrád Group,⁷ the smallest economy among the group, Slovakia, did adopt the euro.

Although this mixed record of euro adoption raises some important questions related to the various speeds of euro adoption and the question of who are the pacesetters and laggards, these questions are outside the scope of this thesis. This thesis focuses on

⁵ Latvia has not exerted much effort prior to the financial crisis, but the crisis hit hard in this country. In 2008 it was the second EU member state (Hungary was the first) to need major financial assistance from the EU and the IMF. As of 2011 Latvia is hoping to adopt the common currency by 2014 as emphasized by the Latvian president (*EUobserver*, September 15, 2011).

⁶ In its attempt to create monetary stability in the European Community (EC) countries, the EC summit in The Hague, in 1978, officially endorsed the plan to build a new European monetary system—i.e. the European Monetary System (EMS) that was launched in March 1979 involving only the currencies of the EC members. The EMS contained two major elements: the ERM, which allowed the EC members' currencies to fluctuate within a limited margin of ± 2.25 per cent. This system of limiting the fluctuation rate of the currencies is known as semi-pegged system. Before the euro was created the currencies used to fluctuate around the European Currency Unit (ECU). As for the value of the ECU, it was calculated as the weighted average of the EC members' currencies, participating in the EMS. On January 1, 1999, ERM-2 succeeded ERM to maintain economic and monetary stability in the single market. Within ERM-2, participating currencies are allowed to fluctuate within a margin plus/minus 15 per cent with respect to the euro, with the exception of the German-Dutch parity that remained at earlier narrow band of 2.25 per cent (see the European Commission website; for EMU history see Gros and Thygesen, 1998; Hosli, 2005).

⁷ The Visegrád Group (also known as Visegrád Four or V4) is an alliance that originated from the meeting of the heads of Czechoslovakia, Hungary and Poland on February 15, 1991. The main aim of the group is strengthening cooperation among each other and deepening European integration. Following the dissolution of Czechoslovakia in 1993, the Czech Republic and Slovakia replaced it in the group.

the three largest CEECs: Czech Republic, Hungary and Poland.⁸ I argue that the three cases have not yet adopted the euro for different domestic political reasons (government ideology, opposition, electoral cycles, veto points, central banks, public opinion and the media). The next sections discuss the main research questions, arguments, selection of variables, aim of the study, and the thesis' outline.

1.1 The Main Research Questions

As per the 2003 Treaty of Accession,⁹ the NMS have to adopt the euro one day, but it does not specify a time frame. Therefore the speed of euro adoption depends primarily on the EU member state in question. Neither the European Commission nor the ECB are pushing the NMS to rush to adopt the euro. Besides, the case of Sweden set a precedent for the NMS since Sweden does not have an official opt-out—as do the United Kingdom (UK) and Denmark¹⁰—yet it is still not a euro member. The Swedish non-adoption might be surprising because it has met all convergence criteria¹¹ except that it has not joined the ERM-2.

In order to evaluate euro adoption policies in the Czech Republic, Hungary and Poland, I focus on the domestic environment and the perceptions of those involved in the

⁸ For a discussion of the case selection, see chapter 3.

⁹ The Treaty of Accession (2003) was signed in Athens on April 16, 2003.

¹⁰ During the Maastricht Treaty negotiations, the UK obtained an opt-out from having to adopt the euro. Denmark negotiated an opt-out at the European Council meeting in December 1992 in Edinburgh, UK.

¹¹ In 2002, the inflation rate was 2.9 per cent of GDP for the reference period (May 2001 to April 2002) (reference value 3.3 per cent). During the reference period of 2001, the budget showed a surplus of 4.8 per cent of GDP which is within the reference value (3 per cent deficit) and the public debt was 55.9 per cent of GDP (reference value 60 per cent). As for the long-term interest rates, Sweden's interest rate was 5.3 per cent which was below the reference value of 7 per cent at that time (European Commission, 2002).

decision-making process and a few of those who may have some influence on the process. The questions this study seeks to address can be summarized as follows:

(1) Why have the Czech Republic, Hungary and Poland not yet adopted the euro?

Why have these three countries moved away from their earlier commitment to adopt the euro quickly? What have been the euro adoption policies in the Czech Republic, Hungary and Poland? Are there some specific financial, political or other factors that inhibit Czech, Hungarian and Polish euro adoption?

(2) How are the various actors (government, opposition, central bank, the public and the media) involved in the decision-making process, and how do they perceive euro adoption in their country and what would they see to be the effects for their country of euro adoption?

(3) How do the financial crisis (2008-2009) and the sovereign debt crisis affect the actors' perceptions regarding euro adoption?

This study seeks to understand the reasons why the Czech Republic, Hungary and Poland moved from their early enthusiasm regarding euro adoption to lagging behind. Let us now turn to the main arguments that will help answer the research questions.

1.2 Assumptions and Arguments

Most studies analyzing euro adoption strategies have dealt with the literature from either a Europeanization perspective and/or by adopting an economic cost-benefit analysis.

Prior to the financial crisis of 2008-2009, many economic cost-benefit analyses suggested that the long-term benefits outweigh the short-term costs of being part of the euro area.

Economists typically looked at macroeconomic conditions to determine whether or not a country is ready (De Grauwe and Schnable, 2005; Lipschutz, Lane and Mourmouras, 2005; Schadler, 2005). However, they were unable to explain the political processes that change those macroeconomic conditions. By contrast, political scientists (e.g. Johnson, 2003, 2006; Dyson, 2006, 2008; and Greskovits, 2006, 2008) have mostly focused on collective identity, the role of policy learning, ideas and knowledge transfer among central bankers and other political elites, as well as adjustment to global pressures and Europeanization.¹²

Neither the existing economic nor political science analyses are fully satisfactory in their explanation of euro adoption strategies of the NMS. Neither satisfactorily addresses the domestic policies and strategies regarding euro adoption in the NMS. In this thesis I argue that for a better understanding of euro adoption strategy in the NMS one needs to look at the domestic political situation. A domestic politics approach (inter alia Huelshoff, 1994; Ladrech, 1994; Bulmer, 1998; Elster, Offe and Preuss, 1998; Heipertz and Verdun, 2010), informs us why a government chooses one policy over another, and is best able to explain the specific timing of policies. How have the domestic economic situation, government's efficiency, ideology of the regime, opposition's stance, public opinion and the media influenced the position regarding the euro?

These domestic factors are not operating in isolation from the international economic factors. For instance, the EU could impose sanctions on member states if

¹² Featherstone defines Europeanization as the “domestic adaptation to the pressures emanating directly or indirectly from EU membership” (Featherstone, 2003: 7). Börzel defines Europeanization as “a process by which domestic policy areas become increasingly subject to European policymaking” (Börzel, 1999: 574). For Radaelli, Europeanization is a “processes of (a) construction, (b) diffusion and (c) institutionalization of formal and informal rules, procedures, policy paradigms, styles, ‘ways of doing things’ and shared beliefs and norms”, which are consolidated in EU decisions “and then incorporated in the logic of domestic discourses, identities, political structures and public policies” (Radaelli, 2000: 4).

excessive deficits exist.¹³ The global financial crisis of 2008-2009 showed that international events could have important effects on the calculation of the costs and benefits associated with being part of the euro area. However, these effects can differ based on the domestic situation of the country.

In cases such as Greece, Ireland, and Portugal, one of the downsides of being part of the euro area is that they no longer have the exchange rate tool available, and thus devaluing their currency was not a policy tool available to them. These countries typically have used this instrument in the past in similar circumstances, and now need to adjust in other ways. Nevertheless, being euro members helped them receive support from the euro members who felt the need to bail them out.¹⁴ In the cases of the UK, Sweden and Denmark, the situation might have been different since they had to face the costs of the crisis on their own. Sometimes, a country (for example, Hungary and Latvia in 2008 as a result of the financial crisis) might end up receiving loans from the EU and the International Monetary Fund (IMF), and then has to abide by rules dictated by the EU and the IMF. These stipulations might not create an environment that facilitates euro adoption. International conditions restrict the room for maneuver of domestic actors.

¹³ As per the convergence criteria, EU member states are not allowed to breach the 3 per cent reference value regarding their deficit except: (a) if the percentage of deficit to the GDP has been corrected and has come close to the reference value; (b) if the violation of the deficit criteria is only temporary and due to exceptional circumstances. In case the percentage of public debt to GDP exceeds the 60 per cent reference, then the debt of this country will be considered excessive (and in violation) unless the debt is improving and coming close to the reference value (Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union (henceforth ‘Consolidated Treaties’) Article 126: Paragraph 2) (Ex Article 104 of the Treaty Establishing the European Community (TEC); see Official Journal of the European Union C321 2007 and Official Journal of the European Union C 83 2010).

¹⁴ The EU and the IMF prepared several bailout packages to support Greece, Ireland and Portugal during 2010 and 2011 (as will see in more details later) The latest effort of the EU leaders to deal with the sovereign debt crisis in general and the Greek crisis in particular was in October 2011 in which they agreed “to force the Continent’s banks to raise new capital to insulate them from potential sovereign debt defaults. But there was little detail on how the Europeans would enlarge their bailout fund to achieve their goal of \$1.4 trillion to better protect Italy and Spain” (*The New York Times*, online edition, October 26, 2011). With respect to Greece, EU leaders forced the banks to take 50 per cent reduction “known as a ‘haircut,’ [...and the IMF] promised more aid to Greece” (*The New York Times*, online edition, October 26, 2011).

It is noteworthy to mention that, right after the fall of communism, these countries did not have many choices. They wanted to move the furthest they could away from communism.¹⁵ Political elites at that time (late 1980s and early 1990s) found a *window of opportunity*¹⁶ opening with the support of major Western countries and international institutions (such as EU member states, the United States (US), the IMF, the World Bank, etc.). CEECs have had a narrow margin of maneuver in planning and implementing their policies. So what kind of institutional developments have these countries gone through on their voyage to joining the EU and adopting the euro later in the future?

Although I offer some analysis of the post-2009 period, the focus of the study is on euro adoption policies taken by the three countries up until 2009. In addition to the domestic politics perspective, this study adopts a historical institutional approach to examine the pre-1989 period since I argue that historical legacies (communist past and experience) and path dependency matter. This analysis is necessary to confirm or refute the existence of any correlation between the communist legacy and the post-1989 approaches to euro adoption policies.

1.3 Selection of the Main Factors

Although the EU played an influential role in CEECs regarding their road to EU membership, and has strengthened the role of governments and shaped the national interests (see Sandholtz, 1993a; 1993b; Moravcsik, 1994), the EU's influence in those

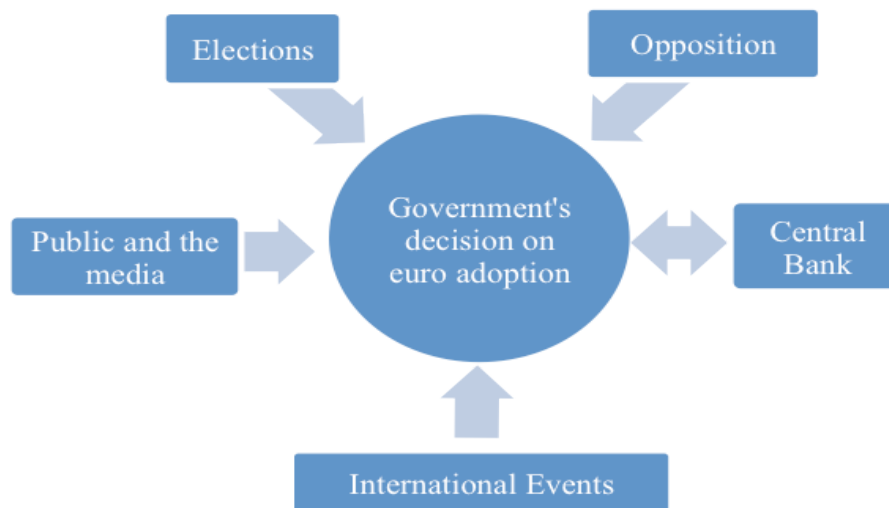
¹⁵ Each country experienced communism differently. Although all countries wanted to move towards democracy and market economy, some were more enthusiastic than others.

¹⁶ According to Kingdon, these windows do not stay open for long time; they offer opportunities for action and then pass (Kingdon, 1995: 203-204).

countries' post accession is not as influential. Regarding euro adoption, the role of the EU is basically limited to that of the convergence criteria in stipulating that EU members are not allowed to have an excessive deficit. This lack of a deadline regarding euro adoption, in addition to the ECB "strict" interpretation of the convergence criteria along with the influential euro opt-out countries (UK and Denmark) led to a weak and non-credible conditionality regarding euro adoption (Johnson, 2008).

This thesis focuses on the main domestic factors that are considered to be the most influential in euro adoption strategies (the government, opposition, central bank, public opinion and the media). These factors are not analyzed in isolation to what is going on in the international environment (such as the 2008-2009 financial crisis and the euro area sovereign debt crisis). Regarding euro adoption, these players are considered the most important ones in the decision-making process (see Figure 1.1).

Figure 1.1 Some Factors Influencing Euro Adoption Decision



Although these main factors are crucial to an understanding of the euro adoption strategies, other involved factors also play a role such as labor unions, interest groups, and epistemic communities. I do not discuss these factors in details but I highlight their

influence insofar as they play an active role in different parts of the euro adoption agenda-setting and policy-making. The cooperation and interaction among them in addition to the effect of the international events such as financial and economic crises lead to certain outcomes either in favor of euro adoption or against it.

Two other factors of importance for this study are elections and public opinion and its stance regarding the euro. The former is important since election results might bring a change of government. I differentiate between three types: (1) a euroskeptic government, (2) a euroenthusiastic government, or (3) a neutral government.

Table 1.1 Government's Ideology and Effectiveness¹⁷

| <i>Government</i> | <i>Effective</i> | <i>Ineffective</i> |
|-----------------------|-------------------------|--------------------------------|
| <i>Euroenthusiast</i> | Fast euro adoption | Delayed euro adoption |
| <i>Euroskeptic</i> | Delayed euro adoption | Furthest delayed euro adoption |
| <i>Neutral</i> | Euro adoption is likely | Delayed euro adoption |

(1) I hypothesize that a euroenthusiastic government will be in favor of the euro but the policies implemented could be divided into two scenarios:

- a. Policies are pursued that are aiming to meet the convergence criteria. In this case, the probability of adopting the euro will be high, provided that the governing board of the central bank and the public are also in favor of euro adoption.

¹⁷ Effective policies are when governments adopt sound fiscal and monetary policies that take into consideration the convergence criteria.

- b. Policies are pursued that do not aim to meet the convergence criteria. In this case, even if the central bank and the public support the euro, the possibility of adopting the euro is unlikely.
- (2) A euroskeptic government will implement policies that are not in favor of euro adoption. If the central bank's monetary council is pro-euro, conflicts may arise.
- a. In case of effective policies (policies that take into consideration the budgetary deficit, public debt, inflation, social spending, etc.), then meeting the convergence criteria is possible, but euro adoption is unlikely.
 - b. In case the policies are ineffective (policies that do not take into consideration the limits on spending, budgetary deficit, public debt, inflation, etc.) then euro adoption is almost impossible.
- (3) The third case, neutral government, it is less clear whether euro adoption would be attributed high or low priority. It depends on the position of the central bank, the public and whether it is perceived to be in the interest of the country, and whether the government is willing and able to pursue policies that will have positive effects on meeting the convergence criteria:
- a. In case the policies are in favor of the convergence criteria, and there is public support for the euro, then euro adoption is likely.
 - b. In case of unsound economic policies that are pushing the country away from meeting the convergence criteria, then euro adoption is unlikely even if the public and the central bank support it.

Of course, reality is more complicated than the six possible scenarios since other factors may interfere. Examples of such factors are the change in government as a result

of elections or sudden incidents.¹⁸ Furthermore, policies might not be consistent over time. Governments might change members on the monetary council of the central bank and replace them with members whose ideas and ideologies are closer to their own ideas (for example, in the Czech Republic and Poland). The role of the media is important since it can direct the attention of the public in certain ways and affect the policies taken. Another factor that affects the policies is the law. Some countries (Poland, for example) need a constitutional change to take certain important decisions as changing the national currency and adopting the euro. The international events affect all these factors and policies. In case of crises, central banks and governments' positions and policies, oppositions' views, media attention and the public interest might change. This change might cause either harmony among the different factors or more division and conflict.

1.4 Aim of the study

This thesis seeks to study two underlying factors. The first is the uneven developments in the CEECs in the 1990s following the end of communism. The second factor is the change in the perceptions of CEECs regarding European integration following the EU accession in 2004. After the fall of communist regimes, CEECs were eager to join the EU. However, following their EU entry, the eagerness changed into hesitance, the perceptions towards deeper integration changed, and the hard work regarding economic, political and institutional reforms, which was done prior to joining the EU in 2004,

¹⁸ Sudden incidents might lead to a change in the president and senior officials (such as the sudden death of the Polish president and governor of the Narodowy Bank Polski (National Bank of Poland-NBP). This might result in a significant policy change.

slowed down. Initially they mainly focused on meeting the convergence criteria and adopting the euro but after some time even that changed.

The aim of this thesis is fourfold. The first is to offer an analysis of the current literature on EMU and its enlargement towards the east. It studies the current economic and political science theories that provide an analysis of euro enlargement and economic and monetary integration regarding CEECs with a view to understanding the divergence in outcomes.

The second aim of the thesis is to shed light on the developments that took place under communism and examine the transformation from communism to capitalism in the three countries since 1989. The importance of the historical analysis is that it highlights the fact that these three countries did not start from the same line and also that they had different experiences under communism. Moreover, the pacesetters during communism and during the post-1989 reforms did not continue to be pacesetters once in the EU; rather they became laggards. This historical analysis shows the positions of the various elites involved in the transition plan and why they moved all the way towards meeting the Copenhagen Criteria¹⁹ and join the EU and stopped there without taking a similar

¹⁹ Article 49 stipulates EU membership criteria: “Any European State which respects the principles set out in Article 6 (1) may apply to become a member of the Union. It shall address its application to the Council, which shall act unanimously after consulting the Commission and after receiving the assent of the European Parliament, which shall act by an absolute majority of its component members. The conditions of admission and the adjustments to the Treaties on which the Union is founded, which such admission entails, shall be the subject of an agreement between the Member States and the Applicant State. This agreement shall be submitted for ratification by all the contracting States in accordance with their respective constitutional requirements”. Article 6 (1) of the Treaty on European Union states the EU principles: “liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States”. The criteria were established in 1993 at the European Council meeting in Copenhagen-Denmark. According to the Copenhagen Presidency Conclusions, for a country to be accepted as a member in the EU, it has to have “achieved stability of institutions guaranteeing democracy, the rule of law, human rights, respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union” (European Council, 1993).

approach regarding euro adoption. The purpose of the historical analysis is to examine whether there is a correlation between the communist legacy and the post-1989 developments and euro adoption strategies.

The third aim is to offer an understanding of the different positions of the main actors involved in the decision-making process regarding euro adoption strategies in each of the three countries. Although I discuss the period prior to 2004, the focus will be mainly on the actors involved in the post EU accession period. I analyze the attitudes of the main actors (government, opposition, central bank, the public and the media), and what factors influence their positions and decisions. I also demonstrate the different interactions among these actors and which are the most influential. The thesis shows the relationship among the various actors that will help us understand not only euro adoption strategies but also their entire attitude towards the EU.

The fourth aim is to fill a gap in the literature regarding euro adoption in CEECs and to offer an alternative theoretical explanation. This thesis applies a domestic politics approach to help us understand euro adoption strategies from the perceptions of the member states. The findings of this thesis contribute to the broader literature on euro adoption (economics, political science and public policy) and will be a useful reference not only for academics but also for policy makers involved in euro adoption policies.

Moreover, candidates should adjust their administrative arrangements as outlined in the December 1995 Madrid European Council. A diffusion of Community laws and legislations should take place at the national level in the candidate countries. The appropriate bureaucratic and judicial structures are responsible for implementing these legislations (European Council, 1995).

1.5 Chapter Outline

Following this introduction, chapter 2 discusses the economic and political science literature regarding euro adoption. Chapter 3 deals with the research method and case selection. Chapter 4 offers a historical background of pre-1989 transformations in the three cases (Czech Republic (Czechoslovakia at that time), Hungary and Poland). Chapters 5, 6 and 7 discuss the three cases. The three chapters start with a brief summary of the post-1989 process of political institution-building, the political party and party system, economic liberalization and the public and voting behavior. The importance of this brief summary is to track how the post-1989 reforms delayed meeting the convergence criteria and adopting the euro as planned by the three governments. Then the discussion focuses on the perceptions of the main actors involved in euro adoption and on their reasons why those countries have not adopted the euro yet. There will be a succinct discussion of the 2008-2009 financial crisis and the effect of it as well as the European sovereign debt crisis on the euro adoption strategies in the three cases. Finally, chapter 8 concludes by analyzing the attitudes regarding the euro and reflects on the importance of domestic politics in studying euro adoption strategies and the whole concept of the euro “going East.”

CHAPTER II: LITERATURE REVIEW

On January 1st, 1999, eleven west European countries²⁰ joined the last stage of EMU and adopted the euro.²¹ How can we understand this integration process according to the economics and political science literatures? What can the current literature tell us about euro adoption strategies in CEECs? Economists view EMU as a macroeconomic problem—should member states give up their control over domestic monetary policy and national currencies in favor of a common currency? Political scientists tend to look at EMU enlargement through the lens of Europeanization based on socialization and learning.

In neither literature has there been sufficient focus on member states' domestic players who influence the euro adoption process. The focal point for most political scientists was the learning process taking place and the involvement of the EU, international organizations and other countries in the transformation of CEECs (see Johnson, 2003, 2006; Dyson, 2006, 2008). Generally speaking, the economic literature, by contrast, tends to ignore the political environment in which euro adoption takes place. Very few scholars have tried to study euro adoption in CEECs from the perspective of policy makers in member states. Yet, without a domestic political environment that is in favor of euro adoption (for example, elites, central bank, opposition and the public should be in favor of euro adoption), adopting the euro cannot be achieved. Before discussing

²⁰ Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

²¹ Exchange rates were irrevocably fixed at this time (1999). In the first three years the euro was introduced in financial markets and in accounting. In some countries both currencies floated side by side in the country for a few months. In some countries the national currencies were replaced right away by the euro.

the theoretical framework of this thesis, i.e. domestic politics approach, and for a complete understanding of the literature, the next sections shed light on the Optimal Currency Area (OCA) theory and the political science literature dealing with euro adoption.

2.1 Economic Literature

Although the economic literature on EMU cannot help us fully understand the decision of countries to be part of a monetary union, it does serve to explain the benefits and costs of fixing exchange rates and, thereby, offers an analysis as to when it may be economically beneficial to join a monetary union. In economic terms, a monetary union resembles an “irrevocable” fixed exchange rate system (Tsoukalis, 1977: 33; see also Buti, 2003), for which there are costs and benefits. Some scholars, such as Bergman and Hutchison (1998), argue that the desire of countries to join EMU is based mainly on the expected costs and benefits.

Theories, such as the OCA theory, which has been initiated by Mundell (1961), McKinnon (1963), Kenen (1969) and Ingram (1973),²² analyze the expected costs and benefits of a monetary union (Löchel, 1998: 5). The OCA literature stipulates that countries benefit from joining a monetary union when their economies are sufficiently similar and synchronized, if factors of production (capital and labor) are mobile, and if there is considerable trade with the area with which an OCA is being considered. To have a smoother adjustment, it is important to consider these components before creating a

²² The works of Friedman (1953) and Meade (1957) already had some “insights” on the OCA (Mongelli, 2002: 7).

currency union. If countries score high on the OCA criteria, there would be a lower probability of asymmetric shocks and economic disturbances (Mundell, 1961).

Based on Mundell's (1961) argument, which favored neither a fixed nor a flexible exchange rate as long as these systems of exchange rates do not result in unemployment while maintaining "external balance", Kenen emphasized that in case "the prevailing exchange-rate regime, fixed or flexible, can maintain external balance without causing unemployment [...], that regime is optimal" (Kenen, 1969: 41). In later work, Mundell (1973)²³ favored a fixed exchange rate to create a common currency for Europe.

In order to create a "unified money market", the "exchange rate should be taken out of both national and international politics within Europe" (Mundell, 1973: 147). Europe should move in the direction of less flexible exchange rates and stronger capital markets' integration instead of more flexibility (Mundell, 1973: 150). He argued that "[a] system of flexible exchange rates is usually presented, by its proponents, as a device whereby depreciation can take the place of unemployment when the external balance is in deficit, and appreciation can replace inflation when it is in surplus" (Mundell, 1961: 657). Mundell warned against the practicability of a flexible exchange rate system. He argued that the "subject of flexible exchange rates can logically be separated into two distinct questions. The first is whether a system of flexible exchange rates can work effectively and efficiently in the modern world economy [²⁴...]. The second question concerns how the world should be divided into currency areas" (Mundell, 1961: 663).

²³ Mundell's 1973 article (A Plan for a European Currency) shows his enthusiasm regarding a European common currency. This article is based on a paper he presented in Madrid in 1970 following the European market's problems in the last three years of the 1960s due to the unstable currencies' value.

²⁴ For a system of flexible exchange rates to work effectively and efficiently in the modern world economy, "it must be demonstrated that: (1) an international price system based on flexible exchange rates is dynamically stable after taking speculative demands into account; (2) the exchange rate changes necessary to eliminate normal disturbances to dynamic equilibrium are not so large as to cause violent and reversible

Mundell identified that a number of problems could arise when moving away from a fixed exchange regime. One of the major problems is the OCA Problem: “the problem of ascertaining the appropriate domain of a fixed exchange rate area” (Mundell, 1969: 31-32). This position contradicts Meade’s argument that the six west European countries do not have the necessary common ground for a common currency. Due to labor immobility and for the sake of stability and balance of payments’ equilibrium, these countries should have a flexible exchange rate regime (Meade, 1957: 385-387).

These scholars have studied the costs resulting from creating a common currency for Europe and the conditions in which asymmetric shocks might occur and the suitable circumstances for having a monetary union (see De Grauwe, 1997; Baldwin and Wyplosz, 2006; and Corsetti, 2008). There is a limitation on the effectiveness of fiscal policies in regulating member states’ economies. With respect to asymmetric shocks such as “the decline in aggregate output in some members [...of the monetary union], fiscal policy would not be able to regulate the economies” as well as exchange rate policy which is impossible in the case of a monetary union (Löchel, 1998: 5). Asymmetric shocks are one of the costs of EMU—if created in unsuitable circumstances. According to various scholars, a harmonized fiscal policy should be established before creating a monetary union in order to avoid economic problems in the member states (Löchel, 1998: 5). Moreover, due to the differences among member states, it is not enough to use “national monetary policies, including the exchange rate instrument” in order to adjust

shifts between export and import-competing industries (this is not ruled out by stability); (3) the risks created by variable exchange rates can be covered at reasonable costs in the forward markets; (4) central banks will refrain from monopolistic speculation; (5) monetary discipline will be maintained by the unfavorable political consequences of continuing depreciation, as it is to some extent maintained today by threats to the levels of foreign exchange reserves; (6) reasonable protection of debtors and creditors can be assured to maintain an increasing flow of long-term capital movements; and (7) wages and profits are not tied to a price index in which import goods are heavily weighted” (Mundell, 1961: 663).

for those differences (De Grauwe, 2006b: 24). For members of a monetary union to lower risks, they should have a sort of insurance against asymmetric shocks. Thus, it is not enough that labor markets enjoy flexibility and mobility, “but also that there are mechanisms in place that allow for income transfers to those countries, so as to alleviate the pain of the shock to the residents of these countries” (De Grauwe, 2006b: 9).

Economists, such as Löchel, find it doubtful that EMU helps achieve some political ambitions or gains since they consider the success of EMU to be related to its role in assisting member states reach their economic and fiscal goals. Moreover, fixing the exchange rate and joining EMU is not free from economic costs even if it also has benefits (Löchel, 1998: 6). Member states concede their control over exchange rate and monetary policy with the expectation that this will lead to “stabilizing output and employment” (Löchel, 1998: 9). Although a country might benefit from fixed exchange rates through the reduction of the negative effects of the economic shocks, countries that join EMU lose one of the most important tools for controlling their macroeconomic policies. However, “there is little evidence that exchange rates in the past moved because of asymmetric shocks” (Gros and Thygesen, 1998: 310). Past experiences show that changes in exchange rates and external shocks did not influence unemployment and productivity. Moreover, there has been an exaggeration in the ability of exchange rate adjustments to face asymmetric shocks as thought by the OCA theory (Gros and Thygesen, 1998: 310). Even with independent monetary policy, exchange rates cannot be used anytime and are not costless since they could lead to macroeconomic instability and cause asymmetric shocks (De Grauwe, 2006b: 61).

With the renewal interest in EMU in the 1980s, its launch by the end of the 1990s and its enlargement in the second half of the 2000s, the OCA literature has been adjusted in light of the experience in the EU. The choice to join EMU is no longer one in which prospective partners can renegotiate the terms; they will join the existing union. The markets know these countries will join one day and the euro area is already a reality. This recent literature suggests that even if, at first, countries may not fit the criteria prescribed by OCA theory, they will soon adjust and converge. According to this endogenous OCA theory (that effectively revises the original OCA theory), joining EMU sooner rather than later would be deemed more beneficial than first considered in the original OCA (Frankel and Rose, 1998; Mongelli, 2005). This literature offers renewed insights into the costs and benefits of giving up the exchange rate instrument. It discusses the factors needed to ensure the adjustment mechanisms are in place once the exchange rate instrument and monetary policy become unavailable to national governments (see De Grauwe, 2006a).

An edited volume by Schadler (2005) looks explicitly at the concrete question of euro adoption and finds that, in the long run, NMS will all benefit from joining the euro. The question then becomes, under what conditions will they join the euro sooner rather than later? Schadler, Drummond, Kuijs, Murgasova, and van Elkan (2005) specify five conditions for a successful euro area accession. First, the deficit and debt must be low (debt should not be “higher than 40-50 per cent of GDP”); second, fiscal policy, wages and price flexibility should be able to absorb shocks (“wage and price flexibility must be protected where strong and enhanced where weak”); third, all activities of the NMS should be synchronized with the euro area; fourth, “financial market supervision must be

strong”; and fifth, NMS should have a high level of competitiveness prior to joining EMU and this “must be reflected first in the ERM2” (Schadler *et al.*, 2005: 5-6).

Some scholars examine the cost of transition as a country might incur major costs if it is not well prepared to join a monetary union (Lipschutz, Lane and Mourmouras, 2005). Frankel (2005) argues if countries still suffer from asymmetric shocks, they should not yet join EMU. But Frankel (2005) then goes on to examine asymmetric shocks and finds that they are not likely to happen as frequently in the contemporary European context. Frankel concludes that the gains of joining the euro are substantial. Moreover, there are policies that can be pursued to counterbalance the fall-out of a rare country-specific shock. Not everyone agrees with Frankel’s conclusion. Thimann (2005) believes that countries would need to be judged on a case-by-case basis to see if the economic conditions are right for countries to join the euro.

De Grauwe and Schnabl (2005) examine the extent to which the exchange rate is an instrument that could assist countries to deal with stabilization. They find that, contrary to what had been conceptualized during the early OCA literature, in the current global financial context, with more integrated and small open economies, having an exchange rate separate from the larger area may actually be a source of shock. In such cases, the loss of the exchange rate might be a benefit. Buiters (2000a) has been a skeptic of the view that “exchange rate flexibility [can serve] as an effective buffer for adjusting to asymmetric shocks originating elsewhere” (Buiters, 2000a: 1). Buiters argues that there is “no evidence that supports such an optimistic reading of what exchange rate flexibility can deliver under conditions of very high international financial capital mobility” (Buiters, 2000a: 1). This optimism and “virtues of exchange rate flexibility, only makes sense in a

world with very limited international financial capital mobility” (Buiter, 2000b: 234).

Eichengreen (2012) argues that OCA theory has shown that EMU will not function easily due to variety of reasons such as the effects of language and cultural barriers on labor mobility; underdeveloped EU fiscal federalism; small EU budget focusing on agriculture and infrastructure, etc. (Eichengreen, 2012: 133).

Even if there are some short-term costs when the conditions are not exactly right, according to Viñals (2005) there are factors that can offset these problems. An example of such a factor would be policies to improve research and development in order to increase the competitiveness of the economy and the financial sector performance to make it more resilient.

2.1.1 Costs and Benefits of EMU

Although there are both costs and benefits, the degree to which a country benefits or loses from adopting the euro varies.²⁵ The variation in the costs and benefits is due to the diversity in the EU members’ domestic environment. The EU members do not have the same economic features and they do not form “a homogeneous economic area” (Gros and Thygesen, 1998: 300). Countries have different trade structures, legal and fiscal systems, growth, unemployment rates, institutions, and so on (see De Grauwe, 2006b: 13-23). In what follows, I discuss the costs and benefits of adopting the euro prior to the 2008-2009 financial crisis and the sovereign debt crisis.

²⁵ Many scholars have tried to test empirically the costs and benefits of EMU as well as test which countries are more ready to join and which will benefit more (Bayoumi and Eichengreen, 1993a, 1993b; Artis and Zhang, 1996, 1997a, 1997b; Bergman, 1996; Bergman, Hutchison and Cheung, 1997; etc.).

2.1.1.1 The Costs of EMU

One of the obvious costs of joining the final stage of EMU is forfeiting the ability to change the exchange rate as needed. A second cost is that countries lose one of the major monetary policy instruments and will not be able to pursue an independent monetary policy (Eichengreen, 1992; De Grauwe, 1997, 2006b; Bergman and Hutchison, 1998; Eudey, 1998; Gros and Thygesen, 1998). In EMU, NCBs lose their ability to control monetary policy and will not be able to adjust their interest rates independently. Each member of a common currency (such as EMU) has one vote among the governing members in the ECB (Protocol on the Statute of the European System of Central Banks and of the European Central Bank, Article 10). Therefore, monetary union members cannot use the currency devaluation or revaluation tool whenever they deem it necessary to face some economic or financial turbulence such as the case of Greece in 2010 and 2011²⁶ followed by Ireland,²⁷ Portugal²⁸ and to a lesser extent Spain and Italy. Such crisis

²⁶ Bad financing and corruption characterized the financial policy-making in Greece. Spending in Greece has been way beyond the available means and for the consecutive Greek governments to finance the deficit and debt. Following euro adoption, the Greek government benefitted from low interest rates to borrow money (for a comprehensive study of the impact of euro adoption on Greece's access to capital at competitive rates, see Jones, 2003). This increased borrowing left Greece more indebted, exposed to international markets and left Greece vulnerable to confidence of international investors (Nelson, Belkin and Mix, 2010). These investors became irritated when the new government formed by Panhellenic Socialist Movement Party (PASOK) in fall 2009 showed a huge difference in the deficit (more than double the deficit announced by the previous government: 12.7 per cent of GDP) in the new budget in comparison to the previous number announced by the former government. The deficit announced by the PASOK government was different by almost 1 per cent from the data shown by the European Commission (13.6 per cent of GDP) (*Financial Times*, April 23, 2010). As for the public debt, according to the Eurostat indicators, it was 126.8 per cent of GDP in 2009 (Eurostat News Release, 170/2010) and is expected to increase. The Greek government took several measures to deal with its debt problem such as the stability program aiming at cutting the budget gap to 2.8 per cent of GDP in 2012, cuts in the public sector wages, tax increases, etc. All these measures were not enough and the euro members had to do something in order to help Greece and not allow the crisis to spread into other euro members. On May 2, 2010, Euro finance

pushed other EMU members (mainly Germany and France) and the IMF to create bailout plans for those countries so they could face the high deficit and debt problems.

For example, if Greece still had the drachma (its currency prior to joining the euro area), it would have had the exchange rate instrument to tackle its problems. Under financially difficult circumstances there would be a downward pressure on the exchange rate that would have depreciated. With the lower exchange rate Greek goods and services would be cheaper vis-à-vis others. The result would likely be Greece could have increased the exports but because of higher prices, the quantity of imports would have come down. This mechanism would have assisted Greece with its current financial problems.²⁹ Another option is that the National Bank of Greece could have printed more drachmas and bought some government debt. This step “might lead to inflation (although even that is doubtful when the economy is depressed), but inflation poses a much smaller threat to investors than outright default” (Krugman, *The New York Times*, online edition, September 11, 2011).³⁰ However, since Greece does not have these tools in hand anymore, the Greek government can only raise taxes and reduce spending, while the population has to suffer from a period of high unemployment (Feldstein, 2010).

ministers and the IMF agreed to Euro 107 billion-bailout for Greece (although originally it was Euro 110 billion “but Slovakia refused to participate and Ireland and Portugal ceased to contribute when they, too, were bailed out” (*The Economist*, online edition, October 26, 2011). Greece since Greece needed another bailout in July 2011 (Euro 109 billion). The second package “was tied to banks and other private institutions agreeing to take a modest hit on their lending to Greece in what was euphemistically called ‘private-sector involvement’ (PSI)” (*The Economist*, online edition, October 26, 2011). Moreover, there was an agreement to increase the lending capacity of the European Financial Stability Facility (EFSF) (this fund is to maintain financial stability in the euro area and to help any euro member facing financial difficulty), and “to give it a freer hand to protect other vulnerable economies, in particular Italy but also Spain” (*The Economist*, online edition, October 26, 2011).

²⁷ On November 28, 2010, the EU agreed on € 85 billion bailout loan for Ireland.

²⁸ On May 16, 2011, euro zone leaders agreed on € 78 billion bailout loan for Portugal.

²⁹ Feldstein (2010) estimates that a devaluation might allow Greece to reduce its deficit by 15 per cent, lower its unemployment rate and might increase growth. We have to keep in mind though that the problem with devaluation is that it may be more difficult and expensive to attract funding in capital markets.

³⁰ Krugman (September 11, 2011) uses the English case and the Bank of England as an example.

In case of labor immobility, and wage and price rigidities, there might be an adjustment problem caused by a shift in public demands and choices. The shift in demand creates disequilibrium among the common currency members leading to inflation in one country and increased unemployment in another country.³¹ Therefore, wage flexibility and/or labor mobility have to exist to face the asymmetric shocks caused, for example, from the change of the citizens' choices towards exported goods rather than domestic ones (Eichengreen, 1992: 12). In cases where countries are still outside the monetary union, they have several demand adjustment tools within their monetary policy to alleviate problems resulting from the asymmetric shocks (De Grauwe, 2006b: 5-9).³²

We have to keep in mind that wage flexibility and labor mobility are not the only instruments used by governments to face asymmetric shocks. Other mechanisms are in place such as “transfer payments”, which send funds to countries faced with these shocks. However, it is not really clear how to organize these transfers. Furthermore, it is unclear whether the asymmetric shocks will be permanent as a result of a change in consumers' preference away from Italian and French products towards goods from other countries such as Germany for example (De Grauwe, 2006b: 9-10).

Another challenge of introducing a common currency is that the EU member states have many differences. They have different preferences regarding inflation and unemployment; have different labor market institutions; have different fiscal and legal systems; and their growth rates vary (De Grauwe, 2006b: 13-23).

³¹ There are several channels to face the increase in unemployment: “(1) domestic wage and price adjustments, (2) interregional migration, (3) interregional flows of private and public capital, and (4) interregional fiscal transfers” (Eichengreen, 1992: 16; see also Bayoumi and Eichengreen, 1993b).

³² According to Eichengreen, “[p]olicymakers can devalue the national currency to enhance the competitiveness of domestic goods on international markets and they can initiate expansionary policies to stimulate domestic spending” (Eichengreen, 1992: 16).

2.1.1.2 The Benefits of EMU

While the costs of a common currency are situated in “the *macroeconomic* management of the economy”, the benefits are located “at the *microeconomic* level” (De Grauwe, 2006b: 65). The most obvious gain from having a common currency is the elimination of transaction costs. The elimination of transaction costs offers direct and indirect gains and helps fulfilling one of the aims of uniting Europe since it strengthens and deepens European integration. These gains are based on the OCA premise that assumes that the degree of openness among members of a common currency increases. This increased openness among EMU members will push their economies to be more alike (European Commission, 2008c: 208; see Frankel and Rose, 1998; De Grauwe and Mongelli, 2005; De Grauwe, 2006b; and Mongelli, 2008). Prices and costs will be more transparent and this will lead to more competition (European Commission, 2008c: 210).

The exchange rates, which might be a shock generator, are expected to vanish once a country joins a monetary union (see Eichengreen, 2003; Gros and Hobza, 2003; Borghijs and Kuijs, 2004; Darvas and Szapáry, 2008). That is why in the case of the NMS, some scholars (such as Buitert and Sibert, 2006) have been in favor of an early euro adoption in order to eliminate the shocks that might be caused by the exchange rates.

There is an agreement among various studies (Rose, 2000; Frankel and Rose, 2002; Micco, Stein and Ordóñez, 2003; Faruqee, 2004; Boeri, 2005; Maliszewska, 2006; etc.) that countries joining EMU benefit from increased trade. However, they disagree on the exact size of the gains. Some are more optimistic than others, expecting trade among

members of a common currency to triple (Schadler *et al.*, 2005: 12; see also Rose, 2000; and Frankel and Rose, 2002). Faruqee (2004) finds that, when compared to trade relations with other developed countries, EMU has increased the intra-trade among currency members by approximately 10 per cent (cited in Schadler *et al.*, 2005: 15). But how much do the NMS—with a long history of central planning and no variety in production—benefit? NMS' benefits depend on the degree of economic convergence with the euro area and how favorable the environment for investments and opening new businesses. Such a business climate would help close the variety gap and increase the profits from trade after the elimination of the transaction costs (Boeri, 2005: 92).

According to the European Commission, adopting the euro creates a favorable low risk environment for foreign direct investment (FDI) with a stable currency and suitable market for investment. Adopting the euro not only leads to a “relatively stable way to finance domestic saving-investment gaps (thus enabling a reduction of risks related to current account imbalances, a common feature among catching-up member states), but also generates technology and knowledge transfer, thereby raising productivity and potential growth” (European Commission, 2008c: 209).³³ This stability, technology and knowledge transfer lead to an increase in job creation and employment. Countries that quickly adopt the euro are expected to benefit more from FDI than others. However, this increase in FDI is highly contingent on the macroeconomic stability in those countries—Greece for example did not attract much FDI compared to Portugal or Spain following euro adoption (Boeri, 2005: 92).³⁴

³³ We should not overestimate the point regarding the increase in FDI since FDI have been flowing in large amounts once those members joined the EU—even though they are still outside the euro area.

³⁴ Portugal and Spain adopted the euro in 1999 while Greece in 2001.

Some studies (Adjaouté *et al.*, 2000; Adjaouté and Danthine, 2001; Adam *et al.*, 2002) have found that the euro strengthens financial integration among EMU members. The strengthening of financial integration is the result of “the removal of a number of assets-liability currency matching requirements for institutional investors such as pension funds and insurance companies: with a single currency, such regulations automatically ceased to constrain institutional investors” (Bottazzi and Giavazzi, 2005: 110-111). However, one has to be careful drawing inferences from those optimistic assessments of the NMS since those studies are based on the old EMU members (for example, Adjaouté *et al.* (2000) findings are based on France and Germany). Moreover, the financial systems in the NMS are not only different from the EU-15³⁵ but also less developed and lack efficiency (see Cērpis, 2005).³⁶

Another benefit from adopting the euro is that it secures “a clear framework for macroeconomic policy discipline” (Schadler *et al.*, 2005: 17). The benefits “from joining the monetary union will be large, if it was accompanied by a “significant degree of macroeconomic stabilization” (De Grauwe and Schnabl, 2004: 3). The independent ECB is expected to enhance monetary credibility and deliver “durably low inflation for the EMU area” leading to lower interest rates—this will be helpful especially for countries that had high unstable inflation rates (Curie, 1997: 6-7). These benefits are debatable and not as clear as the benefits resulting from trade among EMU members (Frankel and Rose: 2002; also Schadler *et al.*, 2005). Eichengreen and Ghironi (2001) question the ability of the ECB to maintain monetary and financial stability in an enlarged euro area. With more members, the ECB will be under more pressure “to strengthen procedures for mutual

³⁵ Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

³⁶ There are some exceptions such as the Baltic states which have more advanced financial systems.

surveillance of national fiscal policies and to coordinate the supervision and regulation of financial institutions at the EU level” (Eichengreen and Ghironi, 2001: 37).

Overall, joining EMU will likely lead to lower transaction costs and increase trade, which will have clear benefits over a long time frame. Being part of EMU increases FDI, causing technological development, job creation and labor mobility. It strengthens financial integration, lowers financial risks and secures a “strong framework for policy discipline” (Schadler *et al.*, 2005: 17). However, how much do countries actually gain from joining EMU? The answer is an open ended one since the gains differ across countries and regions within the EU. As mentioned earlier, EU members have legal, institutional and policy differences especially when it comes to the NMS. It is important to differentiate between the small NMS (such as the Baltics) and large NMS such as (the Czech Republic, Hungary, Poland and Romania) when discussing the short-term cost-benefit analysis. While the short-term economic cost-benefit analysis is uncertain in the case of larger states, it is less so in the smaller states whose benefits from euro adoption more easily outweigh the costs—which has the potential to push the smaller states towards the pacesetters camp while the larger NMS can more easily remain in the laggard camp.³⁷ However, decision-makers in the larger NMS, who think in terms of electoral cycles and care about the short-term political gains, view euro adoption in the short run as irrational since it might cost them the elections.

As we have seen, economists view euro adoption as one in which the NMS decide when and under what circumstances they will have the conditions in place so they can join the last stage of EMU. None of these works examine, analyze or indeed predict

³⁷ With the financial crisis of 2008-2009 followed by the sovereign debt crisis, the argument that costs outweigh the benefits and that EMU is not an OCA has been gaining further strength.

how we can understand the political process of euro adoption, nor do they offer insights into what factors within the country (other than macroeconomic factors) may lead to a country choosing to adopt the euro quickly or slowly. Moreover, if the economic-cost benefit analysis is more helpful in explaining why smaller NMS rush towards adopting the euro (Baltic States, Slovenia and Slovakia joined ERM-2 soon after EU accession),³⁸ but falls short in explaining why the larger NMS would or would not adopt the euro. This analysis shows that when dealing with large states (such as the Czech Republic, Hungary and Poland), the doors are left opened to the domestic politicians (governments and presidents) to interpret the cost-benefit analysis in accordance to their stance on the entire euro project.

Even if a country meets the convergence criteria, this should not lead us to conclude that this country will join EMU eventually. Some countries, such as the Czech Republic, have been close to meeting the criteria. Others, like Sweden, have met the criteria. Yet neither the Czech Republic nor Sweden is a euro area member. So meeting the criteria does not necessarily mean euro adoption is inevitable. Even if the overall consensus supports euro adoption, its implementation is contingent on economic convergence and the presence of necessary policies to address possible challenges. The economic literature tends to ignore the domestic political situation and the rational calculations of the elites. The process of euro adoption and the policies implemented by the NMS to facilitate euro adoption are generally overlooked by the literature. Therefore, it is important to discuss the political science literature regarding euro adoption.

³⁸ Estonia, Lithuania and Slovenia joined ERM-2 on June 28, 2004, Latvia joined on May 2, 2005 and Slovakia joined on November 28, 2005.

2.2 Peeling the Political Science Onion

Since the end of the Cold War, the literature on economic policy decisions in CEECs has focused on the political and economic transition of these countries. The literature revealed a trend of institutional development that has taken place not only as a result of European integration and international incentives but also due to ongoing social learning. The EU played a crucial role in domestic political transition of the post-communist countries by giving them significant incentives throughout the accession process. These EU incentives encouraged the domestic political actors to implement reforms towards meeting the Copenhagen criteria regarding democracy, human rights and the rule of law (Vachudova, 2008: 32).

Consistent with the EU demands and in their move towards a market economy, CEECs did not have much choice except taking what the EU, other Western countries and international organizations offered them. Therefore, CEECs copied the Western economic policies, rules and institutions. One of the main results was the creation of independent central banks (see Johnson, 2002, 2006; Epstein, 2006). Some countries, such as Poland, had to reform their already existing central banks and amend their statutes. Other countries, such as the newly independent countries in the Baltic, had to create new central banks.

The learning process was not only vertical from the EU to member states but also horizontal among the various EU member states (mainly from euro area and ERM-2 members), other Western countries and international organizations. Ideas and beliefs have been transferring from one country to another affecting not only the decision-

making but also think tanks and the emerging epistemic communities (Haas, 1992)³⁹ in the region. Knowing what kind of communities evolved in each CEEC and understanding how each was involved in the transformation of post communist central banks, monetary and financial systems is important. One of the communities created included “central banks in advanced industrial democracies [...] and the departments responsible for working with central banks within the international financial institutions (e.g. the IMF’s Monetary and Exchange Affairs Department)” (Johnson, 2006: 365; see also Johnson, 2002). This central bankers’ community represents an epistemic community “with a high degree of readiness to engage in cross-national policy coordination (cf. Haas 1992)” (Dyson, 2010: 19; see also Dyson *et al.*, 1995; Verdun 1999; Marcussen, 2000; Johnson, 2002, 2006; Andrews, 2003; Kaelberer, 2003, etc.). The central bankers’ community pushed EU members towards giving up one of the main governance tools in nation states—their national currencies (McNamara, 2004: 9).⁴⁰

One of the main beliefs transferred to the CEECs and one that had a major effect on central banks was that “protecting price stability and central bank independence is the key to economic development in democratic states” (Johnson, 2006: 363). The creation of independent central banks was the result of continuous effort of the EU, European institutions (European Bank for Reconstruction and Development (ERBD), European Investment Bank (EIB)). Other national central banks (NCBs) (such as the Bundesbank, the Bank of England, Banque de France, the Federal Reserve), also international

³⁹ Haas’ concept “epistemic communities” was developed to show how “a network of professionals with recognized expertise and competence in a particular domain” plays a crucial role in policy-making (3). Epistemic communities are “channels through which new ideas circulate from societies to governments as well as from country to country” (Haas, 1992: 7).

⁴⁰ This loss of the independent monetary policy affects one of the main pillars of sovereignty. National currencies are considered among the “main components of statebuilding that provide states with powerful tools for governance” (McNamara, 2004: 9).

institutions (such as the IMF, the World Bank and the Bank for International Settlements (BIS)) were involved in the creation of independent central banks and the entire learning process (Johnson, 2002, 2003, 2006).⁴¹

The transfer of ideas, technical assistance and socialization process led to privatization and economic and institutional development that aimed to transform those countries into capital-market economic systems. This technical assistance that focused on central banking aimed at giving the CEECs the necessary tools “to enable them to formulate and implement the effective monetary and exchange policies that are necessary to stabilize their economies and move them to a path of sustainable growth. This objective necessitates reform of the legal and financial systems of these countries, including the establishment of central banks appropriately equipped to function in a market economy” (Zulu, McCarthy and Almuña, 1994: 3).

One aspect of the learning process with respect to euro adoption is to prepare central bankers to be ready to move from a system based on an independent central bank to one in which the NCB is part of the European System of Central Banks (ESCB). The move from independent central banks to being part of the ESCB is simply a logical step (Dyson and Marcussen, 2009). The politically independent ESCB ensures stability and will not be influenced by the member states’ governments. In the case of the NMS, joining ESCB is crucial since these countries either did not have central banks prior to

⁴¹ For an overview of the early reform period and the role of international financial institutions, see Zecchini (1995) who argues that these financial institutions have served three main objectives “in addition to their institutional financial task. They have catalyzed financial support from other resources; they have embodied the most pervasive form of economic conditionality [...]; and they have supplied critical expertise to help neophyte countries in the field of market economics” (Zecchini, 1995: 116-117).

1989 or had highly political and corrupt central banks during communism.⁴² However, this logic of preparing central bankers for EMU is important and necessary but not sufficient for euro adoption.

Political scientists also view EMU through the lens of Europeanization. The Europeanization process is considered to be incremental aiming at “reorienting the direction and shape of politics to the degree that EC political and economic dynamics become part of the organizational logic of national politics and policy-making” (Ladrech, 1994: 69). Those who look at it through this lens study how it affects the national “policies, politics, and public institutions” in member states (Dyson, 2006). In a pioneering book on euro adoption in CEECs edited by Dyson (2006), the authors suggest that the best way to understand EMU’s domestic influence is through a “defining and negotiating fit” framework, which has a “multilevel context”: international, European and domestic. Joining EMU is considered to be a “strategic” and “cognitive” procedure (Dyson, 2006: 2). Dyson distinguishes three main aspects of his defining and negotiating fit argument: power asymmetry between the NMS, European Commission and the ECB; developing an “economic paradigm of ‘sound money and finance’ whose guardian is the ECB”; and a growing “structural and psychological” interdependence between the NMS and the larger EU—in which the NMS strengthen the ties with the EU (Dyson, 2006: 10).

In an attempt to study the reasons and bases of conversion in the NMS, *Enlarging the Euro Area* views Europeanization through various lenses. The first part places EMU in a wider global and regional framework. It analyzes the 1990s’ “global economic governance paradigm” shift toward open trade and capital mobility; and how this affected

⁴² Although CEECs created or reformed their central banks to be independent but the experience these countries have is still not enough. In addition, the interference of the governments in the monetary board of the central banks and the monetary policies still exists, as we will see later.

the choices of the NMS regarding “negotiating fit” with EMU accession (Rollo, 2006: 47). It also addresses the issue of when member states should join EMU based on the debates on fast accession (for or against), the NMS environment and their degree of readiness. The focus here is on the importance of timing as an essential element of negotiating fit (Begg, 2006). Begg emphasizes the need for a market structural adjustment in the NMS and the importance of the cost/benefit calculations of adopting the euro. The growing economic dependence between the NMS and the rest of the EU members should push more towards EMU expansion—keeping in mind the problems and risks of that and not confusing EMU expansion “with complacency” (Begg, 2006: 91-92).

Although explicitly dealing with EMU and CEECs, Dyson’s study does not offer an understanding of how the domestic political environment influences the decisions taken regarding euro adoption. One of the main conclusions of this study is that states with small and open economies are working harder to join than larger states. One of the reasons for joining is having an influence and a vote in the ESCB—which will give them more influential role compared to their economic size. This is an important conclusion, however, it dismisses other factors that are crucial, as we will see later. Some scholars, such as Zubek (2006, 2008) and Greskovits (2008), highlighted some of the domestic issues and how they affect the road to EMU; however, the focus was mostly on the role of central bankers, finance ministers and other internal conflicts from Europeanization perspective.

Dyson and Marcussen (2009) concentrate on the role of euro creation in the transformation of the central banks, their function, structure and the way they deal with the EU demands and the domestic politics and policies. Some countries did go through

fast transformation but have not shown enthusiasm regarding euro adoption such as the Czech Republic and Poland. This is partly because of the failure of Europeanization in pushing these countries towards working hard to meet the convergence criteria (Epstein and Johnson, 2009). Epstein and Johnson argue that the reasons for lagging behind regarding central bank independence are because of the “uncertainty of the domestic actors and the credibility of international institutions’ policy prescriptions” (Epstein and Johnson, 2009: 221).⁴³ Epstein and Johnson (2010) compare central bank independence and euro adoption in the Czech Republic, Poland, Romania and Slovakia. They argue that institutionalization of central bank independence and price stability was a result “of domestic discontinuity and the credibility of international institutions’ advice and prescriptions. With the euro, however, the situation was reversed” (Epstein and Johnson, 2010: 1249). With the low international credibility of the euro because “international actors not only gave inconsistent policy advice regarding the euro, but their own actions and those of the ‘old 15’ undermined the attractiveness of the euro area” (Epstein and Johnson, 2010: 1249), which strengthened the role of the domestic political dynamics in determining when to adopt the euro (Johnson and Epstein, 2010). Greskovits (2009) highlights the compatibility of adopting an independent central bank model with the domestic tasks of securing monetary stability and nation building. In both cases, the focus has been on the central banks’ functions, structures and interactions with their environment.

Finally, Risse *et al.* (1999) have made an influential contribution to the general understanding of how euro adoption might be connected to a sense of national collective identity. Again, however, it is not clear how these insights might be able to explain why

⁴³ Some of these prescriptions are price stability, central banks’ independence, inflation criteria, etc.

euro adoption policies wax and wane, and why some governments are more or less devoted to euro adoption.

Thus, the argument is that one cannot understand euro adoption strategies by focusing narrowly on one actor, such as the central bank, since various domestic players are involved. Most of these studies do not address important domestic factors that might influence the policy-making process since they analyze the issue from a different angle than I do in this thesis. For example, there is no thorough discussion of the political situation of countries, such as: which is the ruling party in the country, what is its ideology, does the country have a two party or multi party system, how stable are the coalition governments, and what is the relation between the government and the central bank on one hand and the government and the opposition on the other. This political situation affects the fiscal and monetary performance and financial institutions in CEECs, which in turn influence meeting the convergence criteria and adopting the euro.

Although these studies provide a useful analysis of the general conditions under which euro adoption might flourish, I find the explanatory factors examined are unable to explain the specific government policies, the success of those policies, and thus answer why some countries adopted the euro while others did not. The Europeanization literature has been crucial for a deeper understanding of the developments in NMS in the period between the end of the Cold War and EU accession in 2004. However, since NMS joined the EU, the framework offered by the Europeanization literature is not fully satisfactory as a framework for analysis to understand euro adoption policies. It offers some insight into broad trends, but is unable to explain timing. This brings us to the discussion of the domestic politics approach and the theoretical framework used for this study.

2.3 Euro Adoption Strategies from a Domestic Angle

Only a few studies have tried to understand euro adoption from the member states' position by studying the domestic environment, actors and institutions involved in policy-making (e.g. Dyson, 2006; Feldmann, 2006, 2008; Greskovits, 2006, 2008, 2009; Johnson, 2006; Zubek, 2006, 2008; Epstein and Johnson, 2009; 2010). This thesis seeks to add to that small body of literature. In order to understand states' preferences, we cannot only rely on the available economic or political science theories to explain the intricate differences in the *timing* or indeed *speed* of euro adoption in the NMS. In fact with those economic and political science theories, we cannot even fully understand why countries decide to delay euro adoption.

Therefore, to grasp the specific domestic political processes that determine the speed and the timing of euro adoption we need to borrow from those who have developed a domestic politics approach (cf Huelshoff, 1994; Ladrech, 1994). Domestic politics falls within the comparative politics and political economy traditions. Katzenstein emphasized the importance of the domestic structure and environment in his argument that “domestic structure of the nation-state is a critical intervening variable without which the interrelation between international interdependence and political strategies cannot be understood” (Katzenstein, 1977: 587).

Within the EU literature, I am not the first to point to the importance of the domestic setting, domestic institutions, political parties, domestic actors and attitudes in explaining European integration and EMU creation (Sandholtz, 1993a; Dyson and

Featherstone, 1996, 1999; Jones, Frieden and Torres, 1998; Verdun, 2000; Hallerberg, 2004a, 2004b; Heipertz and Verdun, 2010) and more generally decision-making at the EC level (Wallace, Wallace and Webb, 1977; Bulmer, 1983).⁴⁴ Yet, many of these authors were writing before eastern enlargement and understandably did not address the question of how to understand the divergence in outcome in euro adoption process among NMS. Scholars who adopt a domestic politics approach not only emphasize the importance of the various domestic actors but also the institutions at the national level since they influence the positions of the governments.

Dyson and Featherstone highlight three main institutional arrangements: the constitution and how it influences the way ““core executive’ politics was played”; how independent is the central bank and its institutional strength; and the role of the Ministry of Finance (MoF), its organization and operation (Dyson and Featherstone, 1999: 25). Differences among the NMS might help us understand why some countries adopted the euro while others did not. EU members do not share the same socioeconomic circumstances that makeup “national interests and policy content. Each state has different ideological cleavages which determine the extent of consensus [...] policy instruments differ as does the extent of centralization in the state” (Bulmer, 1983: 354). The diversity among CEECs results in countries having different interests leading to different strategies not only domestically but also internationally.

Huelshoff emphasized the importance of the “mode of policy making, and the strength of the government” in understanding the positions of the states regarding European integration (Huelshoff, 1994: 262). Unlike a minority government, a majority government has more weight and a stronger position for negotiating and taking decisions

⁴⁴ For an overview of the literature see Sadeh and Verdun (2009).

not only domestically but also at the EU level. Holding referenda⁴⁵ regarding any European decision, agreement or treaty strengthens the position of the government in negotiations at the EU level and gives more legitimacy to the government's policies and decisions.⁴⁶ Elections, election campaigns and programs in addition to the election results affect negotiations in the EU (see Heipertz and Verdun, 2010). The winning party or president already made promises during the election campaign and will try to keep them so that he/she does not end up losing elections in the next term. A euroskeptic government may not support the euro project and will try to stay outside by negotiating an opt-out for example (such as the conservative government in the UK). In other cases, such as Denmark for example, the government was not euroskeptic, however, for various domestic reasons the Danish government negotiated an opt-out.⁴⁷ Therefore, each EU member makes sure that policies taken are as close as possible to the national interests.⁴⁸

To understand the decision-making strategies, one has to emphasize the importance of the domestic environment and the structure and activities of the state and its institutions (Huelshoff, 1994). This "policy environment" not only differs across countries but even within the same country depending on the kind of policy involved

⁴⁵ A referendum can be held in three occasions: First if the constitution requires that (Switzerland); second, if the government wants to involve the public in some important decisions and gain more legitimacy on these decisions; and third, if there is a huge division and controversy regarding some decisions, then the referendum will be a way for settlement (Luthardt, 1993: 55). In all cases, the referendum strengthens the government's negotiation position both domestically and internationally.

⁴⁶ The referenda held at different EU countries (such as France) regarding the constitutional treaty (now Lisbon Treaty) led to some key changes in the Treaty and resulted in postponing its entering into force date until the end of 2009.

⁴⁷ On June 2, 1992, a referendum on the Maastricht Treaty, was held in Denmark. 49.3 per cent said yes while 50.7 per cent said no. The reasons for that are several; among them are the disagreement among the political parties regarding the foreign security and defense policy, social dimension and the single currency (Siune and Svensson, 1993: 102-103).

⁴⁸ On this point, my argument differs from Sandholtz who emphasizes, "those national interests are defined in the context of the EC" (Sandholtz, 1993a: 3). Being part of the EC (now the EU) is present in the cost/benefits calculations of the governments and the various actors involved in agenda setting and policy-making (Sandholtz, 1993a). I believe member states' interests are more autonomous and give priority to the domestic needs.

(Bulmer, 1983: 353). Bulmer studies the causal relationship between domestic politics and decision-making at the EC level. He believes that domestic politics has a great influence on the bargaining and decisions taken at the EC level. The focus here is directed mainly towards the “domestic policy-making *structures* which are involved; the other concerns the *attitudes* held within the member states regarding the EC” (Bulmer, 1983: 350). Using domestic politics is not only useful for specific cases, rather it can be helpful in understanding the different attitudes of the member states in the EC negotiations and decisions and “to examining the continuing sensitivities of individual member states towards Community activity” (Bulmer, 1983: 351). Therefore, the discussions among the various players involved in the domestic level decision-making reflect the outcomes of negotiations at the EC level. This influences not only the debates on certain policies but the entire integration project (Bulmer, 1983: 358).

Electoral cycles, domestic institutions and formations, opposition and the public affect governments’ decisions and their agendas. Consequently, this influences the bargaining position and decisions of the governments to secure their electorates’ interest at the EU level. At the same time, governments can use the EU in order to implement certain policies and influence the domestic environment (Heipertz and Verdun, 2010: 42). The key point here is that in Western democracies, governments represent their electorates and therefore, they would normally avoid unpopular decisions if it meant losing the next election. Therefore, when decision-makers enter into negotiations at a higher level (whether European or International), they only support the agreements that “satisfy domestic pressures, while minimizing the adverse consequences of foreign developments” (Putnam, 1988: 434). In order to understand the negotiations and

agreements at European or international level and the positions of the various states involved, one has to look at the domestic environment and the various actors and institutions. Thus, agreements at the EU level can be viewed as mirrors of the domestic negotiations and promises between decision-makers and other influential groups and institutions.⁴⁹

Following this discussion, the rest of the thesis focuses on five main domestic factors and institutions and how they interact with each other: government, opposition, central bank, the public and the media. The ideology of the government is important since it affects the decision-making process. Governments usually tend to implement policies that reflect the will of the electorates—especially during an election year. Pressure from opposition or interest groups shape the governments' policies both domestically and internationally. Domestic partisan politics influence discussions and decisions at the European level (see Lohmann, 1993). The policies implemented in that sense will be directed towards pleasing the citizens and guaranteeing that the current government stays in power following an upcoming election. In case the citizens' choices shift towards favoring the euro, then this government may adjust its policies to meet the new demands. The main hypothesis here is that *governments take upcoming elections into consideration and implement policies that guarantee their victory and keep them in power. Therefore, if euro adoption brings victory, governments adjust euro adoption strategies accordingly.* In some situations where there is neither public demand nor pressure from the opposition regarding euro adoption, governments do not even include the issue of euro adoption in their programs and the focus is on other economic and financial issues that concern the wellbeing of the citizens. Another hypothesis that I examine while discussing these cases

⁴⁹ These groups and institutions vary in accordance to the policy involved.

is: *the role of the opposition is crucial in influencing the government's policies and negotiations regarding euro adoption.* The degree of domestic competition between the government and the opposition “affects the benefits and sustainability of international cooperation” (Lohmann, 1993: 1390). This competition between the government and the opposition is usually to influence the public opinion and push the public against (or in favor of) certain policies. Certain crucial decisions, such as joining ERM-2 and adopting the euro, require a vote in the parliament or a constitutional amendment that needs the positive vote of both the ruling party and the opposition. This situation pushes the government to bargain and negotiate with the opposition to guarantee that some policies will be implemented. In many cases the government might end up in a deadlock in which it cannot pass some important proposals—causing a decline in its popularity. In other cases, the opposition will put a list of impossible conditions that the government has to fulfill before supporting a government's decision (as we will see in Poland).

One of the institutions that has gone through major reforms and is important for euro adoption is the central bank. The role of the newly independent central banks, which have a goal to guarantee price stability, is important when discussing monetary policy because they influence the economic policy of the government. Central banks affect the public opinion regarding government economic policies due to their objectivity and independence from party politics and power games.⁵⁰ Another hypothesis that I test is that *it is impossible to understand euro adoption strategies, without understanding the role played by the central banks and their relationship with the government.* A good and harmonious relationship (based on shared position regarding euro adoption, coordination

⁵⁰ As we will see later, this independence can be twisted sometimes through appointments of some members to the monetary council that share the views of the ruling party (case of the Czech Republic).

and cooperation) between the central bank and the government helps to stabilize the economy and speed up the reforms. However, a good relationship between the government and central bank is a necessary but not a sufficient condition for euro adoption. Both might not be in favor of euro adoption and/or think it is not in the interest of the country to adopt the euro and decide to put it on hold temporarily since they know they do not have an official opt-out. Even if there are good relations, and a positive stance regarding euro adoption, there may be other influential factors at stake (financial difficulties, no public support, etc.).

My hypothesis regarding the media is that its *role with respect to euro adoption and influencing the public is inconsistent*. When the country witnesses sharp appreciation, the media's coverage and emphasis on the euro increases but often when the issue subsides, coverage returns to its normal trend, which is low or no coverage of the euro at all. In some cases, the media coverage of the euro depends on the policy of the broadcasting channel—if it is a supporter of the ruling party or the opposition. This portrays opposite signals to the public and increases the public's confusion. This confusion can divert attention from euro adoption to more relevant public concerns during election campaigns.

The involvement of public opinion is also emphasized in this thesis. Since adopting the euro affects the entire economic and political situation of the country, then any policy that influences both (euro adoption and the economy) has to be of an interest to the public. The government and opposition's interest in attracting the public towards their plans and policies reaches its peak during what Lohmann (1993) calls "election

cycles”. When elections are nearby, both the opposition and the government compete to attract the voters.

The study focuses on public opinion to the degree it influences the various actors’ position regarding euro adoption. Does the public choose based on values and preferences; and is their position on the euro “cued by political partisanship and attitudes toward the domestic political system” (Allam and Goerres, 2008: 7) (political explanations), or is it because of their personal cost/benefit calculations resulting from euro accession (economic explanation) or are the choices related to national identity and the strength of the national currency and its symbolism (historical-ideational explanations); or may be a mix of the three (Allam and Goerres, 2008: 6-9)?⁵¹ The hypothesis examined here is that *the public salience regarding euro adoption is crucial to understand euro adoption in the three cases*. The discussion of the public opinion also answers the question what explanation (political, economic or historical-ideational) best explains the position of the public with regards to euro adoption.

2.4 Conclusion and Summary of the Hypotheses Examined

The literature on euro adoption in CEECs is not comprehensive and lacks several key indicators. As we have seen in this chapter, the economics literature focuses on a cost/benefit analysis of adopting the euro and does not take into consideration the environment in which the decision to adopt the euro is taken. The political science

⁵¹ On the political explanations, see Anderson (1998), Hooghe and Marks (2005) and Lindhal and Naurin (2005). On the economic explanations, see Baldwin (1989) and Buch and Hansen (2002). On the historical-ideational explanation, see Carey (2002). For a review and analysis of the three approaches, see Allam and Goerres (2008).

literature examines euro adoption mainly from the perspectives of social learning, Europeanization, identity and symbolism. The political science literature also misses important domestic factors that are key in showing why certain policies are taken and why some of these policies work or not. The interaction between the government and opposition and with the central bank is key. Therefore, this thesis adopts a domestic politics approach in order to fill the gap in the literature on euro adoption and to help understand the euro adoption strategies in CEECs.

The hypotheses examined in this thesis are as follows:⁵²

Hypothesis 1: Elections matter and shape not only governments' euro adoption policies but also the opposition's stance on the matter. Government and opposition use the euro as a tool in their election campaigns if the public is interested.

Hypothesis 2: Ideology (intensely held beliefs) of the government and sound policies (good governance) have a significant positive effect on euro adoption in CEECs.

Hypothesis 3: The role of the opposition is crucial in influencing the government's policies and negotiations—especially with the existence of veto points in the constitution. The competition between the government and the opposition usually influences public opinion and pushes the public against (or in favor of) certain policies.

Hypothesis 4: A good and harmonious relationship (based on shared position regarding euro adoption, coordination and cooperation) between the central bank and the government is a necessary but not a sufficient condition for euro adoption.

Hypothesis 5: The role of the media with respect to euro adoption and influencing the public is inconsistent and weak in general.

⁵² A sixth hypothesis, one regarding the historical legacy, will be presented in chapter four following the discussion of the historical background.

Before examining these hypotheses in the Czech Republic, Hungary and Poland, I will now turn to the methodology and case selection.

CHAPTER III: METHODOLOGY AND CASE SELECTION

This chapter briefly discusses the methodology used and the criteria for case selection.

Many studies dealing with EMU and the NMS use quantitative methods (see for example: Eichengreen, 1992, 1997; von Hagen and Fratianni, 1994; Bergman and Hutchison, 1998; Szapáry and von Hagen, 2004; De Grauwe and Mongelli, 2005; De Grauwe, 2006; Sadeh, 2006). This study is based on qualitative research⁵³ that conducts indepth analysis of decision-making, policies, behaviors, and opinions of the actors involved in the process of euro accession in the Czech Republic, Hungary and Poland.

A considerable amount of information needed for this thesis is not publically available, but is known only to a small group of key informants. Therefore, the present study uses interviews to test the main hypotheses. Additional data is collected from other primary sources and secondary literature. The first section discusses the comparative method and its relevance to this study. The second section discusses the case selection and reasoning behind choosing the three cases (the Czech Republic, Hungary and Poland). The third section highlights the methodology used (interviews) and its shortcomings.

⁵³ The term qualitative research, as used in this thesis, is based on the definition by Corbin and Strauss: “any kind of research that produces findings not arrived at by means of statistical procedures or other means of quantification. It can refer to research about persons’ lives, stories, behavior, but also about organizational functioning, social movements, or interactional relationships. Some of the data may be quantified as with census data but the analysis itself is a qualitative one” (Corbin and Strauss, 1990: 17).

3.1 Qualitative Research—The Comparative Method

When we deal with few cases, we cannot apply quantitative methods and statistical testing; therefore other methods are needed—such as case-oriented approach. Smelser (1976) refer to this approach as the comparative method.⁵⁴ The focus here is more on detailed analysis of the cases (small-N analysis) rather than offering generalizations (see Ragin, 1987: 54). I am interested in offering a detailed analysis of why the Czech Republic, Hungary and Poland have not adopted the euro yet. So this case-oriented approach applies to this thesis.

Trying to use statistical methods for the three cases (the Czech Republic, Hungary and Poland) and the limited number of variables (government, opposition, central bank, public opinion and the media) I am looking at is deemed unnecessary for the questions I am asking. Collecting data by doing surveys, or interviewing large numbers of people is not helpful since the information I seek is only known by a small circle of specialized policy-makers, lobbyists, party members, and consultants who are involved in euro adoption strategies in their countries. Therefore, elite interviews with specialized policy-makers and those involved in the euro adoption is the method used for this thesis (for information on elite interviewing see Dexter 1964, 1970; Peabody *et al.*, 1990; Ostrander, 1993 and Richards, 1996).

⁵⁴ Della Porta (2008) argues that it is confusing to use the “term *comparative method* [...] for an approach within comparative analysis that provides an alternative to the statistical method” (Della Porta, 2008: 201). This method “supplements with *logical reasoning* the lack of a sufficient number of cases for systematic tests via partial correlations” (Della Porta, 2008: 201).

3.2 Case Selection

According to Przeworski and Teune (1970), Lijphart (1971) and Ragin (1987), comparing few cases is divided usually into two types: most similar systems design (MSSD) and most different systems design (MDSO). These types of comparisons are based on Mill's methods of difference and agreement (Mill, 1872: 448). MSSD requires having cases that are similar to each other in every aspect, but differing in the phenomenon or outcome the researcher is trying to study. Whatever feature that cannot be omitted without preventing the phenomenon, is the cause or a condition for that phenomenon or outcome (Mill, 1872: 452-453). Researchers using this technique are interested in the main differences among similar cases, which are responsible for causing differences in the observed outcome. Przeworski and Teune (1970) argue that MSSD is based on the idea that among similar systems, the researcher will find theoretically major variations that can be used in explaining the outcomes.

Although MSSD is used as a remedy for the "many variables, small number of cases" problem that Lijphart raised (Lijphart, 1971: 685); MSSD is considered suitable for researchers involved in area studies; and helps conducting a focused research; however it is not free from disadvantages. Some argue that MSSD does not really remove or control for all rival explanations and this results in over-determined outcomes (Przeworski and Teune, 1970). Another disadvantage is that what appears to be similarity for one researcher might be a difference for another (see King, Keohane and Verba, 1994). Moreover, a researcher could bias his/her results by focusing on certain variables that show the differences among the similar cases.

The basis for the MDSD is Mill's method of agreement in which the researcher compares different cases that share the same outcome. One fundamental technique for this method is to identify the causes of this common outcome (which the researcher is interested in explaining) and then search for the common factor that is present in all cases in which that outcome occurred. So MDSD focuses on cases which differ in most of their features except for the outcome and one or few explanatory factors that exist in all cases and are considered important for that outcome (Landman, 2003: 29-30). According to Geddes (1990), this technique (MDSD) is widely used in comparative research especially with scholars who are interested in particular outcomes such as social revolutions (Skocpol, 1979). One of the advantages of using MDSD is that it helps to solve the problem of having large number of variables in comparison to the cases since the researcher will be focusing on the similar explanatory factors that are considered to cause the same result or outcome. This might cause a selection bias problem, since the researcher might be selecting the cases on the dependent variable (or the outcome the researcher is interested in explaining) (Geddes, 1990; King *et al.*, 1994: 128-137).⁵⁵

In selecting my cases, I had to decide whether I would choose countries based on their geography. In other words, I could pick them for their geographic characteristics and choose from: Central European Countries or the Visegrád Group (the Czech Republic, Hungary, Poland and Slovakia), or the three Baltic countries (Estonia, Latvia and Lithuania), or maybe selecting a sample of very small countries (Cyprus, Malta and

⁵⁵ It is important to highlight that a single case study can be considered a comparative study. A single case study can be used to generate or test hypotheses, invalidate or confirm theories. Another role for the single case study is to explain certain deviant cases (Landman, 2003: 34-35). According to Lijhpart, "***Deviant case analyses*** are studies of single cases that are known to deviate from established generalizations. They are selected in order to reveal why the cases are deviant" (Lijhpart, 1971: 692). Deviant cases can "uncover relevant additional variables that were not considered previously, or to refine the (operational) definitions of some or all of the variables" (Lijhpart, 1971: 692).

Slovenia); or selecting countries on the basis of size, and if so what would be the criteria for large and small, i.e. is it by population size, geographical size, size of the economy, or political influence (Maes and Verdun, 2005).

Another categorization is the concept of pacesetters and laggards (Dyson, 2006).⁵⁶ On June 28, 2004, Estonia, Lithuania, and Slovenia became part of ERM-2 followed by Latvia, Cyprus and Malta in April 2005, showing their interest in adopting a speedy euro accession strategy. By contrast, Poland, Hungary, the Czech Republic, do not currently have intentions to join soon or have the capability for that. Among the NMS, only Cyprus, Malta, Slovenia, Slovakia and Estonia adopted the euro. Based on this argument, the conclusion could be made that the smallest states among the NMS are working harder to join EMU and gain from accession, while the bigger states are “more worried about the loss of flexibility” (Rollo, 2006: 69). Dyson concludes that the distinction (pacesetters and laggards) regarding EMU accession “suggests that east central European world is losing its coherence” (Dyson, 2006: 326).

The problem with Dyson’s distinction is that it gives a lot of weight to stability, trade, and other economic indicators (cost-benefit expectations), but misses the importance of other factors such as the role of culture, identity, institutional development, public opinion, and nationalism.⁵⁷ Another problem with Dyson’s conclusion is that he considers those countries to be losing their coherence, but as we will see in chapter 4, CEECs were never totally coherent and they always had differences that outweigh the similarities. One final issue with this argument is that it tries to draw a line differentiating between two groups of countries: pacesetters and laggards. I believe there are more

⁵⁶ On pacesetters and laggards see also Maes and Verdun (2005).

⁵⁷ Nationalism “emerged as the most powerful ideology that most important and popular political elites and parties advanced and that publics in these countries found appealing” (Czergo, 2008: 88).

categories than that and although we do have pacesetters, we also have countries in between. Besides, countries can swing between being pacesetters and laggards, which is demonstrated by the cases of Hungary and the Czech Republic (who initially were much more positive about euro adoption but changed and became laggards). So the dichotomy is not fixed. We can consider some countries to be laggards with respect to EMU accession. At the same time, they can be pacesetters in other related fields such as the financial sector development (cf. Hungary, Estonia and Poland) (Mohácsi Nagy, 2006: 252-257). Therefore, this argument cannot be used for case selection due to its failure to take into consideration other influential factors that affect euro adoption.

Another selection method is selecting the countries on the basis of either the most similar case design or the most different case design. However, reality is more complicated than grouping cases based on either method since we are not dealing with hard sciences—what is similar to me might be different for other researchers. Unlike what is sometimes referred to in the literature, I do not believe CEECs are very similar; I believe there are some similarities, but there are also distinct differences. One of the significant similarities is that for “most of their histories, the peoples of this region have not had their own states” (Wolchik and Curry, 2008: 6). Another similarity is that following the collapse of communism, leaders of CEECs had to address similar problems which can be summarized by “[d]emocracy, the market, and a return to Europe” (Wolchik and Curry, 2008: 25).

As for the differences among these countries, they are many, such as having different languages, religions, cultures, economies and industrialization, even their struggle against communism and experience during the communist era differ. Moreover,

at the end of communism, leaders had to implement different policies to deal with the pertinent issues. Different countries implemented different policies regarding democratization, institutional building and reforming, and liberalizing their economies.

Thus, in this study I choose to analyse the three largest CEECs. These countries have more political and economic clout in the region. My understanding was that they would be the most 'free' in deciding on their policies, as they would be less influenced by the global economy. The smaller states are more vulnerable and because of their relative small size and lack of a large domestic market will likely be more open because they are more dependent on imports and exports. Furthermore, my selection will show that even countries that are still not part of the euro area are not similar. These three countries differ in their relative enthusiasm (or reservation) towards euro adoption, since the early 2000s. Some of them were first enthusiastic and set optimistic goals, yet had to postpone these target euro adoption dates for variety of reasons, as we will see in the discussion of the cases. The three selected countries differ in a number of important ways. They have an interesting historical background regarding nationalism, sovereignty, fighting communism and institutional development that cannot be characterized as similar. Another interesting factor is that regarding the speed of euro adoption, their policies changed from pacesetters to laggards.

The Baltic States, Cyprus, Malta and Slovenia, are very small open economies – a GDP of less than 50 billion US dollars per year, (to put it in perspective, each of these six national economies are so small they each only represent between 0.1 to 0.3 percent of EU GDP). Moreover, these countries have populations ranging from half a million (Malta) to just over 3 million (Lithuania). These small open economies are much more

vulnerable to the world economy and, one could argue, the choice for euro adoption may be more logical for a small country. Moreover, the euro adoption benefits for those small NMS is more likely to outweigh the costs—so it is a normal step to try to adopt the euro and be among the pacesetters.

The country most similar to the three countries examined in this thesis is Slovakia—a country that joined euro area in the midst of the financial crisis. But it too has a very small open economy (90 billion US dollar per year or 0.5 per cent of the EU GDP). Furthermore, these six small countries have been consistent in their enthusiasm regarding euro adoption. The NMS are diverse which explains why we have countries already in the EMU, others rejected, and some still out. The choice fell on the three largest countries that joined the EU in 2004: the Czech Republic, Hungary and Poland. Thus, why did I choose these cases?

The laggard/pacesetters dichotomy is not really a good way to go about selecting the cases besides, as I mentioned earlier, it has a lot of shortcomings. But if a researcher is interested in some cases that do not fit the selection methods used in Comparative politics, does he/she change the cases? The answer is no. Comparative research has to move beyond this narrow understanding of case selection. Even some scholars who used the MSSD or MDSD were criticized for selection bias (for example Skocpol, 1979).

I do not think the three cases studied here strictly fulfill the selection criteria proposed by the MSSD or MDSD. However, based on one of the research questions I raise (why have these countries not adopted the euro yet?) and the hypotheses I highlighted earlier, and since the outcome studied in the three cases is the same, then the case selection fits more with the broader understanding of the MDSD. As indicated in the

hypotheses, there are some common factors that affect the entire process, such as: the ideology and effectiveness of the government; opposition's ideology; electoral cycles; central bank position; public opinion and the media. The interaction among these factors and the degree in which they influence euro adoption process might differ across countries, as we will see later.

The intention is to understand the situation in those countries, not offer generalizations about all other NMS' path to euro adoption. But I do believe that the domestic politics variables used in this study could be applied not only to the NMS but also all EU members who have/have not joined the euro area.⁵⁸ By expanding the number of cases, I can offer more generalizable conclusions. As for the speed of accession for the NMS, it could be plotted on a continuum of speed (how close are those countries to meet the convergence criteria?), but this continuum is contingent on time. Sometimes the Czech Republic might be in the lead while Poland in the back and vice versa.

3.3 Research Methodology

When the NMS joined the EU, the extent to which their governments were trying to join the euro varied considerably. Some governments were making major efforts to join the euro area; others much less. Since this time, some of them succeeded—such as Slovenia, Cyprus, Malta, Slovakia and Estonia—others failed such as Lithuania. Other countries delaying euro accession as much as they can. Although I examine the developments post May 1st, 2004, I am keeping in mind and analyzing the process that led those countries to

⁵⁸ Amy Verdun has also done the same type of research on the seven other NMS.

be part of the EU. I examine the different factors in each of the three cases in order to better understand the divergence in strategies towards euro adoption.

This thesis is based mainly on three data resources: (1) primary literature, i.e., reports by governments, central banks, European Commission, and ECB; public statements made by EU officials (from Commission, the ECB, etc.) and national governments' officials; few presentations by key informants at conferences (2) secondary literature, i.e., books, journal articles, newspaper articles, etc., and (3) interviews with key informants, such as members of ministries of finance, national central banks, in addition to officials and academics involved in the euro project.

The primary resources are used to analyze the different policies adopted by the NMS, how they originated, why they were implemented and what is the expected outcome to be achieved from such policies. Then I examine which factors determine such policies and their outcome. In this second stage, the usage of the secondary literature and interviews will be very helpful for finding some answers. The interviews with national government officials and key influential players who have been involved in euro adoption were conducted between April and July 2009. By conducting the interviews at that stage of the project, I was able to have a better understanding of the cases (because most of the research was done prior to the interviews) and the questions were directed to find answers that cannot be found in the primary sources. Moreover, the interviews were conducted at a very critical moment: in the midst of the 2008-2009 financial crisis.

The research benefitted from the time I spent in Central Europe (Poland and Hungary)⁵⁹ and visiting the Czech Republic and Slovenia for interviews. The conference on the Financial Crisis and Euro adoption in the NMS in April 2008⁶⁰ enriched this thesis and allowed me to have some discussions with policy-makers and scholars involved in euro adoption. I was also able to communicate not only with students and professors but also the general public and ask about their perceptions of euro adoption and what they think about the fact that one day their currency will be replaced by the euro.

3.3.1 Interviews⁶¹—Important Method in Qualitative Research

In qualitative research interviews, the researcher tries to understand the reasoning behind certain decisions and uncover the motives, interests, and experience of the interviewee. Interviews open the door for information that could not be known otherwise. The researcher is looking for information that is not available to the public and not found in books, journals, reports, etc. The information is only available to those who are involved in the policy-making area. The statistical data available on some of the questions asked in an interview cannot provide details since its findings are too broad and generalized.

⁵⁹ Between September 2008 and May 2009 I was at Uniwersytet Ekonomiczny w Krakowie, Kraków, Poland as a visiting researcher and between May and July 2009, I was at the Central European University, Budapest, through the Doctoral Support Program.

⁶⁰ Global Financial Crisis and Euro Zone Enlargement Conference at Uniwersytet Ekonomiczny w Krakowie, Kraków, Poland on April 8, 2009. The papers presented at the conference resulted by a published book *Global financial crisis and euro zone enlargement* (edited by Assem Dandashly, Aleksander Surdej and Helena Tendera-Właszczuk).

⁶¹ Interview is used here based on the definition by Henerson, Morris and Fitz-Gibbon: “An *interview* is a face-to-face meeting between two or more people in which the respondent answers questions posed by the interviewer. An interview may involve predetermined questions, but the interviewer is free to pursue interesting responses if he or she feels it useful. The interviewer records the respondent’s answers in some way, usually by taking notes. The interviewer then develops a more complete summary after the meeting has been concluded” (Henerson, Morris and Fitz-Gibbon, 1987: 24).

In case the research requires collecting data from a large sample, then I could send a questionnaire (either via mail or email, or setup a web survey, or even in person), however, and based on experience, the data collected will be too brief, people would not answer all questions due to many reasons (such as too long questionnaire, too bored or have no time to answer all the questions in a thoughtful way, some people prefer to keep their opinions private and do not want to share it with the wide public or anyone, and in many cases, people do not take the surveys seriously), and people tend to lie in the surveys. Even when having all the information about the reasoning of the survey and intention of collecting the data, in many cases, the response rate is low and people tend not to read all the details. Regardless of how much survey questions ask, the answers would be too brief and would not be rich and thorough in comparison to the interview and the kind of questions I ask. Finally, surveys are time consuming and in many cases people do not feel like writing their opinion on papers (Verdun, 2000: 104), they prefer talking and discussing with another person. So the personal factor is absent in surveys.

Therefore, when conducting qualitative research involving important decision, interviews become highly significant. Interviews allow the respondent to discuss easily without restraints. He/She has the ability to provide his/her personal opinion, speak on or off the record and is guaranteed that the information collected is based on the consent form he/she agreed to sign and that this agreement cannot be violated. Moreover, the interviewee is aware of the length of the interview and it is up to him/her to decide to be short on answers or spend time elaborating on each question (Verdun, 2000: 105).

3.3.2 Why Use Interviews for this Research?

The main aim of this thesis is to understand the strategies and policies taken regarding euro adoption in three central European countries. Therefore using interviews is a logical way to find some answers for the questions raised earlier. Interviews were conducted with key informants from ministries of finance and economics, central banks and other monetary institutions and organizations. Based on the nature of the questions, the respondents needed to be specialized and directly involved in euro adoption strategies' portfolios and policy adoption and implementation. Due to the small circle of those involved in euro issues, the intention was to interview most of them.

The questions were in accordance with the explanatory factors used to understand decision-making process in the three countries. The questions focused on euro adoption policies of the interviewees' organization and to a lesser extent elite perceptions on euro adoption policies.⁶² One question was about the historical past (communist legacy) and the issue of identity and its role in pushing decision-makers to be hesitant or keen to join EMU quickly. Another question was about the anticipated costs and benefits from adopting the euro. The interviewees were asked to provide their organization's opinion or position on euro adoption, how did it change over the years and the future plans. In addition to their organization's stance on euro issues, the interviewees were asked about their personal attitudes and perceptions. The aim of interviewing various players and not only government officials was to capture in depth the different views and better understand the role played by the various key players involved in euro adoption.

⁶² The interview questions, list of interviewees and their affiliation and their selection method, are provided in the appendix.

3.3.3 Reliability of Interview Data

How can the researcher make sure that the answers are true and the data collected from the interview is reliable? A researcher cannot ask a direct question about why the informant has “certain attitude, perception or motive” (Verdun, 2000: 105). On several occasions, the interviewee might provide answers that do not really reflect his/her opinion because he/she wants to be diplomatic or politically correct (see Henerson, Morris and Fitz-Gibbon, 1987). So there is risk of bias in these kinds of answers that needs to be dealt with. One of the ways to deal with the bias is by asking more direct follow up questions or “additional ‘control’ questions” in which the interviewee feels he/she should give more direct answer that reflects his/her opinion (Verdun, 2000: 106). This problem is even more apparent when interviewing decision-makers who may need to measure every word they say and are very careful in making sure that they provide a good image of the organization they work for.

Another issue with such interviews is the story telling in which the respondents have a pre-thought answers that they give to any researcher approaching them. In addition to that, the researcher might fall into two more conflicting problems: the respondent is either using the researcher as a tool to spread out certain information or the respondent might not tell the researcher about the real policies and plans since he/she does not want this to be expressed and made available to others. In these three cases mentioned, the researcher has to address these problems. First, the researcher has to conduct a thorough research on the topic prior to the interviews. Second, by conducting

more than one interview with people from the same organization, the researcher will be able to compare the views of employees of the same organizations. Third, interviewing respondents from other organizations allows the researcher to compare the results and make more conclusive findings. Fourth, the follow up questions are crucial in pushing the respondent to give more accurate and specific information. And fifth, the structure of the questionnaire helps in making sure the respondents are expressing their organization's opinion (unless indicated otherwise by them) by “cross-checking” the answers, for example by asking the interviewees about the answers of the respondents in other organizations and institutions (Verdun, 2000: 106).

But is there another method that provides the same detailed information without this bias and without these problems? The answer is no. All methods have their pros and cons and I do not believe that for such kind of research, any method will give the same detailed answers needed. So with these shortcomings, interviews are still better equipped to investigate my research questions.

3.4 Conclusion

This chapter has discussed the case selection criteria and the logic behind adopting a qualitative methodology, including the usage of interviews. The discussions include a review of the importance of interviews, their shortcomings and why they are particular relevant for this project. The list of the questions asked is presented in the appendix along with the rationale behind the questions. The findings of the analysis of the interviews are presented while discussing the three cases in chapters 5, 6 and 7.

The main question I am seeking to answer in the three cases is why these countries have not yet adopted the euro. The answer lies within the domestic variables and their interaction with each other: government, opposition, central bank, public and media. The following sections show that these domestic variables are crucial to understand the reasons why the Czech Republic, Hungary and Poland have not adopted the euro yet.

CHAPTER IV: HISTORICAL DEVELOPMENT AND THE COMMUNIST LEGACY—DOES IT MATTER?

This chapter discusses the major events in former Czechoslovakia, Hungary and Poland between the 1950s and 1989. The importance of studying historical legacies is to confirm or refute my hypothesis that historical legacies (communist past and experience) and path dependency affected post-1989 reforms and euro adoption strategies. Some scholars such as Ekiert, argue that in order to understand the current political, institutional, economic developments in CEECs and to show the reasons behind their diversity,⁶³ it is vital to study the developments under “state socialism” (Ekiert, 1997: 338).

The period of communism in CEECs was full of problems and continuous attempts for reforms as early as 1956. However, communism survived until the domestic demands and pressures were accompanied by international events. The breakdown of the Bretton Woods system in the early 1970s, the oil crisis (oil prices increased sharply in 1973) and the 1975 global recession, put more pressure on the communist regimes in CEECs. These developments resulted in an increase in energy prices and products. Subsequently the demand for CEECs’ exports fell sharply due to the recession spreading throughout the world (Csaba, 1990; Pittaway, 2007: 23-24). All these economic, social and political problems pushed the then Union of Soviet Socialist Republics’ (USSR: Soviet Union) President Michael Gorbachev to admit in 1985 that there were serious

⁶³ As we will see later, CEECs had diverse experience under communism leading them to have a different degree of development with the fall of communism in 1989 and the launch of the economic and political reforms. This diversity is still persistent until now.

problems in CEECs that needed to be addressed. The Soviet Union's leaders, previously suspicious of any sort of reform in CEECs, and who considered any kind of reform to threaten the power and leadership of the Soviet Union, became more supportive for such economic, political, institutional and social innovations (Pittaway, 2007: 26). Without Gorbachev's reform policies in the Soviet Union and his easiness on similar acts in CEECs, the 1989 revolutions and the fall of communism might have been delayed.

Reforming and building the institutional structures in CEECs have characterized the post-1989 period. Not only west European countries, or EU institutions, but also other players—such as the US, IMF, BIS and the World Bank—have been involved in the transfer of ideas and social beliefs and have supported this process towards democracy and market economy (see Johnson, 2003, 2006; Schimmelfennig and Sedelmeier, 2004; Epstein, 2005). However, post-communist countries did not have a choice as to what political, economic and judicial system they want. With the fall of the Berlin Wall in 1989, CEECs basically had no other alternative but to take what is offered to them by the EU and the West. CEECs wanted to benefit from the momentum caused by the end of the Cold War and cut any ties with their communist past.

According to Dahl (1971) and others (such as Rose, 2009), democratization develops and progresses slowly and requires major dedication and endurance. For example, it took England “three centuries to evolve into a democracy” (Rose, 2009: 36). Although CEECs' transformation is considered rapid, it has not been easy or without problems. The three countries have faced some unrest, disorder and “uncertainty” at various stages (Millard, 2007: 37). How did these countries move rapidly towards democracy and market economy and meet the Copenhagen criteria? How could political

regimes change quickly in CEECs—knowing that it is an uneasy process and does not happen regularly (see Weber, 1957)?

Before discussing the historical development during the communist era and its relevance to the current situation in the three cases, it is important to briefly highlight the theoretical framework for this part: historical institutional approach, which I do not use as a competing theoretical approach to the domestic politics one. Rather, I use historical institutionalism because I expect that historical legacies (communist past and experience) and path dependency affect the post-1989 reforms and euro adoption.

4.1 Historical Institutionalism

The study of historical institutionalism in European politics and integration studies has been crucial in understanding the developments in the EU (Hall and Taylor, 1996; Pollack, 2001). In addition to its importance in understanding Western European politics, historical institutionalism has been shaped and influenced by the EU developments as well (Immergut and Anderson, 2008: 345). Hall and Taylor define institutions “as the formal or informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or the political economy” (Hall and Taylor, 1996: 938). Institutions have the ability to “establish the very criteria by which people discover their preferences” (DiMaggio and Powell, 1991: fn. 3, 11). Skocpol emphasizes the importance of organizational designs of institutions “along with their overall patterns of activity, affect political culture, encourage some kinds of group formation and collective

political actions (but not others), and make possible the raising of certain political issues (but not others)” (Skocpol, 1985: 21).

The importance of historical institutionalism is its facilitation of our understanding of the developments of ideas, ideology, religion, culture and politics and the relations between them (Berger, 1982). Hall (1993) and Rothstein (1998) highlight the importance of ideas (Hall refers to them as “policy paradigms”), and the role they play in the study of historical institutionalism. For Hall, decision-makers “work within a framework of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems they are meant to be addressing” (Hall, 1993: 279).

According to Skocpol, historical institutionalism “views the polity as the primary locus of action, yet understands political activities, whether carried out by politicians or by social groups, as conditioned by the institutional configurations of governments and political party systems” (Skocpol, 1992: 41). This is significant when studying the developments in CEECs, which moved away from communism to a democratized system based on market economy principles. It is important to examine the choices and decisions made by political leaders regarding “how much of the past to preserve in the modern political system” (Berger, 1973: 334). This falls under the concept of “contextual causality” in which the “causal workings of institutions may depend upon their historic contexts, which include the interpretations that political actors bring to institutions” (Immergut and Anderson, 2008: 353)—which was the case of the CEECs in their transition from Communism to liberal democracy.

Putnam argues that “where you can get to depends on where you’re coming from, and some destinations you simply cannot get to from here. Path dependence can produce durable differences in performance between two societies, even when the formal institutions, resources, relative prices, and individual preferences in two are similar” (Putnam, 1993: 179). Several scholars, such as Paul Pierson support this reference to path dependency and historical influence on studying institutions and why certain decisions are taken. In his book *Politics in Time*, Pierson highlights the importance of history and its role in studying institutions through investigating their long-term development (Pierson, 2004). The study of this gradual development that causes changes in institutions is central to the study of historical institutionalism (Streeck and Thelen, 2005).

Historical institutionalism provides a useful method that helps to “bring together the high-profile politics of the [Single European Market/Single European Act] SEM/SEA, on the one hand, and the day-to-day policy-making, policy administration and judicial dynamics of the EC pillar, on the other” (Bulmer, 1998: 377). It might help recognize the historical developments in CEECs that might be important in understanding the developments in CEECs post-1989 as we will see in chapters five, six and seven. Therefore, the following section discusses the historical institutional development in former Czechoslovakia, Hungary and Poland.

4.2 Half a Century of Developments in Central Europe: Learning from the East

The second half of the 1940s witnessed the “abandonment of people’s democracy, and the start of the full-court press toward socialist industrialism” (Connor, 1997: 15). The

continuous attempts to “standardize Leninist institutions” in CEECs, were faced with “extremely high levels of social resistance” (Ekiert and Hanson, 2003: 29). The voices for freedoms, liberties and economic prosperity started to get louder. The three main incidents or revolutions taking place during the half century following the Second World War (Soviet intervention to put an end to the Hungarian revolution in 1956 and Czechoslovakia in the spring of 1968 and the Martial law in 1981 in Poland which was backed by the Soviet regime), “can be seen as ‘critical junctures’ leading to profoundly changed relationships between regime and society” (Ekiert and Hanson, 2003: 29).

Following the Second World War, economic and social development has been the standard dominating not only the Western world but also the communist bloc. The difference was that the communist bloc has been developing at a slower pace than west European countries. This caused Central Europe to fall behind fast developing Western Europe (Rose, 1995).⁶⁴ During the communist decades, CEECs “underwent complex processes of transformation [...] and developed distinct institutional forms and modes of relations between the state and society” (Ekiert, 2003: 89).

⁶⁴ This situation was highlighted by President Vladimir V. Putin in his Millennium Address to the Russian people at the end of the twentieth century: Russia would be wrong to ignore the achievements obtained under the Bolshevik rule. “But it would be an even bigger mistake not to realize the outrageous price our country and its people had to pay for that Bolshevik experiment” (*The New York Times*, online edition, January 2, 2000). Putin emphasized “Communism and the power of the Soviets did not make Russia a prosperous country with a dynamically developing society and free people. Communism vividly demonstrated its inability to foster sound self-development, dooming our country to lagging steadily behind economically advanced countries. It was a blind alley, far away from the mainstream of world civilization” (cited in Sakwa, 2004: 45). This assessment highlights the situation not only in the former Soviet Union but also the communist bloc.

4.2.1 From Yalta⁶⁵ to the 1956 Revolution (Hungarian Revolution)

With the Second World War coming to its end, the victorious group (the UK, US and their allies) started thinking about the future of the East European countries (such as Hungary, Poland, Czechoslovakia) that fell into the hands of the Germans, Russians and/or the allies. The Yalta meeting between Churchill, Roosevelt and Stalin on February 4-11, 1945, followed by a summit of the War alliance in Postdam in August 1945 focused on the German dilemma, the future of Poland and the situation of Yugoslavia.⁶⁶

The importance of Yalta is that it affected the future institutional development of CEECs and all the revolutions and incidents in the second half of the Twentieth Century. Most protests and revolutions⁶⁷ from the Hungarian revolution in 1956, through the Prague Spring of 1968 to the Polish Solidarity movement, the martial law of 1981 and the aftermath, were in response to the Yalta system. Each of these events led to serious attempts to “demobilize collective actors who emerged to challenge the regime and reequilibrate the institutional system of the party-state” (Ekiert, 1996: 3). These revolutions were not only a response to the Soviet policies. The revolutions were also based on “domestic causes, unique combinations of domestic, and geopolitical pressures” (Ekiert, 1996: 7) in addition to changes in the international arena.

During the second half of the 1940s, CEECs witnessed the creation of communist

⁶⁵ The focus is on the institutional developments during that period without dealing in depth with the Yalta system and the historical specifics.

⁶⁶ The meeting focused on other issues such as the Far East, the situation of Turkey and Iran.

⁶⁷ The mass protests until the late 1970s: The Berlin uprising in June 1953 (see Baring, 1972); Pilsen-Czechoslovakia workers revolt in June 1953 (see Ulc, 1965); June 1956 Poznan-Poland upheaval followed by the October crisis during the same year (see Syrop, 1957; Karpinski, 1982); Hungarian revolution in October-November 1956; students' uprising and political crisis in Poland in 1968 (see Bielasiak, 1988); the Prague Spring of 1968 and was brutally crushed by the Soviets; 1970 and 1976 workers strife in Poland and the Solidarity movement. These revolts or revolutions responded to the system created by the Soviets and followed Stalin's death in 1953. This period could be referred to as “de-Stalinization” (see Ekiert, 1996).

regimes along with major constitutional changes based on the “Soviet constitution of 1936” (Elster *et al.*, 1998: 40).⁶⁸ CEECs went through a series of changes covering not only formal and informal institutions, but even the political elites (Mendelski, 2008: 7; for analysis of elite change see Higley and Lengyel, 2000). This elimination of the elites resulted in changes in the “power relations and led to new institutional changes” (Mendelski, 2008: 7).

The post-Second World War period was characterized by slow economic development caused by the Soviets’ policies that extracted CEECs’ economy by “carting away machinery”, extorting “joint stock companies”—where they took most of the production profit—and by buying CEECs’ products at much cheaper prices in comparison to the market prices (Marer, 1984: 156). CEECs witnessed a forced learning and policy transfer coming from the Soviet Union. This policy transfer was based on the communist beliefs of industrialization, policy-making, and institutionalization.

In order to maintain their influence and control in CEECs, the Soviet Union constructed a “complex set of institutions and informal practices” such as: Warsaw Treaty Organization and the Council for Mutual Economic Assistance (Comecon or CMEA) in 1949, in addition to “bilateral agreements and informal arrangements” (Ekiert, 1996: 22). The CMEA was a controlling tool used by the Soviets to manipulate CEECs institutions and economies. The Soviet Union shaped the industrialization process in Central and Eastern Europe by changing it into “an imposed, uneconomical, and excessively paced parallel development of high-cost industrial branches throughout the region” (Marer, 1984: 159). The economic program implemented in CEECs needed a

⁶⁸ The role of constitutions in central and eastern Europe was not that important since although they existed in theory and “were formally in force”, however, they were not formed to “constrain and to obligate the power elites” (Elster *et al.*, 1998: 63).

strong authoritarian rule to function since it exploited “the peasantry and wage-earners” (Berend, 2001: 293). The ruling regimes did not take into consideration the infrastructure of these countries, nor their industrial and economic specialties (mainly light industries and agricultural products). The focus was directed on heavy industrialization at the expense of the smaller industries and agriculture. At the end of the first decade of communism, these policies proved to be inefficient and caused economic and social problems in CEECs.⁶⁹

Another instrument that was used by the Soviet Union to enforce its will and choices was the *embassy system*. The *plan coordination* system enabled the Soviets to set long and short-term plans and enforce certain quotas on production in the communist bloc. They also controlled and managed important industries and projects in all communist countries “except for Poland” (Marer, 1984: 158). For example, in East Germany, all the important “economic functionaries had their ‘partners’ in the Soviet embassy whom they consulted for every important move” (Pryor, 1963: 200-01). The Soviet leaders considered this kind of industrialization the right strategy for communist countries to follow in order to catchup with early industrial countries.⁷⁰ Moreover, none of the political leaders in the communist bloc were against this industrialization since most of them were trained in the Soviet Union and saw the economic and military

⁶⁹ The changes (industrial, agricultural, social, institutional, political, etc.) that affected the entire system from the leaders and elites to the regular citizens were not the same in all CEECs. Major structural differences existed along with different application of communism that can partly explain the differences in developments after the fall of communism. In addition to the institutional differences, governments governed differently and did not have similar “strategies of regime stabilization and legitimization” (Elster *et al.*, 1998: 42). Moreover, in the case of social security, East Europeans were discontent with the “Soviet model” which proved to be inadequate and underdeveloped. This led the various east European countries to “adopt their own individual versions of ‘socialist social policy’” (Inglot, 1996: 214).

⁷⁰ Since those countries were not among the early industrial countries, Soviets enforced “a path of development that emphasised state mobilisation of resources in order to catch up with early industrialisers” (Chase-Dunn, 1992: 30).

progress in the 1930s and 1940s (Marer, 1984: 159).

One of the consequences of the enforced socialization was the damage it caused to the existing institutions. This institutional breaking was done through the replacement of the current western-like institutions by communist ones. The system of laws, regulations and legislation was politicized and the jurists were manipulated, which resulted in emptying the judicial branch from its essence (Mendelski, 2008: 7; see also Giaro, 2006: 323). As for the bureaucracies and their modes of governance, they were implementing decisions coming from the Soviet Union's government. Sometimes, the government uses these bureaucracies to repress the citizens. Moreover, except for Yugoslavia, Central and Eastern Europe witnessed an eradication of the "professional civil service", which lacked organization and legal structure, and led to its inefficiency (Verheijen, 2003: 490). Bureaucracies were oversized with unskilled employees who were appointed based on their loyalty.

Upholding communist rule was considered a matter of national security for the Soviet Union. Soviet leaders were against any kind of reform that would move CEECs in the direction of market economy and more political freedoms and civil liberties. In their attempt to deal with the arising economic problems, CEECs tried introducing some economic reforms that were based on market principles. Countries such as former Yugoslavia and Hungary were among the first to try to introduce such reforms. These attempts led to political problems not only within those countries but also with the Soviet Union since they threatened the foundations of the communist rule.

As the economic, political and social problems increased in the mid 1950s, citizens started losing faith not only in the highly centralized and corrupted bureaucracies

and public administrations (Vanagunas, 1999), but also in the entire communist system. By the second half of the 1960s, the social obstacle became more obvious in CEECs (mainly in former Czechoslovakia, Poland and former Yugoslavia) with the increased popular demand for wider political participation and freedoms.

Social learning from the east succeeded in shaping the thought, manners, traditions, and the culture in CEECs for a long time (Elster *et al.*, 1998: 158). Under communism, CEECs' citizens acquired some values that needed time to change. Among these values is what is referred to as "Mental residues of the communism" which are summarized as follows: "bad work habits, a contempt for effort and initiative, a fear of innovation, and an inclination to trade the expression of their loyalty for patronage and protection" (Elster *et al.*, 1998: 61). This environment spread a belief that violating the law, stealing from the government are good acts. The fear from the secret service created an environment of terror and distrust that affected the citizens' relations among each others. Four decades under communism resulted in "desertification" (Schöpflin, 1993: 256) of the societies from their norms, values traditions, customs and attitudes.

4.2.2 The Beginning of De-Stalinization and the Hungarian Revolution

The environment of fear and oppression created by Stalin would not last long after his death on March 5, 1953. The Hungarian revolution of 1956 was a very important incident "in the cycle of political changes following Stalin's death and unraveling of Stalinist regimes in the region" (Ekiert, 1996: 37). The 1956 revolution was a response to the Soviet attempts to *Stalinize* the country that alienated the majority of the Hungarians

including a considerable part of the elites.⁷¹ The revolution was a normal reaction to the failure of the communist industrialization, economic collapse, poverty, and sharp decline in the wages, accompanied by social upheaval characterized the period of 1953-1956 (Ekiert, 1996: 45). Moreover, the revolution was against religious oppression and continuous deportation and imprisonment of Catholic priests and nuns.⁷²

The gap caused by Stalin's death led to a succession problem among the party leaders in the Soviet Union that resulted by Nikita Khrushchev becoming the first secretary of the Communist Party.⁷³ This change in leadership marked the launch of the de-Stalinization⁷⁴ period (Ekiert, 1996: 45) and the introduction of some institutional reorganization in the Soviet Union (mainly by Khrushchev) that influenced the development in CEECs. East European leaders "realized that their domestic institutional linkages were extremely weak, leaving them vulnerable to the impact of changes in Soviet domestic and international policy" (O'Neil, 1996: 586).

Stalin's death led to the rise of reformists in the ruling communist parties in

⁷¹ Rothschild described the harsh situation in Hungary in a straightforward manner: "in Hungary, the cult of Stalin was particularly egregious, the treatment of 'undesirable' social categories (for example, the bourgeoisie) particularly cruel, the superindustrialization commitment particularly heedless, and the circle of decision makers particularly restricted and 'Muscovite'. Presiding over this orgy of political sycophancy and economic irrationality was the arch-Stalinist Mátyás Rákosi, on whom Tito was particularly determined to wreak vengeance" (Rothschild and Wingfield, 2000: 153-154).

⁷² Most remarkable was the arrest of the primate of the Catholic Church Cardinal Jozsef Mindszenty. The Church's officials who were not arrested or deported were forced to take a loyalty oath to the communist constitution. Religious schools were seized by the communist regime. The majority of the Catholic clubs and associations were dispersed. Religious newspapers were prohibited (Ekiert, 1996: 80). Following the Hungarian Revolution, the relation between the church and the ruling party was reconciled. In 1964, the Hungarian regime reached an agreement with the Vatican, which was the first in any communist country, giving the church more freedom of movement within Hungary. By 1974, the relations became better and the newly selected primate Cardinal Laszlo Lekai managed to settle the disagreements between the church and the regime.

⁷³ Many party members, such as Lavrenti Beria and Georgi Malenkov, were interested in taking Stalin's position—as they were viewed Stalin's loyal personnel. However, Nikita Khrushchev managed to become the party chief while Malenkov had to resign as a premier in 1955 and Beria was executed earlier in 1953.

⁷⁴ De-Stalinization had one main commonality with Stalinization as Schopflin highlighted: both were "imposed by the Kremlin on Eastern Europe without regard for the appropriateness of the de-Stalinization strategies" (Schopflin, 1993: 105), or even taking into consideration the domestic environment when implementing any policy.

CEECs causing an internal struggle with the hardcore Stalinists. Imre Nagy, a reformist, replaced Stalin's ally Prime Minister (PM) Mátyás Rákosi—who remained the party's general secretary. This era was characterized by the introduction of the New Course⁷⁵—economic and political reforms. Nagy became the symbol for reform and modernization in Hungary. Anti-Stalinist groups, massive numbers of students, elites and people (those imprisoned during the rule of Rákosi) became great supporters of Nagy. However, the hopes for a radical change to the system were not realized due to the power and strength of the Stalinists' supporters.⁷⁶ Nagy did not really build a solid “political base within the party and state apparatus, where Stalinists still dominated” (Ekiert, 1996: 47). In April 1955, Rákosi succeeded in undermining all the reforms taken by Nagy and managed to remove him from office (Gati, 2006). Later on, Khrushchev tried to move away from the Stalinist rule and replaced any one who was too close to Stalin.⁷⁷

The removal of Nagy in 1955 increased the fear and disappointment among the Hungarians and led to a “radicalization” of the society (Valenta, 1984: 95). However, unlike what some scholars (such as Valenta 1984) argue that the revolution in Hungary happened suddenly and unexpectedly in response to the 1956 events in Poland, I believe it was the result of: first, the terrorism practiced by the communists since the late 1940s and an attempt to protect what had been established by Nagy's regime. And second, the revolution needed something to trigger it, and the incidents in Poland were sufficient enough due to the traditional alliance between Hungary and Poland.⁷⁸ The “revisionist

⁷⁵ The New Course is usually associated with Nagy. However, according to Lomax (1985), this was not the case since the design of the New Course policies was the result of a collective effort by party elites such as Gerő, Rakosi, and others.

⁷⁶ The supporters are mainly those who benefited from the regime or were scared.

⁷⁷ In July 1956 Rákosi was replaced by Ernő Gerő.

⁷⁸ The sympathy with what was happening in Poland led students to demonstrate peacefully on October 23, 1956 in Budapest.

opposition” to the regime was institutionalized in March 1956 with the birth of the Petofi Circle⁷⁹ (Ekiert, 1996: 47). This platform demanded economic and political reforms, end of the police state and introduction of some basic freedoms. What was missing is a concrete program for reform and a review of the pillars of the “socialist organization of the state and the economy” (Ekiert, 1996: 47). The absence of an alternative program to the centralized rule and the weakened ruling party led to the failure of the different institutions “leaving the country in political void” (Aczel, 1978: 32).

The way the Soviets handled the October 1956 incidents showed confusion and a slight decline of the rigid communist rule in Hungary. In order to deal with the loud voices and demands of the revolutionists,⁸⁰ Stalinist leaders in Hungary asked for Soviet intervention. The hesitancy of the Soviet leadership resulted in a timid military intervention that was defeated by the resistance. Many expelled and imprisoned reformists in the communist party were freed and asked to join the central committee of the ruling party. Nagy was brought back to the premiership, and Janos Kádár (imprisoned during the rule of Rakosi) was freed and replaced Gerő as the first secretary of the party. By October 1956, the party’s situation was chaotic and its institutional basis collapsed. On November 1st, Kádár dissolved the Hungarian Working Party and requested the establishment of a new communist party.⁸¹ The same day Kádár disappeared and the Soviets launched their second intervention in Hungary—this time a more brutal one. Nagy’s government responded by announcing the neutrality of Hungary and the

⁷⁹ Petofi Circle (organized by the Official Youth Organization (Dolgozó Ifjúság Szövetsége (DISZ)) was a students’ forum for intellectuals and opponents of the elites to discuss and criticize the communist regime.

⁸⁰ Local party leaders joined the revolutionists and took a leading role in the revolution, (for more information see Lomax, 1956: 96-98).

⁸¹ Kádár defended his decision in 1982 arguing that he did not have alternative option since the “Party collapsed, lost all credibility, and there was a need to organize it from scratch” (Nowak, 1988: 164) cited in Ekiert (1996: 51).

abandonment of the Warsaw pact (Ekiert, 1996).

The popular urge for change could not be silenced except with brutal military action. The revolution was crushed, Nagy's government was overthrown and Kádár was brought back as the head of the new Soviet supported government—what Kádár called “Worker Peasant Revolutionary Government” (Ekiert, 1996: 38). Although the Soviets brought Kádár back to reinstall state socialism, it was impossible to get back to the pre-1956 Stalinist situation that caused the revolution. The chaotic situation, loss of party leaders and elites (due to exile, execution or imprisonment), and organizational and infrastructural collapse of the party, gave Kádár a great opportunity to rebuild the party. Instead of abiding by the centralized coercive rule, Kádár chose a more lenient track in which he created “a new institutional base for Hungarian socialism by pursuing a policy of reconciliation rather than continued force” (O’Neil, 1996: 587). Kádár’s policies were based on inclusion rather than exclusion of the majority of the citizens and elites.

Despite the brutal crushing of the revolution, the outcome was the launch of a progressive set of policies that adjusted Hungary’s centrally planned economy and the rigid Stalinist system. Some elements of the liberal market economy were introduced without completely eliminating the role of the state. This new era of Kádárism or *Goulash Communism*⁸² represented the birth of a new kind of communism that was unique to Hungary only. On December 10, 1956, Kádár’s government created epistemic communities that were responsible for finding good ways to solve the economic problems and suggest economic policies and organization (Párttörténeti Intézet Archívuma (PTIA), 288, f. 23/1957, cited in Berend, 2001: 300). One of the reforms’ main tasks was freeing

⁸² *Goulash Communism* was based on a combination of “political command, licensing, ethical and political suasion, and the application of economic parameters in both transparent and non-transparent ways” (Gács, 2000: 2).

the enterprises from the control of the state by adjusting the prices' system. This reform required terminating the state subsidies and allowing the prices to mirror "the enterprise and social costs involved" (Berend, 2001: 301). A large portion of the productions would be sold according to market prices. Reforms covered also the exports' rates and their prices. One major suggestion was abolishing the "branch-directing role of the ministries" and replacing them with a Ministry of Industry (Berend, 2001: 301).

Unfortunately, this economic reform plan was put on hold for several years. The delay in the reforms was not only the result of the domestic politics but also the external environment. The struggle over power and complications in the Soviet Union's leadership were mirrored in the Moscow Conference of Representatives of Communist and Workers' Parties of Socialist Countries in November 1957. This meeting concluded that "the main danger at present is revisionism" (Foreign Affairs, 1959/1960: 681) and this was reflected in the Hungarian Socialist Workers Party (Magyar Szocialista Munkáspárt: MSZMP). The meetings of the MSZMP highlighted the importance of the central role of the State in economic planning and emphasized that any plan to change this centrality or to decrease the role of the state should be rejected since it will lead to chaos. Therefore, economic reforms were delayed and only the agricultural sector witnessed some progress—for political reasons (Berend, 2001: 301-302).⁸³

⁸³ In the early 1950s, agriculture was based on "compulsory deliveries" and "collectivization" of products to governmental agencies in order to support the industrial sector. This policy caused "stagnation of output a major exodus of labor from farming in the first half of the 1950s" (Boote and Somogyi, 1991: 29). In the summer of 1957, the government decided to reform the agricultural sector. The compulsory delivery system was eliminated and a new voluntary cooperative system based on contracts was introduced. In the second half of the 1960s, the "mandatory plan directives regarding production" for both "agricultural cooperatives" and state farms" was eradicated. However, this does not mean that the intervention of the state in the production and marketing was also eliminated. Although the formal intervention of the state in the production and marketing decreased, however, the informal one continued. One thing that did not change was the low prices of food, which was a priority for the government (Boote and Somogyi, 1991: 29; also Berend, 2001: 302). In the 1970s, the agricultural sector flourished more: Cooperatives and state farms

Political and economic changes in Hungary in the early 1960s were not only the outcome of domestic pressure, but also a reflection of the power struggle in the Soviet Union and Khrushchev policies (strengthening his position in the Kremlin and the de-Stalinization policies). Kádár took these changes in the Soviet Union as a sign to enact changes and replace many of the hardcore communist elites in the MSZMP with moderate ones—basically his supporters.⁸⁴ Kádár became the prime minister and the first secretary of MSZMP. In his attempt to legitimize and stabilize his rule, Kádár reduced oppression and release political prisoners. Moreover, the percentage of technocrats recruited by the MSZMP increased, reaching 4.7, 9.7 and 11.7 per cent in 1962, 1966 and 1970 respectively (Adair, 2003: 111). These changes were meant to equip the party with experts who could help in the political, institutional and economic reforms.⁸⁵

In 1963, MSZMP Central Committee appointed a technocrat Rezső Nyers to form an economic experts' committee to reform the economy and create the New Economic Mechanism (NEM).⁸⁶ On May 7, 1966, the MSZMP Central Committee announced Kádár's economic reform strategy—the NEM. On January 1, 1968, the NEM (considered the most significant change in the communist bloc following the Second World War) was officially adopted and its major focus was moving away from the centralization and

enjoyed more “managerial freedoms”; support for small farmers increased; “farming technologies were introduced” (Boote and Smogyi, 1991: 29). This development was reflected in the growth produced by the agricultural sector and had positive effect on the entire economy in Hungary.

⁸⁴ Many of these changes took place during the Eighth Party Congress of the MSZMP in November 1962.

⁸⁵ These reforms were important but did not really mean that Hungary was moving towards a democratic system with liberal market economy. A lot of the elites (such as Jenő Fock (deputy prime minister 1961-1967 and prime minister 1967-1975) were criticizing Kádár for being a communist hardliner.

⁸⁶ This group was further divided into committees, which were crucial for the functioning of the NEM and to link the “micro-, meso-, and macro level networks within the regime” (Adair, 2003: 109). The Party leadership thought to recruit technocrats who had positions at the macrolevel such as Nyers, Fock and Fehér who held seats in the MSZMP Central Committee and the Politburo; and at the mesolevel such as Nyers, Fock, Fehér and Timár. Those technocrats served on various economic committees responsible for the transition. The MSZMP leadership “institutionalized the networks among the reformers on the meso- and macrolevel in terms of policy formation and implementation” (Adair, 2003: 111).

deficiencies of central planning (Balassa, 1970; Granick, 1973).

The NEM was a “comprehensive reform of the economic system”, establishing “market relationships among firms” in which prices are used as “allocative functions” (Balassa, 1970: 3). The new policy linked the prices of exports and imports to “foreign prices” through having a harmonized “foreign exchange conversion ration” (Balassa, 1970: 3). In their attempt to increase profits, companies had to be flexible and responsive to price changes. Moreover, part of the firms’ earnings, “budgetary and bank credits” had to be dedicated to investments (Balassa, 1970: 3). Motivations, such as financial incentives, were used by the reformers to increase the efficiency of the ventures both at the management and the employees’ level. The NEM increased the independence of the ventures and encouraged them to be more competitive. Large industries’ managers did not like such reforms because they lost some of their powers. So they were very critical and created some problems in the MSZMP by using their contacts there.⁸⁷ Criticisms were directed towards the “internal contradictions created by the NEM: ideological loyalty to communism versus elements of capitalism” (Adair, 2003: 115).

Regardless of the progress and reforms, criticisms continued and reached the MSZMP Central Committee, which showed some fractures regarding the previous support to the NEM (Adair, 2003: 115). The Soviet leaders were not at ease with the reforms and questioned Kádár leadership. This pressure led to changes in the leading positions in the MSZMP. Re-centralization of the economy characterized the 1973-1975 period and the changes made to the NEM by the Central Committee, returned the economy back to its “pre-economic reform period” (Adair, 2003: 119). From the mid

⁸⁷ The large firms’ managers were hired by the communists and had close relations with members of the ruling party who benefitted from them economically.

1960s to 1980s, the period witnessed competition between technocrats (pro-economic reforms) and enterprises' managers (benefitting from the status quo). This disagreement over reform policies continued during the 1970s and 1980s causing slow economic growth. The poor economic performance helped technocrats attract supporters to the reform plans and put more pressure on the MSZMP leadership. Therefore, substantial economic reforms were launched in the early 1980s (Adair, 2003: 121).

By mid 1980s, the economic crisis was spreading throughout the communist bloc. Stagnation, large foreign debt, internal and external pressures for more reforms characterized the situation in Hungary. Kádár tried to absorb the pressure by allowing for more participation in the parliamentary elections. However, the internal pressure for more democratization and liberalization was stronger than even Kádár could deal with. Even the replacement of Kádár by Károly Grósz did not result in the anticipated changes. Internal pressures accompanied by Soviet pressures resulted by limited institutionalization and reforms. However, these reforms were not enough to face the changes in the world order ushered in by the end of the 1980s (O'Neil, 1996: 591).

Reform circles originated in Csongrád County, which issued the first declaration on November 28, 1988. This declaration called for economic, social and political reforms. By the spring of 1989, reform circles spread all over Hungary and their supporters were growing in number. Although these reform circles were united in their criticism of the MSZMP and their calls for reforms, they were not able to establish a unified leadership or cooperate their course of action. This division limited their effect and had political implications that led to the postponement of the Hungarian multiparty elections to 1995 (see O'Neil, 1996: 592-595).

4.2.3 The Prague Spring and its Aftermath

The creation of Czechoslovakia was one of the outcomes of the First World War peace conference in 1918 in Paris. The newly established country at that time was considered one of the most developed, industrialized and successful countries in Central and East Europe. Furthermore, Czechoslovakia during the two world wars was considered a well functioning and stable parliamentary democracy. With the end of the Second World War, Czechoslovakia fell in the hands of the Red Army. The Soviets forced Benes government (who just returned from exile) to include communists in the government.⁸⁸

In October 1945, most enterprises were nationalized—especially large and economically important ones. In the years following the Second World War, Czechoslovakia went through a major nationalization program that influenced the construction of its social, political and economic structures (Ekiert, 1995: 126-128). By 1945, the traditional elites, landlords and industrialists lost their power. The task of shaping and reforming the economy was transferred from the elites to the communist state. The poor social classes “improved their position through the distribution of property confiscated from the Germans and from wartime collaborators” (Kaplan, 1989: 149). Moreover, the Stalinist regime created the “forced labor camps under the authority of the Ministry of Interior” (Ekiert, 1996: 129). Czechoslovaks were sent to these camps either without a trial or by trials with political motivations (Ekiert, 1996: 129).

⁸⁸ It is important to highlight here that the Czechoslovak Communist Party (CPCz) was not implanted by external forces (as in Poland or Hungary for example); CPCz has been there and had its supporters. In the last free elections in 1946, the Communist party came out as the winner with 38 per cent of the votes.

In May 1948, the new communist elites adopted a new constitution that “finalized the establishment of a ‘people’s democracy’ in Czechoslovakia along the orthodox Stalinist lines” (Ekiert, 1995: 128). The strengthening of the Stalinist regime was underway and an era based on fear, state terror and political oppression, execution and imprisonment had started. Even the Catholic Church’s priests, bishops, religious intellectuals, monks, etc. did not survive the prosecution and imprisonment for no reason except being religiously active (Ekiert, 1996: 129; see also Ramet, 1989; Renner, 1989).

The Czechoslovak communists who were not foreigners to their people and were considered “to be the ‘softest’ in East Central Europe—with their initial postwar stance toward democratic institutions, competing parties, and the West—were to emerge during the 1950s as the area’s most Stalinist party” (Rothschild, 1989: 97). The Czechoslovak communists managed to establish a totalitarian regime and were supported by a significant portion of the population who were given a lot of false hopes and promises that were “never fulfilled” (Kaplan, 1987: 189). With the support of the Soviet Union, communist leaders dominated and Czechoslovakia lost its earlier democratic position and its relationship with the West deteriorated (Skilling, 1989: 245).

The move towards communism through central planning, nationalization of enterprises and collectivization of agriculture did not have the destructive results seen in other CEECs (such as Hungary). The results of the reforms starting in 1948 were “disappointing but not disastrous” (Myant, 1989: 1). Communist leaders were given certain quotas that they had to achieve in constructing a socialist Czechoslovak state. Realizing that these quotas were beyond the ability of Czechoslovakia, Gottwald⁸⁹

⁸⁹ Klement Gottwald was the leader of the Communist Party and the President of Czechoslovakia from June 14, 1948 until March 14, 1953.

decided to get more Soviet advisors to take the blame in case the industrialization and militarization programs did not work. By 1951, the Soviet advisors implemented the Soviet central planning system. All methods, tools and institutions were copied from the Soviet model (Selucký, 1991: 165).

The achievement of the socialist industrialization was based on the first five-year plan introduced in 1949. The main aim of the five-year plan was to reconstruct the economy that had suffered during the Second World War. In February 1950, a decision was taken by the communist party's central committee to speed up the socialist industrialization process. Unfortunately, the reforms did not take into consideration the structure of the Czechoslovak economy, society and specialties; rather it focused on the "development of heavy industry" (Skilling, 1951: 115). As for the agricultural sector, there were no serious reform efforts in the short-term. This meant that the "collectivization of agriculture" had to wait (see Skilling, 1951: 116), which led to a decline in agricultural products.⁹⁰

The problem with the kind of reform and industrialization process that occurred in the communist bloc was that it focused on heavy industries and ignored the prosperous traditional light industries that those countries specialized in. This industrialization did not take into consideration each country's characteristics. In the Czechoslovak case, the country lacked the necessary raw materials for heavy industries, which made the country heavily dependent on the Soviet Union.⁹¹ Unfortunately, it was clear from the five-year plan (especially during its last stage) that light industry suffered the most from the

⁹⁰ The agricultural production was low to the extent that it "did not reach its 1937 level of output until 1965" (Selucký, 1991: 166).

⁹¹ For example, Czechoslovakia became the "steel superpower" in terms of its "per capita output" without even having the necessary "iron ore" (Selucký, 1991: 166).

reforms (Ekiert, 1996: 129-130; see also Selucký, 1991).

Something had to be done to save what was left of the light industry. By the mid 1950s, the ruling regime decided to divert the focus slightly towards the light industries and agriculture and to face the increasing economic problems. These policies did not really help much. However, due to the strong Czechoslovak economy (prior to communism), the negative consequences of the communists' policies were not as troublesome as they were in Hungary and Poland during the same time (1950s) (Ekiert, 1996: 130; see Myant, 1989). One positive thing that should be highlighted here regarding the economic policies implemented during this period is the “economic equalization” strategy. The economic inequality and the gap that existed between the Czech and Slovak lands were reduced. In terms of “regional economic equalization” the communists managed to have a successful economic policy (Selucký, 1991: 167).

The policies taken during the Stalinization period and the militarization programme resulted in negative economic, social and institutional consequences. With the death of Gottwald and Stalin in 1953, a window of opportunity for a change appeared. The post-Stalin Soviet leaders decided that the policies taken were not working and a change was needed. The focus on heavy industrialization and militarization was replaced by a concentration on “consumer industries and agriculture” (Selucký, 1991: 168). This de-Stalinization period did not last long since 1956 witnessed the birth of the second five-year plan. The focus was again on heavy industry and militarization. Unlike Hungary, Stalinization continued to be the norm in Czechoslovakia not only regarding the economy

and institutions, but also with respect to the terror practiced by the communist leaders⁹² (Skilling, 1989: 245-246; Selucký, 1991: 168).

In 1958, a limited economic reform was introduced, however it did not bring any significant changes to address the deteriorating economic situation. By 1960, the “Stalinist reconstruction of the polity and the economy was concluded” when the National Assembly ratified the new constitution and announced socialism’s triumph “and the beginning of the transition to communism” (Ekiert, 1996: 128-129). While socialism was being declared victorious, the economic problems were increasing. Many projects were not finished; investments were cut and it became apparent in the early 1960s that the economic situation (unemployment increasing; income, production and growth were decreasing) was declining (Myant, 1989: 97-106; Ekiert, 1996). With the failure of the third five-year plan (1960-1965) in 1963 and the beginning of economic recession⁹³ (see Selucký, 1991: 168-169), it became a top priority to “stabilize the economic system, restore its balance, and stimulate economic growth” (Ekiert, 1996: 132).

In order to deal with the deteriorating economic situation, the Czechoslovak government created an Economists’ commission. The commission was headed by Ota Šik and was meant to do some major reforms to the “central planning mechanism” (Ekiert, 1996: 132). This commission acted as a window of freedom for reformists and

⁹² Political trials and executions of opponents to the Communist rule (such as Gustáv Husák) and Slovak nationalists continued. Environment of fear persisted everywhere in Czechoslovakia and people were too scared to oppose the Communist policies (see Skilling, 1989).

⁹³ The bases for the economic problems in Czechoslovakia are similar to the problems faced by the communist bloc. The recession was caused by several internal and external factors: Too ambitious plans that were beyond the capability of Czechoslovakia and the failure of the centralized planning methods to deal with the Czechoslovak economy; increase in the gap between the available raw material and the industrial production; agricultural production was disregarded and weak; the produced material lacked the competitive quality on a global level; changes in the Soviet investments’ agenda which focused on few sectors; and the Soviet problems with China which resulted in cancelling several export deals to China (Selucký, 1991: 169; Ekiert, 1996: 132).

technocrats who were critical of the economic policies in the country. These reformists were able to criticize the regime from within through the publications of their ideas within the framework of the commission (Myant, 1989: 111). Šik believed that economic reforms could not be achieved without political changes. These reformists thought that changes to the economic system would spawn a political reform that would lead to liberalization and democratization of the political system.

The communist leaders blocked the reform plans since they were not ready to give up the benefits they enjoyed from draining the country of its resources. So the communist leaders' economic control and tyrannical leadership delayed the implementation of any meaningful reforms. The delay demonstrated that no economic reforms could be realized without a prior political change. It was not until January 1968, when Aleksander Dubček replaced Antonín Novotný as the First Secretary of the Communist Party of Czechoslovakia (Komunistická strana Československa (KSČ)), that economic reforms were accompanied through the use of political and social reforms (Stevens, 1985: 137-138; Selucký, 1991: 169-170).

With the fall of Novotný, a new era started in Czechoslovakia known as the Prague Spring. This period was characterized by an attempt by Dubček and other reformists (such as Šik) to liberalize and democratize the communist regime in addition to the necessary economic reforms. On April 5, 1968, a plan for economic, political and social reform was published. Dubček, Mlynář⁹⁴, Šik and other reformists in the KSČ were the main architects for the plan known as the Action Programme. The Action Programme

⁹⁴ Mlynář wrote "Towards a Democratic Political Organization of Society" which was made public on May 5, 1968. In this piece he argues that there is a need for a pluralist system in Czechoslovakia to face the various political and economic problems (see *Towards a Democratic Political Organization of Society*, cited in Stokes, 1996; also Mlynář, 1980, 267-281).

is considered the blueprint for the Prague Spring era and the democratization of Czechoslovakia. This Programme reflected the belief that socialism “cannot mean only liberation of the working people from the domination of exploiting class relations, but must make more provisions for a fuller life of the personality than any bourgeois democracy” (The Action Programme, 1968: 9).⁹⁵ The leadership’s belief at that time—as the Action Programme reflects—was that any economic reform had to be preceded by political reforms (see Ello, 1968; Selucký, 1973: 6-7; Navrátil, 1998).

The Action Programme reviewed the system created after the Second World War by the Soviet Union in order to liberalize the economy and democratize the entire political system.⁹⁶ The Action Programme called for the creation of a suitable socialist system based on the needs of the Czechoslovak Republic, rather than on the unquestioned Soviet framework. The programme included measures for liberalization, economic reform, liberties, freedoms, and pluralism. Moreover, trade unions were reactivated and witnessed “actual changes in the structure and practices” (Ekiert, 1996: 152). As for the farmers, they pushed for creating their own organization and by the end of May 1968, “committees were organized in 50 percent of districts” (Ekiert, 1996: 153).⁹⁷

During the Prague Spring, there were some attempts “to organize independent political forces” that were considered illegal by the ruling party. This situation did not

⁹⁵ This Action Programme was compiled along with other official speeches and documents by Paul Ello. You can find this quotation also in Ello, 1968: (32a) 120.

⁹⁶ According to the Action Programme, there should be a restructuring of “the whole political system so that it will permit the dynamic development of social relations appropriate for socialism, combine broad democracy with scientific, highly qualified management, strengthen the social order, stabilise socialist relations, and maintain social discipline. The basic structure of the political system must, at the same time, provide firm guarantees against a return to the old methods of subjectivism and highhandedness”. Moreover, a new constitution of Czechoslovakia has to be drafted and discussed thoroughly by experts and it has to have a public support before it is presented to the National Assembly (“Akční program Komunistické strany Československa,” *Rudé právo*, Prague, April 10, 1968, pp. 1-6 cited in Navrátil, 1998).

⁹⁷ Pressures for the Central Collective farm management and pressures from the Slovaks to create their own organization, two unions were formed: “A Czech Union of Collective Farmers and a Slovak Union of Private and Collective Farmers” (Ekiert, 1996: 153).

stop the attempts to create some political clubs or groups such as Klub Angažovaných Nestraníků (Club of Committed Non-Communist) (KAN) and Klub 231 (Ekiert, 1996: 155). The “independent political society” remained immature due to several reasons. First, the reform period was too short.⁹⁸ Second, the leadership of the KSČ was divided, which stifled the policies and decision-making process. Third, the reformists were very careful in promoting the reforms out of fear that any hiccup might trouble their relations with the other Warsaw Pact countries. And fourth, the continuous threats by the communist bloc kept hindering these reforms (Ekiert, 1996: 159-161).

Although a political window was opened, it did not lead to any institutional restructuring of the *party-state* or the growth of independent groups that might threaten the power of the *party-state*. Eventhough the Prague Spring did not threaten the stability of the regime or the power of the ruling party (Ekiert, 1996: 158); the communist bloc (except for Hungary under Kádár) viewed the changes in Czechoslovakia suspiciously. The communist leaders were worried that any reform similar to the one suggested by the Action Programme might jeopardize the position of the bloc with respect to the West (see Navrátil, 1998).⁹⁹ However, in my opinion, the main concern was the fear that this environment of freedom and an increase in the voices calling for more democratization would weaken the positions of the communist leaders forcing them to relinquish some of their power. These fears led to the Dresden Meeting of the Warsaw Pact-Five leaders (Soviet Union, Hungary, Poland, Bulgaria and East Germany) on March 23, 1968. The Czechoslovak leaders were deceived regarding the intentions of the meeting. They came

⁹⁸ The Soviets did not allow the reforms to move on.

⁹⁹ Navrátil compiled a lot of the official documents and minutes from meetings of the Communist bloc regarding Czechoslovakia which gives the reader a sense of what was going on in the meetings and the fear that was spread among the Warsaw Pact leaders.

to discuss the deepening of the economic cooperation, yet they were surprised by the fact that the meeting was meant to know more about the broad institutional reform under the Action Programme (Navrátil, 1998, Document 14: 64).

The Soviet leaders were not pleased with the institutional reforms and wanted to stop them. Before using the military option, bilateral talks between the Soviet Union and Czechoslovakia took place in the end of July 1968 at Čierna and Tisou. Dubček and the reformist wing in the KSČ leadership¹⁰⁰ tried to assure the Soviets that the reforms are not against socialism. These reforms were merely internal institutional reforms that would give more legitimacy to the regime without shaking the socialist foundation and the close ties between the Soviet Union and the communist bloc.

A compromise was reached in which the Czechoslovak representatives promised not to take any measure that would weaken the superiority of the KSČ or give more freedoms (especially freedom of press). A follow-up meeting was scheduled to take place in Bratislava on August 3, 1968. In the Bratislava meeting, representatives from the Soviet Union, East Germany, Poland, Hungary, Bulgaria and Czechoslovakia were present and they signed the Bratislava Declaration. The Bratislava declaration emphasized the importance of socialism, unity among the communist bloc members, defense of socialism against any attempt by imperialists and “anti-communist forces”¹⁰¹, and the devotion to Marx and Lenin’s teachings (Navrátil, 1998, 326-327).

Following the Bratislava Declaration, a few phone calls and meetings between the

¹⁰⁰ The KSČ leadership was divided between a reformist group (such as Josef Smrkovský, Oldřich Černík, and František Kriegel) and a conservative anti reformist group (such as Vasil Bil’ak, Drahomír Kolder, and Oldřich Švestka).

¹⁰¹ The usage of military force to defend socialism against any attempts to create a pluralist society became one of the key elements in the Brezhnev Doctrine. This responsibility regarding the defense of socialism was the key to justifying the intervention of the Five and the invasion of Czechoslovakia (Navrátil, 1998: 309). Any attempt for reform in any country in the Communist bloc cannot be accepted without the approval and blessing of the Soviet Union.

Soviet Ambassador to Czechoslovakia and Dubček took place. The results of the discussions were not satisfactory to Brezhnev who thought the Czechoslovak reformist leaders had failed to fulfill their commitments in Čierna and Bratislava. In close coordination between the Czechoslovak conservative leaders and the Soviet Union, the Politburo (during a three-day meeting on August 15-17, 1968) decided to use military intervention. The argument was that all diplomatic means failed to protect socialism in Czechoslovakia and that time had come “to resort to active measures in defense of Socialism” and “to provide help to the Communist Party and people of Czechoslovakia through military force” (Document No. 88, cited in Navrátil, 1998: 376).

On the night of August 20-21, 1968, Czechoslovakia’s invasion (Operation Danube) started with the participation of four Warsaw Pact countries: Bulgaria, Hungary, Poland and the Soviet Union. The Czechoslovak army was not asked to resist the invasion. To prevent bloodshed, Dubček urged people not to resist. The invasion did not result in a new socialist government. The reform leaders (Černík, Dubček, Kriegel, Smrkovský and Špaček) were arrested while the remaining party leaders and President Svoboda “were neither dismissed nor detained” (Ekiert, 1996: 163). The country entered into a power vacuum since the remaining leaders were not able to create a new pro-Soviet government. President Svoboda, along with centrist and conservative party members, was forced to appeal to Moscow. Svoboda insisted on freeing the arrested leaders and allowing them to join the negotiations (Ekiert, 1996: 164). Under extreme pressure and humiliation from the Soviet leaders, the Czechoslovak leaders (except for Kriegel) signed the Moscow Protocol before they returned to Prague on August 27, 1968 (see Document No. 119, The Moscow Protocol, in Navrátil, 1998, 477-480).

The Moscow Protocol's main aim was to overturn the Action Programme and any reform taken during the Prague Spring era. The Czechoslovak leaders had to withdraw most of the reforms they took before. Moreover, they had to implement new policies and "introduce new control mechanisms and propaganda to win support for the Moscow Protocol" (Williams, 1997: 162). KSC Presidium adopted a work plan to implement those policies on September 17, 1968. The work plan highlighted some important issues such as: the improvement and advancement of the party's; the implementation of the Moscow Protocol; the completion of measures in accordance to the Action Programme; and the preparation of "the party congress" (Williams, 1996: 163).

Although the Soviets forced Czechoslovakia to take those measures, they could not replace Dubček—who was supported by the vast majority of the Czechoslovaks. In order to absorb the anti-invasion/occupation protests, the Soviets returned Dubček to power "until a quisling government could be set up" (Goertz, 1994: 155). However, throughout 1969, protests continued against the invasion. In response, the Soviet Minister of Defense warned that force would be used to put down any act against the Soviets (Goertz, 1994: 155).

The Czechoslovak leaders were asked to reinstate the censorship and control of mass media; ban any anti-socialist programs or phrases in the radio, newspapers and television; close the political organizations and clubs; discharge some reformists who were unfavorable by Moscow (such as Kriegel, Císař, Pelikán, Šik, Hájek, in addition to other reformists); and not to fire or mistreat officials who were in favor of the invasion. In September 1968, the parliament suspended "the June amendment to the old press law", approved two bills: one creating the Office for Press and Information (OPI) and the other

“declaring the National Front as the sole basis of political action” (Williams, 1997: 161). The National Front took a law banning any groups similar to KAN and Klub 231 (which were banned after the invasion). Moreover, a new law (126/68) was approved that allowed the use of force to disperse “public assemblies, demonstrations, and parades, and dissolution of organizations” (Williams, 1997: 161).¹⁰²

A new era of normalization started with the appointment of Gustáv Husák (supported by Moscow) as the leader of the Communist Party of Slovakia in August 1968 who replaced Dubček as the first secretary of the KSČ in April 1969. Husák not only rolled back the reforms but also managed to get rid of the reformist members of the party. Most of the party’s liberal members were dismissed. Any one from the bureaucrats, officials, elites, and intellectual who criticized the backward transformation of the political and economic system was fired or imprisoned. The police authorities and secret services were given more powers. Stronger relations with the other socialist states were developed. The freedoms enjoyed by some businesses and factories during the reform period were terminated. Economic liberalization was stopped and a return to centralization was launched (Goertz, 1995: 154-157).

As for the media, in addition to its censorship, Husák demanded that any person not considered to be completely loyal to the party and trustworthy could not make any political comment (Williams, 1997: 164). By 1975, Husák had combined the positions of the KSČ first secretary and the Czechoslovak president and placed all powers in his hands. Under Husák, Czechoslovakia became the Soviet Union’s best ally or more

¹⁰² The Security Council had concerns regarding the Czechoslovak case. The Soviet compelled that the Czechoslovak leaders ask that this case be dropped. As for the invading troops, the protocol did not mention a timeline for withdrawal, however it only indicated that the withdrawal would happen “in stages” (see Document No. 119, The Moscow Protocol, in Navrátil, 1998, 477-480).

accurately controlled by the Soviet Union. The country became “an obedient satellite, ready to model itself on the Soviet Union and to support the latter’s foreign policies without question” (Skillling, 1989: 250).

This new era was characterized by being an institutionalization period—what I would like to call *institutionalization backward*. This new period was meant to restore and strengthen the previous institutions and prohibit any signs of reforms, freedoms and liberalization. The return of oppressive and centralized economic policies resulted in economic problems (not as severe as in other communist countries such as Poland). The economic stagnation needed to be addressed and Husák recognized in the second half of the 1980s that reforms were needed. Husák became aware that along with economic reform, there was a need for democratic reforms too (Skillling, 1989: 252).

Several measures were taken in 1987 to deal with the deteriorating economic situation but little progress was achieved due to the division among the party leaders (three main opinions: those who rejected any kind of reform, those who believed reform should be done without delay and those who supported a slow reform). Czechoslovak PM Lubomír Štrougal¹⁰³ was in favor of an immediate reform. Štrougal’s chief adviser, Sedlák, argued, “without political change, there can be no effective economic change” (cited in Skillling, 1989: 252).¹⁰⁴

¹⁰³ Lubomír Štrougal was Czechoslovakia’s Prime Minister from January 28, 1970 until October 12, 1988.

¹⁰⁴ It should be highlighted here that the Czechoslovak leadership was aware that a change is needed not only due to the domestic need and general discontent but also due to the economic and political changes taking place in the Soviet Union.

4.2.4 Solidarność¹⁰⁵ and the Revival of Poland

From the Hungarian Revolution in 1956 to the Polish October of 1956¹⁰⁶ to the Prague Spring in 1968, all represent dissatisfaction with the Stalinization period, which was built on bad economic policies, corruption, “forced industrialization and political terror” (Ekiert, 1996: 215). Although the life span of the Polish October was not as long and dramatic as in Hungary in 1956, the consequences of the Polish October and the spillover to other communist countries were remarkable (Berend, 1999: 115-116).

With the death of Stalin in 1953 and the Polish leader Bolesław Bierut¹⁰⁷ in March 1956, the Stalinist hardliners in Poland became weaker marking the beginning of a new era. In addition to some limited short-term de-Stalinization, this new era witnessed several incidents and upheavals (1956, 1968, 1970, 1976, 1980 and 1981) due to disappointments and deteriorating economic, social and political conditions. During this short period of de-Stalinization, Poland witnessed minimal liberalization such as some limited freedoms to groups and organizations. This period, which was full of promises of economic and political reforms, came to end with the June 1956 incidents in Poznań (Ekiert, 1996: 216; see also Meiklejohn Terry, 1989).

With the abolishment of the Ministry of Security and freeing many political prisoners, reforms triggered a desire for more reforms by the Poles especially regarding the economic situation. On the *Black Thursday* on June 28, 1956, industrial workers in Poznań organized the *Bread and Freedom* demonstration against the poor economic

¹⁰⁵ Full name is: Independent Self-governing Trade Union “Solidarity” — *Niezależny Samorządny Związek Zawodowy “Solidarność” (NSZZS)*.

¹⁰⁶ Polish October is also known as October 1956, Polish thaw, or Gomułka’s thaw.

¹⁰⁷ The first Secretary General of the ruling Polish United Workers Party at that time.

policies and economic conditions (lack of basic needs of life such as absence of proper housing, food shortage, low wages, etc.). The Polish government responded by suppressing the riots by force. Polish PM Józef Cyrankiewicz blamed these riots on “imperialists” and “murderous provocateurs” (Myant, 1982: 41-44; see also Zinner, 1956: 131-132). This move by the Polish leaders fueled the protests, which subsequently spread throughout Poland calling for economic, political and party reforms.

Although this de-Stalinization ended soon, the institutional consequences were remarkable. First, the ruling communist party *Polska Zjednoczona Partia Robotnicza* (PZPR) had to bring back Władysław Gomułka as the first secretary of the party.¹⁰⁸ Second, the Polish Catholic Church remained independent and went on to become the strongest organization after the PZPR by the end of 1950s. The church’s position was very influential in Poland and it played a significant role in supporting the Solidarity movement (especially when Jean-Paul II was the Pope) (see Curry, 2008: 176-178). The Catholic Church played a significant role in building a strong civil society¹⁰⁹ and providing an alternative ideology to counter the ruling regime’s secular and materialistic ideology. Third, attempts to “collectivize the Polish agriculture” vanished and Poland was “the only Soviet bloc country where the bulk of arable land [...] remained in private hands” (Ekiert, 1996: 216). And fourth, the private ownership of “retail trade and services

¹⁰⁸ Due to the industrial unrest that reached its peak in June 1956 (mainly in Poznan), The PZPR had to do something. Since his arrest, Gomułka gained popular support which made him an important person. Therefore, the PZPR had to readmit Gomułka back to PZPR in August 1956 and appoint him as the first secretary (despite the Soviet opposition) in August 1956 in order to deal with the public unrest.

¹⁰⁹ Civil society could be defined as “the independent self-organisation of society, the constituent parts of which voluntarily engage in public activity to pursue individual, group or national interests within the context of a legally defined state-society relationship” (Weigle and Butterfield, 1992: 3). For Howard, civil society refers to “the realm of organizations, groups and associations that are formally established, legally protected, autonomously run, and voluntarily joined by ordinary citizens” (Howard, 2003: 34-35). However, we have to keep in mind that during communism, not all features of civil society apply. For example, “legally protected” was not the case in most communist countries.

remained sizable” employing almost one million employees and producing around 5.5 and 6 per cent of the national income in 1970 and 1980 respectively (Ekiert, 1996: 216).

Gomułka started his period as a national hero who criticized the use of force in Poznań and argued for important measures to be taken to fulfill the calls for more freedoms and pluralism. Gomułka’s “understanding with the Soviets” and his belief that “there were many roads to Socialism”, gave him the strength to “make a series of strategic concessions to popular demands and to permit the three specific features of the Polish order—an independent Catholic Church,¹¹⁰ a free peasantry, and a curious brand of bogus political pluralism” (Davies, 1984: 10-11). In a speech in Warsaw on November 4th, 1956 Gomułka emphasized the importance that the “Party must direct the process of democratization” that “is aimed at strengthening the people’s authority by means of wide participation of the working classes” (Zinner, 1956: 285).¹¹¹

Gomułka promised to change the electoral system and increase the powers of the parliament. Although these measures were important, the PZPR would still be dominant. No opposition was allowed although there was an increase in the number of candidates running for the parliamentary elections in December 1956. Nevertheless, the iron fist mentality did not really vanish from Gomułka’s mind since he threatened to cross “Poland off the map of European states” if he did not receive full support during the elections (Myant, 1982: 46). Moreover, Gomułka argued that the new electoral law is “to permit the people to elect and not merely to vote” (Davies, 2005: 440). As for the economic policies, Gomułka assured that reform strategies will be taken and direct the

¹¹⁰ During this time, the Church enjoyed a lot of freedom and restored “much of its autonomy” (Myant, 1982: 46)

¹¹¹ For the entire address made by Gomułka before a National Conference of Party Activists in Warsaw on November 4, 1956, please see Zinner, 1956: 284-306.

economy away from the centralized Stalinist model. The emphasis shifted from the heavy industry to more diversity to fulfill the needs of the Poles (Meiklejohn Terry, 1989: 181).

Gomułka's commitment to modify socialism in accordance with the needs, culture and tradition of Polish people ended up in disappointment. Poles lost hope that their situation would be better with Gomułka. By mid 1960s—with continuous pressures from the Soviet Union (especially when Brezhnev was in power), lack of domestic institutional reform at the party and government level and the conflict between the reformists and Stalinists in the party—most of the 1956 promises and developments vanished and “gave way to what came to be called the ‘small stabilization’” (Meiklejohn Terry, 1989: 181).

The first victims of the new Gomułka's era were the so-called freedoms granted to the media and intellectuals. The economic reforms of the centralized stagnant economy were never done and remained ideas and plans. All promises for a better standard of living disappeared. While there was no renewal of the collectivization of agriculture, the private sector suffered from restrictions and discrimination based on ideology. As for the Sejm, it returned back to its old tasks—being just a parliament by name with no real powers. The PZPR ignored the Sejm and did not consult it or seek its approval of important policies (Meiklejohn Terry, 1989: 181; Berend, 1999: 114-116). Gomułka created a small group of allies who offered him a singular view of the political environment, which in a lot of instances was not popular neither among the other party members nor the public (Davies, 2005: 441). By the mid 1960s, it became apparent that the promises made by Gomułka in 1956 had vanished. As a result, the public became

enraged at the lack of movement in regards to the economy.¹¹²

The second half of the 1960s witnessed the decline of Gomułka's power and the rise of the conservatives in the ruling party. With the end of the Khurchev era in 1964 and the beginning of the Brezhnev era, the Stalinist faction in the party became stronger leading to more centralization, suppression, and an "atmosphere of intellectual and political stultification that characterized the 'small stabilization'" (Meiklejohn Terry, 1989: 181; see also Myant, 1982; Brown, 1991: 72-74; and Davies, 2005: 441-442). Major factions of the population (intellectuals, students, and the technocrats in the Party) felt frustrated and disappointed with the situation. This frustration, supported with what was going on in Czechoslovakia during the Prague Spring, led to "protests against censorship and cultural repression" (Meiklejohn Terry, 1989: 181). These incidents gave opportunity to the conservatives in the PZPR to topple Gomułka along with many liberals from the party and from public positions. Edward Gierek became the first secretary of the PZPR on December 20, 1970.

Gierek started his period by promising economic reform based on plan to institutionalize and modernize the industrial production and make sure that people's basic needs are met. He also emphasized the need for a party reform; however, no real institutional change was viewed in the party (Myant, 1982: 83). Most of the administrative reforms taken in the Sixth PZPR Congress (1971) witnessed the recommencement of the "higher-party decision-making" organs (Lepak, 1988: 64-65). Satisfied with the economic situation in the early 1970s, Gierek's Politburo adopted an economic expansion policy in order to strengthen Poland's "socialist society" (Lepak,

¹¹² Although the reforms were reversed and ignored, but it is important to mention that the situation never went back totally to the earlier times prior to 1956.

1988: 65). One additional consequence for this optimism was the illogical organization of the society reflected in the reformation of the youth groups. This act threatened to divide the population who for a short time were grouped around Gierek. The 1972 Central Committee legislative assembly suggested that a “federation of youth organizations” should be created (Lepak, 1988: 67; see also Dziewanowski, 1977: 196-197). This reorganization of the youth groups and university students was accompanied by a reform of the educational system. The Catholic Church considered the reforms to include measures against the Catholic teaching and also would put pressures and restrictions on Catholic students which resulted in the worsening of the relations between the Church and the regime starting from mid 1973 (Lepak, 1988: 67-68).

The PZPR under Gierek’s leadership sought to make some amendments to the 1952 Constitution. The 1976 Constitutional amendments brought major changes to the 1952 Constitution. Gierek emphasized the importance of socialist democracy and the inseparable relation between democracy and socialism to have a strong state. However, all these arguments about social democracy highlighted “the role played by the military, the police, and the security services in maintaining the ‘socialist order and respect for the law’” (Lepak, 1988: 71). The 1976 constitutional amendments emphasized the close kinship to the Soviet Union and all the Comecon countries. The controversial clause added was the eternal alliance with the Soviet Union that cannot be broken and any act against this alliance is considered “illegal and any Soviet intervention to preserve the alliance constitutional” (Wróbel, 2005: 41). The new amendments specified that Poland is a socialist country with the superiority and leadership of the PZPR. PZPR is the “leading political force of society” responsible for building the socialist foundations in

Poland and is the guardian of socialism (Article 3 of the Polish Constitution).¹¹³ Although the suggested amendments had to be modified slightly under the protesters' pressures (Catholic Church, University students, academicians, intellectuals), the damage facing Gierek rule could not be repaired (Bromke, 1981: 153; Lepak, 1988: 71).

Among the measures Gierek took directly after becoming the first secretary were increase the wages for those with low salaries; increase the pension; and guarantee that food prices will be fixed for two years (Myant, 1982: 81).¹¹⁴ Gierek promised more freedoms and liberties, in addition to open to the West,¹¹⁵ improve the functioning of the Sjem and all "representative institutions, trade unions and worker self-management, and other professional groups" (Meiklejohn Terry, 1989: 182). Gierek main policy was launching a program to reform the economy, renew and develop Poland's industry and raise the standards of living. His approach was based on getting western loans to finance the imported heavy technology coming from the West.

The first half of the 1970s was full of promises and the economic situation was not too bad at that time. Poland enjoyed high growth, growing industry and good agricultural production. But the domestic needs for housing, health care, and other basic needs on one hand; and the oil crisis effect and recession on the other had negative influence on the weak economy.¹¹⁶ What added to the deteriorating economic situation

¹¹³ Constitution of the Polish People's Republic, translated by Hanna and Richard Szawlowski. *Dziennik Ustaw* 1952 No. 32 item 232 (as amended). Consolidated text in *Dziennik Ustaw* 1976 No. 7 item 36 (cited in Simons, 1980: 288).

¹¹⁴ Due to the continuous strikes moving from Szczecin and Gdańsk to Łódź in early 1971, Gierek decided the earlier price increases taken in December under Gomułka had to be frozen. The prices were "frozen at their pre-December levels for two year" (Lepak, 1988: 51).

¹¹⁵ His promises to open to the western countries was based on his friendships and close relation with some European leaders.

¹¹⁶ Gierek's decisions were not that successful in coping with the economic problems facing Poland and prioritizing them. Rather than choosing between the rapid industrialization or "improving the lot of the

was the “bad harvest” in 1975 accompanied with a similar situation in the Soviet Union (Myant, 1982: 90-91). This required importing grains from the West and paying by “hard currency” in order to cover the people’s needs. To be able to pay for the Western exports, Poland had to export more to the West “at the expense of domestic consumption” (Myant, 1982: 91). Such a plan caused more shortages in the food and led to sharp increase in food prices on June 24, 1976. The prices’ increase could not last for more than two days; it had to be withdrawn under the pressures of the protests and riots—especially strikers from Radom and Ursus who faced harsh sanctions by the Gierek regime.

The opposition grew stronger and a Committee for Defence of the Workers (Komitet Obrony Robotników (KOR)) was created on September 27, 1976. The Committee’s aim was forcing the Gierek regime to stop the prosecutions and free all the arrested workers. The regime responded by arresting a lot of the KOR activists in May 1977. The support for KOR grew stronger not only among the workers but it also received the aid of intellectuals and the Catholic Church.¹¹⁷ This opposition forced the government to release not only the KOR activists but also the workers who were arrested during the 1976 protests (Bromke, 1981: 153).¹¹⁸

By the late 1970s, the opposition became more organized, united, composed of different factions of the society (workers, intellectuals, students, young and old, women

long-deprived Polish consumer”; Gierek chose to do both (Meiklejohn Terry, 1989: 182). This was not possible due to the economic and political limitations facing Poland at that time.

¹¹⁷ In its attempt to pressure the Gierek regime to free the arrested workers, the Church decided to go openly in its criticism of the arrest of the workers (see Lepak, 1988: 180).

¹¹⁸ Prior to the protests of 1976 and their aftermath, the movement by the Church, workers, intellectuals and other groups did not result in creating a strong civil society facing the regime. Even the March 1976 elections proved that the opposition to the Constitutional amendments by these groups did not lead to boycotting the elections or even lowering the turnout (98 per cent turnout). The result of those elections was almost a full support for the National Front (Lepak, 1988: 74). After the increase in prices and all the arrests made, the Church, workers and intellectuals were creating a strong civil society, and a strong opposition to the regime was growing.

and men, etc.) and backed by the Catholic Church.¹¹⁹ Following the assassination of Stanisław Pyjas¹²⁰ on May 7, 1977, the criticism and protests against the regime increased. The government responded by arresting important KOR leaders.¹²¹ These arrests and protests were happening at a critical moment with the Belgrade Conference on European Security and Cooperation scheduled at the same time. Poland's need to western funds and financial market, and in order to preserve "Poland's 'liberal' international reputation", Gierek announced during the Belgrade meeting the general pardon for the arrested KOR members and other workers (Lepak, 1988: 181-182).

The year 1977 witnessed the birth of important unofficial organizations that would lead later to the birth of Solidarity. In March 1977, *Ruch Obrony Praw Człowieka i Obywatela* (ROPCiO) (Movement for Defense of Human and Civic Rights) was established as a resistance movement against the regime. Later in September 1977 an unofficial paper *Robotnik* (The Labor or Worker) was launched by a number of active KOR members. The new paper aimed to educate the workers about the continuous struggle with the regime. The paper led to the creation of the first unofficial free union cell in November 1977 followed by the initiation of the Committee of the Free Trading Unions (*Komitet Założycielski Wolnych Związków Zawodowych*) in Gdańsk on the eve of May 1978. In addition to that trade union, several others were created in Katowice, Radom and Szczecin in the late 1970s, but the strongest and most influential union was

¹¹⁹ The increase in the opposition's power in Poland was happening simultaneously with the signing of Charter 77 in January 1977 (during the Husak rule) in Prague-Czechoslovakia condemning the practices by the government and "calling for the restoration of basic civil liberties" (Bromke, 1981: 154). Both the KOR and the opposition in Czechoslovakia communicated and supported each other. They agreed to cooperate and to be loyal to the ideals and regarding civil liberties, democracy and human rights: "achieve truth, human rights, democracy, social justice and national independence" (*The Times*, August 17, 1978: 11).

¹²⁰ A Student at the Jagiellonian University-Krakow and an active member of the anti-communist student movement.

¹²¹ The Catholic Church, domestic activist groups and also the French and Italian Communist parties condemned the arrests.

the one in Gdańsk prior to the establishment of the Solidarity movement. The Committee for Free Trade Unions's aim was mainly to defend the workers and citizens' rights and to bring democracy back in. Among its activities was the underground newspaper *Robotnik Wybrzeża* (The Workers of the Coast) (Garton Ash, 1983: 23-24).

In September 1979, KOR published a *Charter of Workers' Rights* (signed by activists not only from workers but also intellectuals and other groups) calling for better working environment, better salaries, decent working hours and the ability to establish legal free trade unions. So the 1979 witnessed the flourishing in the relations between the Church, workers and intellectuals creating a unique trinity—facilitating the birth of Solidarity later on (Garton Ash, 1983: 25). With the beginning of the 1980s and the deteriorating economic situation, new strikes and protests broke at the Lenin Shipyards in Gdańsk under the leadership of Lech Wałęsa.¹²² Despite the July 1980 arrests, the strikes continued in the Baltic coasts and were spreading to other parts of Poland, with the workers in the front lines. The new strikes were more organized and advanced since the strikers learned a lot from their struggle with the regime for several decades.

In mid August, Gdańsk witnessed the birth of the Interfactory Strike Committee (*Międzyzakładowy Komitet Strajkowy*, MKS), which presented its list of twenty-one

¹²² It is important to highlight here that the deteriorating economic situation was not the main reason for the strikes; few other reasons played a crucial role. Some scholars such as Pravda argue that the 1980 strikes were the results of “a crisis of distribution, a crisis of legitimacy and a crisis of participation” (Pravda, 1980: 168). Pravda's argument is partly true since it misses the crisis at the leadership level and the relaxation of the iron grip on the people. The incidents and revolution of 1980/81 are more similar to what de Tocqueville argued: “it is not always when things are going from bad to worse that revolutions break out. On the contrary, it oftener happens that when a people which has put up with an oppressive rule over a long period without protest suddenly finds the government relaxing its pressure, it takes up arms against it” (de Tocqueville, (On Democracy, Revolution and Society) in a volume edited by Stone and Mennell: 1980: 230). So with the confusion and disagreement among the PZPR leaders, a bit of relaxation of the pressure by the regime, the trinity formed by the Church, workers and intellectuals, and the learning process from earlier strikes and protests, all this led to the revolution in 1980-81. So the bad economic situation was necessary but not a sufficient condition to trigger the strikes (see Garton Ash, 1983: 32-33).

demands¹²³ to the Polish government. Under the continuous pressures, the government reached an agreement with the strikers on August 30, 1980. The accord emphasized the demands of the strikers by permitting free and independent unions, freedom to strike and protest, freedom of expression and speech, and freedom for religious practices. This Polish success highlights the effect of “political culture, experience and leadership” and the support of the Catholic Church in making history (Pravda, 1980: 192).¹²⁴

On September 22, 1980, representatives of thirty-six trade unions met at the Lenin shipyard in Gdańsk and agreed on unification. This unification gave birth to the Solidarity movement with Wałęsa as the chairman. The growing public support to Solidarity along with backing of the Catholic Church, Solidarity’s members grew significantly to reach over a third of the population (over ten-million). Not only workers formed the core of Solidarity, but also intellectuals, students, farmers, members of the Catholic Church and some party members. Solidarity’s attempt for change was peaceful. In the first congress held by Solidarity, *the Self Governing Republic* program was adopted on October 7, 1981. The program highlighted the previous demands regarding institutional reform and that the current crisis (economic and institutional) are the results of “the lack of democracy and social justice” (Dadak and Bryk, 1985: 347). Moreover, Solidarity considered its duty and the duty of everyone not to let the country fall. The only way for that is by restructuring the society, the economy and reforming the

¹²³ The Demands were based on the KOR’s *Charter of Workers’ Rights*. For the list of the twenty-one demands please check: *Protokoły porozumień Gdańsk, Szczecin, Jastrzębie. Statut NSZZ, ‘Solidarność’*, KAW, Warszawa, 1980.

¹²⁴ Among the casualties of the strikers’ success and the failure of Communist institutions was the replacement of Gierek by Stanisław Kania as the First Secretary of the PZPR. However, due to the suspicion and lack of trust from the Soviets in Kania’s agendas and policies, his government fell in October 1981 and was replaced by the Minister of Defence General Wojciech Jaruzelski.

government at all levels on democratic basis.¹²⁵

This growing importance and support for Solidarity represented a threat to Jaruzelski's military regime. All the freedoms and achievements that Solidarity enjoyed were ended with the introduction of the Martial Law on December 13, 1981. Solidarity was banned and thousands were imprisoned. Lech Wałęsa, among other Solidarity leaders, was arrested. The situation did not go back to pre-Solidarity period but even worse. All the achieved accomplishment, freedoms and civil liberties disappeared. The military controlled and monitored everything: media, factories, bureaucracies, schools, universities, etc. Military courts were active and convicting anyone whose loyalty to the regime is questioned. Economic situation deteriorated further and the economy went into a recession. The inflow of foreign credit decreased sharply reaching USD 200 million by 1985 compared to around USD 8 billion in the 1970s. Immigration increased sharply in the 1980s. While the supply of main products and commodities became slightly better, but due to the market incompetence and the "price controls", the shortage in some commodities exceeded "the pre-crisis period" (Kondratowicz and Okolski, 1993: 15). The scarcity in the main products "became a common phenomenon of daily life" (Kondratowicz and Okolski, 1993: 15). Moreover, Poland lost its international status as a communist country that respects human rights and civil liberties. The US regarded the military government as an extension of the Soviet Union and imposed economic sanctions (Davies, 2005: 494).

The aim of the regime was to destroy the Solidarity movement and all the unions

¹²⁵ For the entire program see: Program NSZZ "Solidarność" uchwalony przez I Krajowy Zjazd Delegatów—"Samorządna Rzeczpospolita". Checked online on October 20, 2010. Available at: <http://www.internacjonalista.pl/menu-kraj/historia-solidarnosci/1484-program-nszz-solidarno-uchwalony-przez-l-krajowy-zjazd-delegatow.html>

established in the late 1970s and early 1980s. The attempt to get rid of the unions did not work. Despite the deteriorating situation, a lot of Poles did not lose hope and the underground movement remained very active. This does not mean that Solidarity was not affected by the repression. The weakness and confusion in the Solidarity lines helped in easing the Martial Law in the second half of 1982.¹²⁶ Wałęsa stayed active and once he was released in November 1982, he continued the underground movement of Solidarity. The underground paper *Tygodnik Mazowsze* continued its activities during the 1980s. What helped in the release of the political prisoners was the historic visit by Pope Jean Paul II in 1983 to Poland. By 1986, most of the political prisoners were released.

The second half of the 1980s was characterized by major changes in the Soviet Union with the reforms implemented by Gorbachev. The effects of these changes spilled over to the communist bloc. In Poland, the opposition was too weak to influence the regime or push for political reforms. As for the economic situation, it kept deteriorating and the Polish regime was unable to implement necessary changes. There was confusion in the leadership and Jaruzelski was planning to resign. In the mid of that situation in Poland, the Solidarity started “floating the idea of dialogue” (Davies, 2005: 500). It became apparent that the current dictatorship cannot last and “that dialogue with Solidarity was unavoidable” (Davies, 2005: 501).

The year 1988 witnessed some strikes that came to an end in September 1988. By that time a secret meeting was held between the government and Solidarity, which resulted in the agreement to launch the Roundtable talks on February 6, 1989. The Roundtable talks took place between February and April 1989. The Roundtable talks

¹²⁶ Although the suspension of Martial Law was by the end of 1982, but in reality, it did not end until July 22, 1983.

discussed the reform of the political and economic system in Poland. The Roundtable Agreement was signed on April 5, 1989. As a result, the government legalized Solidarity and other labor unions and brought back the Senate as the upper house of the parliament with the veto power over Sejm decisions. Furthermore, limited elections was promised in which thirty-five per cent of the seats in the Sejm and all Senate seats were to be decided by free and fair elections. Within four years, elections should be totally free in Poland. June 4th, 1989 witnessed the first limited free elections in Poland. Solidarity won the vast majority of the seats in the Senate and one-third of the seats in the Sejm. In December 1989, the Sejm approved the reform program to move Poland into a democratic country with functioning market economy, amended the Constitution and returned the name of the country back to *Republic of Poland*.

4.3 Conclusion and the Communist Legacy Hypothesis

The historical analysis presented in this chapter is crucial for understanding the situation of each country when post-1989 reforms started. Unlike in Czechoslovakia and Hungary where the reform came from leaders in the ruling party, the situation in Poland in 1980 was different. Poland's Solidarity was a bottom-up movement seeking change and succeeding in that. The three countries went through different revolutions against the Communist regimes' policies. The degree of freedoms and reforms enjoyed by the three countries was also different, as we have seen. Hungary was the first to launch a set of economic, political and institutional reforms following the Hungarian revolution. The Czech Republic attempts for reforms were suppressed in 1968. As for Poland, its post-

World War II experience was characterized by a continuous struggle with the communist regime that lasted until the end of 1980s. The differences described in institutional development, role of civil society and economic prosperity shows that the Czech Republic, Hungary and Poland started their post-1989 reform from distinct positions.

From the historical analysis, the expectation is that the experience or institutional and societal evolution of the Czech Republic, Hungary and Poland under communism should affect the path they took post-1989. Based on that, then the hypothesis generated should be:

Hypothesis 6: The different experience the Czech Republic, Hungary and Poland had under communism should be reflected in their development post-1989. The different experience should reflect different outcomes during the post-1989 reforms. Therefore, Hungary, which was more economically and institutionally advanced than the Czech Republic and Poland, should be the pacesetter and the closest to meet the convergence criteria and adopt the euro.

CHAPTER V: THE CZECH REPUBLIC—THE EUROSKEPTIC LEADER OF CENTRAL AND EASTERN EUROPE

5.1 Background

The Czech Republic used to be among the pacesetters keen to adopt the euro soon after having joined the EU. The Czech Republic initially wanted to join ERM-2 following the EU accession and stay for the shortest possible time in ERM-2 (around 2-2.5 years) and then adopt the euro. In 2004, the Czech Republic was very close, but later it delayed euro adoption further, thereby effectively joining the laggards' camp.

With the financial crisis followed by the European sovereign debt crisis and the current euro problems, it is not clear when the Czech Republic will join ERM-2, but it does not seem to be in the near future. There is currently no announced date regarding euro adoption. The only news heard from the Czech elites is that it is not in the interest of the Czech Republic to adopt the euro anytime soon—especially with the problems the euro area is facing. Why did the Czech Republic move from a pacesetter to a laggard with regard to euro adoption? How can we understand this shift? And how did the financial crisis affect the euro adoption policy in this country?

This chapter is organized as follows: first an analysis of the early institutional development and privatization is offered. Then there is a discussion of the macroeconomic policies and economic situation of the Czech Republic. The importance of this part is to enable us to see how close is the Czech Republic to meeting the

convergence criteria¹²⁷ and adopting the euro. In addition, these two sections help us examine whether the historical legacy and the communist past can help explain the path taken in the post-1989 reforms and ultimately the euro adoption policies. Then the other hypotheses are examined, namely those that deal with the analysis of the government and opposition, central bank, the public and the media. These factors are discussed in relation to each other and in relation to other variables that affect the euro adoption policies. Although the study focuses on the pre-2009 period, it is important briefly to discuss the effect of the financial crisis and the sovereign debt crisis on the euro adoption policies and the perceptions of the euro of the players involved in the decision-making in the Czech Republic. The final section concludes with the main findings.

5.2 Europeanization, Social Learning and the Early Institutional Developments

The majority of the Czechs were in favor of joining the EU. With 55 per cent turnout in the 2003 referendum, 77.33 per cent said yes to EU membership with 22.67 voting against (Hanley, 2003: 1). In addition to the public support, all political parties supported this step with the communist party being the only outlier (Baun, Dürr, Marek and Šaradín, 2006). This result followed more than a decade of hard work by the political elites, governments and different communities to move the Czech Republic back to the western world and place it back in the heart of Europe (Baun *et al.*, 2006: 250). It was also the outcome of the social learning, policy transfer, conditionality and Europeanization process that was taking place since early 1990s and had a major impact

¹²⁷ Recall that being close to meeting the criteria does not mean that the country will be applying for euro adoption any time soon (cf Sweden).

on the domestic political environment, ideologies of the parties and formation of the institutions (political, economic, financial, social, etc.). It is important in this section to focus on two major issues: Political and institutional change; and the economic development and move to market-based economy in the post-1989 transition period. This section examines the progress towards democratization and market reform and sets the framework for euro adoption strategies' analysis. The analysis in this section enables me to test *hypothesis 6* regarding the communist legacy.

5.2.1 Political and Institutional Change

November 17, 1989 is considered a remarkable day in the post-1989 development in the Czech Republic (Czechoslovakia at that time)—it illustrates the beginning of the Velvet Revolution (Sametová Revoluce) and the start of a new era in the Czech history. The demonstrations, organized by students originally to honor Jan Opletal¹²⁸ and the international students day, turned quickly to an anti-communist and anti-regime protests calling for democratization, freedoms and for the current government to step down. The police tried to end the riot by extensive force. However, the protests attracted more supporters and spread to other parts of the country. These internal protests were accompanied by important external events characterized by the fall of communism in other CEECs. These events were crucial in forcing the communist ruling party to announce on November 28, 1989 that it would step down putting an end for the one party system (see Ulc, 1992; Goldman, 1997; Wolchik, 2000). Moreover, in the midst of the

¹²⁸ Jan Opletal was a Medicine student at Charles University-Prague who was shot in November 1939 by the Nazis in a students' demonstration.

protests, on November 19, 1989, Václav Havel formed a new party known as the Civic Forum (Goldman, 1997: 121).

These events forced Gustáv Husák (president of Czechoslovakia at that time) to appoint a new government dominated by non-communist members before he resigned on December 10, 1989. Later, on December 28 and 29 respectively, Dubček¹²⁹ was elected as the speaker/chairman of the parliament and Havel as the President of Czechoslovakia. These changes were followed by the first democratic elections since the Second World War in June 1990 (Goldman, 1997: 122). Two parties out of the twenty-two, that were running in this elections, inherited the parliament from the communists: Havel's party the Civic Forum and "its comovement in Slovakia, the Public Against Violence (PAV)" (Goldman, 1997: 123). We have to keep in mind that the newly established parties at that time were not as organized and institutionalized as the parties in Western democracies. Besides, their popular support could be traced back to two reasons. First, candidates and parties running in the elections had been oppressed under communism for opposing the regime, and, second, they managed to force the communists to step down.

The fall of communism succeeded in uniting the people in Czechoslovakia. However, this unity, as Václav Klaus described it, was not that positive, since it united the people against something (communism) and not in support of a new system or reform (Klaus, 2006). The elites and leaders agreed that reform was needed—the country needed to move to democracy, market-economy, freedoms and institutionalization. The elites

¹²⁹ As we have seen in chapter 4, Dubček, who was the first secretary of the communist party (January 5, 1968-April 17, 1969), played a crucial role in the reforms during the Prague Spring. For more information on Dubček, see chapter 4.

(especially Komárek¹³⁰ supported by Havel on one hand and Klaus¹³¹ on the other) differed radically regarding how to achieve these reforms or what kind of system had to be established. For the major part (such as Havel), Czech elites did not support capitalism or “liberal democracy” rather a “utopian ‘third way’” that would build on the economic system of that time and that would “deepen perestroika” (Klaus, 2006). A smaller group (Klaus was one of the main proponents) believed that the country had to move towards a parliamentary democratic system based on a capitalist market economy (Klaus, 2006).

While Komárek and Havel supported a gradual move that would not be a burden on the people who suffered enough under communism, Klaus argued in favor of a fast-track economic reform or a shock therapy that would move the country fast to a market-economy. Klaus, adhering to the ideas of Milton Friedman, believed that state-owned companies should be privatized quickly even if this would cause difficulties to the people. In comparison to Komárek, “Klaus’s priorities were righting macroeconomic imbalances (via low inflation, a stable currency, and balanced trade and government budgets) [... and his] primary concern was not social justice” (Schwartz, 2006: 113). Another difference was their view regarding the role of the president. Havel believed that the president’s role should be more symbolic. Klaus wanted the president to have high level of responsibilities and to play a role similar to the president’s role in the US system. Moreover, Havel and Klaus disagreed over the organization of the party (Civic Forum). While Havel wanted the party to be more of a “catch all” party that will unite the

¹³⁰ Komárek was the Deputy Prime Minister in the Government of National Understanding of December 10, 1989.

¹³¹ Klaus was the Minister of Finance in the Government of National Understanding (national unity) of December 10, 1989.

nation.¹³² Klaus thought that the party should be unified and have defined ideology, belief, a “clearly defined agenda and registered membership” (Goldman, 1997: 126).

Although these differences did not stop Havel from winning two presidential terms before he was succeeded by Klaus in 2003, yet they divided the Civic Forum. In April 1991, Klaus found a new conservative party: the Civic Democratic Party (Občanská Demokratická Strana (ODS)) (Hanley, 2002; see also Wheaton and Kavan, 1992). These ideological differences have shaped the changes in the Czech Republic following the fall of communism and the peaceful dissolution of Czechoslovakia by the Constitutional Act No. 542/92 which was passed on November 25, 1992 (Mikulka, 1999: 109).

The early years of reforms (1989 until mid 1990s) witnessed the transformation from a totalitarian system to a fragile democratic system, and then to a more institutionalized parliamentary democracy in mid 1990s (Machonin, 1994: 81). The change was gradual and the electorates’ attitudes developed from the first elections in 1990 to the second elections in 1992. In the first elections, the Civic Forum—consisting mainly of elites who were oppressed during the communist era and those who were involved in the reform attempts in the 1960s and 1970s—won 49.5 per cent of the votes. Following the first elections, a new elite was emerging, dominated by new “younger middle generation” who were enthralled by the West. Older neo-liberals (Klaus for example) found a loyal audience in this generation and managed to win in the 1992 elections based on the economic political reforms promises. The new elite formed the “basis of the new right-wing parties”, who managed to win the 1992 elections and form a

¹³² This caused the Government of National Understanding to be weak since it was made up of too diverse group (see Bönker, 2006: 63-70).

coalition government (Machonin, 1994: 82). ODS stayed in power until 1997 when the right-wing coalition government fell and an early elections was scheduled.

The reform period started with two priorities: to move towards stable democratic system and liberalize the centralized economy. On September 1, 1990, the government submitted the *Scenario for Economic Reform* to the parliament that approved it on September 20, 1990. This document was a compromise between the two opposite ideologies regarding reform. The Scenario for Economic Reform included “the first detailed set of economic and social principles, specific measures, and time parameters” (Dyba and Svejnar, 1991: 187). This document also had the main laws and policies needed to move away from the centrally planned economy such as: “annulling thousands of orders and bans, allowing Czech and foreign subjects to enter the market, liberalizing prices and foreign trade, and privatizing state enterprises” (Klaus, online edition, 2006).

One important step towards democracy was changing the 1960 constitution. On December 16, 1992, the Czech National Council adopted a new constitution that has eight chapters and is based on the separation of powers’ concept. The constitution has since gone through four amendments (1992-2008). Chapter one has the general structure of the Czech Republic and the main freedoms; chapter two, three and four are about the legislative power, the executive power and the judiciary respectively; chapter five establishes the Supreme Control Office; chapter six creates the Czech National Bank (CNB); chapter seven is about the local governments (municipalities); and chapter eight has different interim issues.

After 1993, the trade relations with the EU developed significantly and the European investments in the Czech Republic strongly increased. EU accession has been

the main concern for the major parties. However, during the right coalition government under the premiership of Klaus, the accession question “became increasingly [among the] divisive issues in Czech party politics” (Hanley, 2004: 692). This division on EU accession delayed the signing of the EU accession treaty to 1996 (Hungary and Poland in 1994; Slovakia 1995).¹³³ Following the fall of the right coalition government and the 1998 early elections, a new minority Social Democratic government was formed and was the main negotiator with the EU regarding accession (Hanley, 2004: 693; see also LaPlant, Baun, Lach and Marek, 2004: 37).¹³⁴ With the preparation for EU accession, the Czech Republic benefitted largely from the EU funds via several programmes—such as the Phare programme¹³⁵—to conduct major economic, social, legal, regional, political and institutional reforms in order to meet the Copenhagen Criteria. To understand these reforms, it is not enough to view the external pressures, mainly from the EU, since the domestic pressure and the internal situation are of more importance.¹³⁶

¹³³ In an interview by *Die Zeit* (2003), Klaus answered a question regarding EU accession by saying that the Czech Republic did not have a choice or alternative since the Czech Republic has been and will always stay part of Europe. “Today, one cannot exist without EU membership in Europe. This is a marriage of reason, not of love. For a Central European country which is not located on an island or on the edge of Europe, it is simply impossible not to join the EU” (*Die Zeit*, online edition, 17/2003).

¹³⁴ Even if the formal accession negotiations were delayed until 1998, however, the coming back to Europe along with joining the North Atlantic Treaty Organisation (NATO) was important for the Czech government (LaPlant et al, 2004: 37). Even if the elites differed on the reasoning behind joining the EU, the majority of them were in favor of EU accession.

¹³⁵ The Phare programme with respect to CEECs was mainly to provide aid to prepare countries that applied for EU membership in the pre-accession stage to join the EU. The programme helped CEECs institutionalize and move towards democracy and market economy. There have been other programmes for the development of different sectors in the Czech economy such as the Special Accession Programme for Agriculture and Rural Development (SAPARD) and the Instrument for Structural Policies for Pre-Accession (ISPA) Programme.

¹³⁶ For example, in the case of the regional reform, the Czech case proved that without understanding the domestic political situation, we will not be able to fully understand the reform. The external pressure from the EU in addition to the internal situation and demands, a compromise had to be reached in the 1993 Constitution. Article 99 states that the “Czech Republic shall be divided into municipalities, which shall be fundamental self-governing territorial divisions, and regions, which shall be superior self-governing territorial divisions” (Constitution of the Czech Republic, December 16, 1992). The framers of the Czech Constitution “viewed decentralization and the diffusion of power as a major democratic goal, while the existence of regional bodies would also satisfy an important EU condition for accession. Because of

5.2.2 Economic Development—EU Accession and the Long Way to EMU

The Czech economic reform was launched right after the national unity government in December 1989. Compared to the other CEECs, the Czech Republic started from a relatively better economic situation: low inflation, public debt and unemployment, and a surplus in 1993 (see The World Bank, 1999). The early economic reform agenda was characterized by three main issues: “quick systemic changes (price liberalization, dismantling of the legal monopoly on foreign trade, substantial change in the legal framework, tax reform”, etc.)”; “macroeconomic stabilization [such as...] anti-inflationary policies, change in the exchange rate regime [...and] privatization” (Dlouhý, 2001: 176). The EU and other international institutions supported these reforms. The EU (in its Phare Programme) provided assistance to reform the banking sector, rebuild/reform institutions, develop the legislative structures in order to meet the EU accession demands (National Phare Programme, 1998).

The reform started by liberalizing the prices in most sectors. With the beginning of 1991, the Czechoslovak government adopted a fixed exchange rate regime in which the koruna was pegged to the US dollar with a ± 0.5 per cent fluctuation band. With the dissolution of Czechoslovakia, the Czech Republic “redefined [its currency peg] against a basket” of Deutsche Mark and US dollar while maintaining the same fluctuation band of

disagreement about the nature and extent of decentralization, however, the Constitution was intentionally vague about the form and content of any new regional system” (LePlant *et al.*, 2004: 38; on decentralization and democracy in the Czech Republic, Hungary and Poland see Illner, 1999).

0.5 per cent (Begg, 1998: 671).¹³⁷ This fiscal policy helped to stabilize the macroeconomic condition and increased the Czech exports (Dlouhý, 2001: 177; see also Gitter and Scheuer, 1998: 32). One of the effects of the devalued pegged currency was the increase in the domestic purchasing of the Czechoslovak products since the majority of the people could not afford to purchase the imports from the West. Moreover, regulations on prices, wages, and foreign trade were lifted and witnessed a total liberalization (The World Bank, 1999: 23).

In order to attract FDI into the country, the government had to reform its legal and administrative organization, reform the tax system and offer incentives (on tax incentives see Sedmihradsky and Klazar, 2002; Cass, 2007). All these policies, accompanied by “favorable external conditions” and balanced budgets increased the economic growth and attracted more investments, which resulted by lowering the inflation and unemployment rates, GDP to grow (The World Bank, 1999: 23; see also Gitter and Scheuer, 1998: 32) (see Table 5.1). By 1995, the Czech Republic was seen to be the most successful transition country among all CEECs.

Table 5.1 Economic Indicators (per cent): 1993-1999

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---------------------------|------|------|------|------|------|------|------|
| GDP | 0.6 | 2.7 | 6.4 | 4.0 | -0.7 | -0.8 | 1.3 |
| Inflation | 20.8 | 10.0 | 9.1 | 8.8 | 8.0 | 9.7 | 1.8 |
| Deficit* | - | - | 0.5 | -0.1 | -0.9 | -5.0 | -3.7 |
| Public Debt | - | - | 14.6 | 12.5 | 13.1 | 15 | 16.4 |
| General Unemployment Rate | 4.3 | 4.3 | 4.0 | 3.9 | 4.8 | 6.5 | 8.7 |

* When there is a negative sign (-), it means deficit, otherwise surplus.

Source: Eurostat, Czech Statistical Office and The World Bank (1999).

¹³⁷ As we will see later, the Czech Republic abandoned its currency peg in favor of a floating exchange system in May 1997 (see Begg, 1998: 671).

The role of Václav Klaus (Prime Minister 1992-1997; President since 2003) is key to the Czech transition—indeed to the *fast* economic transition. Klaus’ government believed in “interventionist and redistributive regional policies” and focused on “neoliberal macroeconomic policies” (Baun, 2002: 267). Klaus was able to move the Czech Republic towards market economy rapidly and surpass other CEECs that were considered to be among the pacesetters and more successful such as Hungary in the early and mid 1990s. The Czech Republic was the first among CEECs to join the Organization for Economic Cooperation and Development (OECD) on November 28, 1995 (Jeffries, 2002: 156). However, Klaus’s government was a supporter of centralization and did not pay attention to institutional development, which was necessary for creating a decentralized institutional system that would support regional development (Baun, 2002; also Jacoby and Cernoch, 2002: 324).

One important policy that the Czech Republic had to deal with was the privatization issue. A huge domestic debate was going on regarding how to privatize and what system of privatization to implement. As we will see in the next section, the privatization question shows few things: First, despite all the EU and International calls for a massive privatization, the domestic debate showed how complicated the situation was and that it was a merely domestic issue. Second, the privatization debate proved that the Europeanization literature stands short in its explanation. Despite the peer pressure and all the European and international support, the Czech will for reform in that field was still not there—causing privatization reform to lag behind. The majority of elites were hesitant to take major reform steps with respect to privatization.

5.2.2.1 The Privatization Process¹³⁸ and the 1990s Financial Crises

The transfer of ideas, technical assistance and socialization pushed the Czech elite in the direction of privatization. Although the main goal was to privatize the state owned enterprises quickly, however, the elites did not have a unified answer to how to privatize and what method to implement (Dlouhý, 2001: 178; Schwartz, 2006: 100-111; also Schütte, 2000). The only thing both the Czech and Slovak elites agreed on when they started thinking about privatization in the late 1980s was that it was necessary and should happen “gradually” (Schwartz, 2006: 101; see also Komárek, 1990 and Zieleniec, 1990). In the 1990s, the debate continued in the direction of either choosing a voucher privatization or standard privatization methods (such as insider privatization; market privatization; contingent privatization, reprivatization, etc.) (for a discussion of the different forms and debates, see Schwartz, 2006). At the end, the neoliberal view (the voucher method) prevailed.

The voucher method “accounted for 64 per cent of the value assets in joint-stock companies transferred out of state ownership up to mid-1995” (Myant, Fleischer, Hornschild, Vintrová, Zeman and Souček, 1996: 141). Choosing the voucher privatization was domestically more feasible than other standard forms of privatization, which might have been better for the economy. First, the population did not want to have most of their enterprises privatized to foreigners—especially Germans. Second, many elites who did not favor standard privatization, which would be realized quickly, thought

¹³⁸ This section focuses on showing the importance of domestic politics in the reform strategies and choices. I do not offer a detailed overview of the privatization process. In addition to the privatization issue, which is related to the transition and had an effect on meeting the convergence criteria regarding euro accession, there is the institutionalization process and creation of an independent central bank. I discuss the central bank independence when analyzing the domestic politics approach in order to avoid repetition.

that this type of privatization (mainly the insider privatization) would give the socialists and leftists a chance to own again the vast majority of enterprises (Schwartz, 2006: 100 and 111). Therefore, it was important not to allow the old *nomenklatura*¹³⁹ to be involved in the privatization process at all. Third, the voucher privatization (in its two waves) gave a chance to the Czech people to own part of the enterprises and play a key role in the transition away from communism. Klaus and his supporters from the neoliberal elites did not want to repeat the mistakes of 1968 and to “devise a privatization approach that fit the mood of the new elite and the people” (Schwartz, 2006: 100). Klaus benefitted from this voucher method since it was fast, got the people involved and did not allow “the old *nomenklatura* and incumbent managers to form an opposition to the reform in its later stages” (Marcinkin and van Wijnbergen, 1997: 291).

A question that needs to be answered is why to choose voucher privatization? Was it the best and most efficient way? Several objectives have to exist for a privatization program to be efficient: first, no political or financial influence should stay; second, “assets should be allocated to the most efficient users”; third to have good governance and restructuring of the administration in the newly privatized firms; and fourth, “to avoid continued mismanagement of assets under state ownership, efficiency-promoting privatization must be fast” (Boycko, Shleifer and Vishny, 1994: 251-252). Usually, governments seeking privatization would look for the best offer they receive. However, by looking at the domestic situation in Czechoslovakia, two main players have to be kept in mind: any program has to be favored by the public and the new influential elites (Boycko, *et al.*, 1994: 252). Even though some privatization methods could have

¹³⁹ A small elite group in the Communist bloc that used to occupy all important positions in the governments, administrations, industries, education, agriculture, etc.

had better economic benefits, the domestic environment would not allow anything other than the voucher method at that time.

The voucher privatization in the Czech Republic was considered one of the most successful methods in the CEECs in the mid 1990s. The main success was its ability to move the ownership of public enterprises to the private sector rapidly. It also gave rise to “smaller and medium sized enterprises” (Myant *et al.*, 1996: 147)—a case that would not have happened with other kinds of privatization. Despite the success, there were some doubts and concerns regarding the voucher privatization (Myant *et al.*, 1996: 140). The first reservation was the vast majority of the state enterprises were not “fully privatized”, rather were partly privatized. Although the Czech government at that time was arguing that 60 per cent of the GDP was coming from the private sector, this included the “state’s share in enterprises that had been converted into joint-stock companies and transferred to National Property Fund” (Myant *et al.*, 1996: 140).¹⁴⁰ The second concern was the behavior of the privatized companies that did not go through the transition and did not adjust in order to meet the requirements of a “successful market economy” (Myant *et al.*, 1996: 141). In addition to that, a huge debate¹⁴¹ was going on regarding the benefits of this method and how good it was to have a huge number of small business owners and could this method lead to a functioning market economy (Myant *et al.*, 1996, 144).¹⁴²

¹⁴⁰ The Czechoslovak government created the Fond Národního Majetku (National Property Fund: NPF) in 1991 to help in the technicalities of the privatization process. NPF was under the supervision of the Ministry of National Property and Privatization.

¹⁴¹ There was an internal debate going on which is crucial to understand the decision regarding privatization. This debate is ignored usually by the Europeanization literature.

¹⁴² Myant *et al.* (1996) highlights few themes on the voucher privatization which were among the debatable topics in Czechoslovakia in the early 1990s. First, “the danger of instability at the macroeconomic level” because of the high probability that the new inexperienced owners might rush to sell their shares to get some extra money “strengthening inflationary pressures or harming the balance of payments”; second, there are doubts that this method will result in a functioning market economy; third, it will be hard to manage the large numbers of new ownerships; and fourth, “the debates over voucher privatization is an

This idea about the success of the privatization project in the Czech Republic did not last long. Although the privatization succeeded in creating a stock market and the wages were relatively high in comparison to other CEECs, some important legal and institutional changes were not taken. So instead of dealing with the problem, the Czech authorities were just pushing it forward. The privatization process was not accompanied by the creation of “a regulatory framework to keep these development in check” (Vliegthart and Horn, 2007: 142). The implementation of voucher privatization “led to considerable problems in the field of corporate control and caused chaos in financial structures” (Vliegthart and Horn, 2007: 142). These problems, in turn, resulted in missing a crucial step in institutional reform. Furthermore, corruption still existed within the banking system and the stock market. The Prague Stock Exchange, established on November 24, 1992 “with the first trades made [...] on April 6, 2003” (Prague Stock Exchange, Online edition, 2011), still did not have an “independent regulator”, and the “legal system seems incapable of punishing white-collar crimes” (*The Economist*, online edition, May 29, 1997).

The lagging in the privatization project and the restructuring of public owned enterprises accompanied by the political problems in the 1997, which resulted by the fall of the Klaus government and the call for early elections, led to a serious economic crisis. Even with the central bank intervention in the market, it could not cope with the attack on the Czech koruna and the increase in the selling of the Czech currency. In February 1996, the CNB “decided to widen the exchange rate band to ± 7.5 percent around the central parity, in an effort to allow more flexibility to the crown” (The World Bank, 1999: 25).

argument that it would make the task of restructuring inefficient enterprises more difficult” (Myant *et al.*, 1996: 144-147).

These steps could not help the market and push the crisis away. The CNB “use of long-term foreign exchange intervention was limited by the impact of non-sterilised interventions on the money market and by the large volume of koruna converted to foreign currency which significantly reduced the level of CNB foreign exchange reserves” (Šmídková *et al.*, 1998: 33). All these imperfections led to the currency turmoil, economic recession and market failure in 1997. The CNB board met on May 25, 1997 and decided to meet with the government the next day regarding the exchange rate system. On May 26, 1997, the government and the CNB board announced the abandonment of the fixed exchange rate parity (Šmídková *et al.*, 1998: 33-34).¹⁴³

The failure of privatization in the second half of the 1990s and the financial turmoil pushed the OECD to state that one of the building blocks of good governance and economic performance in the Czech Republic is the privatization of the state-owned banks (OECD, 2000: 79). However, the Czech government step regarding banks privatization fell short of full privatization and thus was not taken seriously until the Czech Republic was hit by the 1999 financial crisis that led to the belief that fast action had to be taken (Vliegenthart and Horn, 2007: 143). This delay was not costless since it affected the overall economic performance and the “market value” (OECD, 2000: 79). The growth declined from 4.0 per cent in 1996 to -0.7 and -0.8 per cent in 1997 and 1998 respectively. The deficit also increased further to reach 5 per cent in 1998 (see Table 5.1).

¹⁴³ On lessons from the Czech exchange rate crisis, see Begg (1998).

5.3 Role of Domestic Politics in Understanding Euro Adoption Strategies—The Main Factors and their Interactions

In the early years of reform, the Czech Republic was considered the most successful story on the road towards joining the EU and then EMU. However, the enthusiasm did not last and the Czech Republic joined the laggards group regarding euro adoption. Why the Czech policy makers took such a “cautious approach” regarding the euro (Bönker, 2006: 160)? How can we understand such a decision to delay euro adoption? The cost/benefit analysis and the Europeanization literature cannot really help us understand the positions of the key players and the decision-making process regarding the euro. Therefore, we need to unveil the domestic environment and look at some key factors and their interactions: macroeconomic policies, government, opposition, central bank, the public and the media. In this section, I examine the hypotheses raised earlier in order to deduce some important conclusions to be compared with the other cases.

5.3.1 Macroeconomic Indicators

Until 2005, the Czech Republic was among the likely NMS to join EMU sooner rather than later in so far as the macroeconomic indicators were concerned (it met all but one of the convergence criteria in 2004), and because the government of the day intended to adopt the euro sooner rather than later. As can be seen from Table 5.2, the Czech Republic met the criteria concerning inflation rate, interest rate and public debt, missed only the reference value for the budgetary deficit. Yet, despite this strong start, the Czech

Republic was not long on track to speedy euro adoption since it soon started lagging behind on more convergence criteria.

One of the main aims of the fiscal policy has been targeting the excessive deficit the Czech Republic had since joining the EU in 2004. In 2008, the government succeeded in bringing the deficit to 2.7 per cent (below the threshold). Inflation was also still too high (6.3 per cent in 2008), but the Czech Republic performed well on the other two criteria: long-term interest rate and public debt. The Czech Republic managed to bring the inflation down to 0.6 per cent in 2009 before it increased to 1.2 per cent in 2010. However, because of the financial crisis, the country was running an excessive deficit 5.9 and 4.7 per cent in 2009 and 2010 respectively. The excessive deficit is expected to last until least 2013 or 2014. The debt increased slightly (from 30 per cent in 2008 to 35.3 and 38.5 per cent in 2009 and 2010) (European Commission, 2009a; see Table 5.2).

Table 5.2 Performance of the Czech Republic on the Convergence Criteria (per cent) (2004-2010)

| Czech Republic | | | | | | | | |
|----------------|------------|----------------------|------------|----------------------|------------|-------------------------------------|------------|----------------------|
| | 2004 | 2004 Reference Value | 2008 | 2008 Reference Value | 2009 | 2009 Reference Value ¹⁴⁴ | 2010 | 2010 Reference value |
| Inflation Rate | 1.8 | 2.4 | <u>6.3</u> | 3.2 | 0.6 | 1.0 | <u>1.2</u> | 1.0 ^a |
| Interest Rate | 4.7 | 6.4 | 4.63 | 6.5 | 4.84 | 6.0 | 3.88 | 6.0 ^a |
| Public Debt | 37.9 | 60 | 30.0 | 60 | 35.3 | 60 | 38.5 | 60 |
| Deficit* | <u>5.0</u> | 3.0 | 2.7 | 3.0 | <u>5.9</u> | 3.0 | <u>4.7</u> | 3.0 |
| GDP Growth | 4.5 | NA | 2.5 | NA | -4.7 | NA | 2.7 | NA |

* When there is a negative sign (-), it means deficit, otherwise surplus.

a. Reference value refers to the period April 2009 until March 2010.

Source: European Commission (2004; 2008b; 2010a); Eurostat, 2011; ECB, 2010.

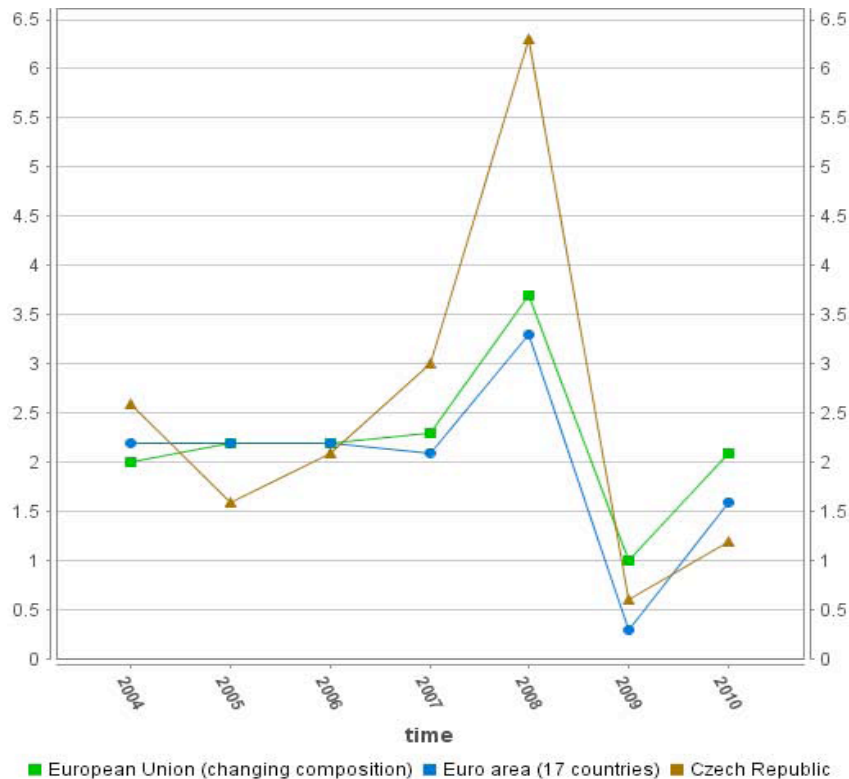
¹⁴⁴ Calculated as the average of the 12-month (April 2009-March 2010) as used in the European Commission 2010 Convergence Report.

Although the public debt criterion is within the reference value, however, there are fears that this would not be the case in the future. With a fast aging population, there will be an increase in social spending that will cause the public debt to go up (see Czech Ministry of Finance and the Czech National Bank, 2010). According to an OECD report: “Healthcare and pensions will account for the largest part of the growth of age-related public sector expenditures, which are projected to rise by 6 percentage points of GDP over the period to 2060. Reforms in these two areas have been initiated but they have largely stalled in recent years and need to be reinvigorated” (OECD, 2010). The Czech Republic has to implement a reform policy for its pension system in case it wants to have a sound economic system.

With the financial crisis, the target of the government is again getting the deficit below the 3 per cent threshold by 2013. The government has three main objectives with respect to sound fiscal policy: “Limiting the negative impacts of economic development in 2009 on general government finances through the adoption of measures to reduce the deficit”; “reducing the administrative burden and tax distortion by simplifying the tax system”, and “increasing the effectiveness of government expenditures” (Czech Ministry of Finance, 2011). As for the monetary policy implemented by the CNB, it is based on inflation targeting as of 1998 (CNB, 2011). The inflation target is considered by the CNB “as medium-term in nature, and real inflation may temporarily deviate from them as a result of exogenous shocks” (Czech Ministry of Finance, 2011). The CNB inflation target of 3 per cent (announced in 2004 and was effective in January 2006) has been decreased to 2 per cent effective in January 2010 with a 1 per cent “tolerance band” (CNB, 2007).

This new target reflects “the longer-term perspective for inflation targeting in the Czech Republic due to postponing the euro adoption date beyond the originally envisaged 2010” (Czech Ministry of Finance, 2011). It also reflects the aim of the CNB for further convergence with more advanced economies and will stay until the Czech Republic adopts the euro in which the policy making will be in the hands of the ECB (CNB, 2007). However, meeting the official targets has not been the case all the time. Following the decrease in the inflation rate after joining the EU in 2004, it started increasing by the end of 2005 to reach 2.1 and 3 per cent in 2006 and 2007 respectively (EU average was 2.2 and 2.3 per cent respectively). The trend continued and the inflation increased significantly to 6.3 per cent in 2008 (reference value for that period was 3.2 per cent) (see Figure 5.1).

Figure 5.1 Annual Average Inflation Rate in the Czech Republic



Source: Eurostat

The Czech government managed to bring the inflation down to 0.6 per cent in 2009 before it increased again to 1.2 per cent in 2010 (see Figure 5.1). Although the inflation is still within the government’s January 2010 target (2 per cent with 1 per cent tolerance band)—but it does not meet the reference value.

In terms of its exchange rate economy, following the 1997 financial turmoil, the Czech Republic has chosen to have a flexible exchange rate and has had it for more than a decade. In comparison to other NMS, the Czech Republic has been able to conduct a credible monetary policy for over a decade, which made the public more attached to their currency that they trust (interview with CNB officials, 2009). Up until the 2008 financial crisis, the Czech koruna has typically been more or less stable against the euro and other currencies in the region (from 1999-mid 2008 the koruna gradually appreciated about 30 percent against the euro) (see Figure 5.2).

Figure 5.2 Exchange Rate—Czech Koruna/Euro (1999-2011)



Source: ECB

With the global financial meltdown of the fall of 2008, the currency depreciated considerably (15 per cent) over a period of three months (October 1st, 2008– mid February 2009) but then picked up again (6 per cent) in the same period thereafter. Moreover, the GDP in the Czech Republic grew in 2008 (2.5 per cent), contracted by 4.1 per cent in 2009, before increasing again to reach around 2.4 per cent in 2010 (Eurostat, 2011; see Figure 5.2).

As we have seen, before the financial crisis the Czech Republic had not quite met the convergence criteria, even if it was not far removed from meeting them. But it was not keen to adopt the euro. What has been missing and pushing the Czech Republic away from euro adoption is the lack of political will among the leaders (Interviews with officials from MoF, June 2009), as I will elaborate on more below.

5.3.2 Government, Opposition, Electoral Cycles and the Euro

The June 13-14, 2003 referendum on EU accession represented a victory not only of the 77.3 per cent (55.2 per cent turnout) who voted in favor of joining the EU (Hanley, 2004), but also to the efforts of the political elites, policy communities and successive governments that had worked hard to ensure the Czech Republic be part of this wave of EU enlargement. Most of the major political parties, as well as the euroskeptic Civic Democrats, were in favor of EU accession; the Communists were the only exception (Baun, *et al.*, 2006: 250-251).

In the Czech Republic, the major parties have been divided on their overall stance to the EU and, by extension, the euro. The four parties that have had seats in parliament

since 2002,¹⁴⁵ two of them are major parties: ODS which is a euroskeptic party created by President Klaus and the Czech Social Democratic Party (Česká strana sociálně demokratická (ČSSD))—a centre-left party. The two other parties are much smaller—a communist party and a smaller Christian Democratic Party. In 2002 the ČSSD was the largest party with 70 of the 200 seats, while the ODS had 58 seats. The parliamentary elections of June 2006 produced an outcome whereby two coalitions with exactly 100 seats each could be made. The stalemate was broken when in January 2007 the Civic Democrats, Christian Democrats and Greens finally gained confidence and could start ruling, under the leadership of PM Topolánek. But the balance of power was very delicate. Indeed, after four attempts, the parliament succeeded on March 23, 2009 to bring down the Topolánek government (*Financial Times*, March 25, 2009).¹⁴⁶

From the outset the Czech government had planned to adopt the euro in 2010. However, by 2006 this date was becoming increasingly unlikely. During the 2006 parliamentary elections, euro adoption was not significant since the focus was on developing social security. None of the political parties had euro adoption in their electoral campaigns and programs (interviews with CNB officials, June 2009). Therefore, euro adoption date was further delayed. In February 2007 the Czech Minister of Finance proclaimed 2012 to be a more realistic date. By November 2007 it became clear that the target date was still too ambitious. In May 2008, ERSTE Bank conducted an assessment in which it suggested that euro adoption would not take place before 2015. In January 2009, the Topolánek government announced that a date to adopt the euro would be decided by November 1, 2009 (*Prague Daily Monitor*, January 2, 2009). Opposition

¹⁴⁵ As we will see, this division of power changed with the 2010 parliamentary elections.

¹⁴⁶ The fall of government occurred during the six-month period in which the country was holding the presidency of the European Union.

parties welcomed the announcement, though in the end it was never fulfilled, due to the unstable political situation.

In addition, the term of the technocratic government led by Jan Fischer, which was appointed following the fall of Topolánek government, lacked the mandate to make major decisions during its short time in power before the parliamentary elections took place in May 2010.¹⁴⁷ The May 28-29, 2010 parliamentary elections in the Czech Republic have generated a “political earthquake” in the Czech political system (Král, 2010). The domination of the two-party system (ČSSD /ODS) characterizing the post Cold War era ended, leaving space for other parties to gain more seats in the parliament, which brought the system closer to a multiparty system. Although this situation might be temporary due to the dissatisfaction of the Czechs with both parties’ policies, I believe it is the result of the development of the democratic mentality among the Czechs and the evolution of other ideas and ideologies within the right and left in the Czech Republic.

The 62.6 per cent turnout in the elections gave ČSSD 22.08 per cent; ODS 20.22 per cent; Tradice Odpovědnost Prosperita 09 (TOP 09)¹⁴⁸ 16.70 per cent; the Communist Party (Komunistická strana Čech a Moravy (KSČM)) came fourth with 11.27 per cent and the Public Affairs Party (Věci Veřejné (VV)) (a conservative liberal party) with 10.88 per cent (Czech Statistical Office, 2010). The 2010 parliamentary elections focused on reform, facing the financial crisis, corruption, transparency and good governance. A coalition government was formed between ODS, TOP 09 and VV under the leadership of

¹⁴⁷ Following the fall of the Topolánek government in the spring of 2009, an early parliamentary election was scheduled for October 9-10, 2009. In September 2009, the Czech Constitutional Court canceled the law that shortens the term of the lower house and allows for early elections. Immediately, the Chamber of Deputies and the Senate tried to pass an amendment that would allow early elections to be held on November 6-7, 2009. However, the amendment did not pass due to the lack of support—the Social Democrats, Communists and Greens blocked it. Therefore, the parliamentary elections took place when the four-year term of the chamber ended in May 2010.

¹⁴⁸ Big supporter of free market and the EU.

Petr Nečas (ODS Leader). The focus of the government is on improving public finances and “help to raise the credit status of the Czech Republic on the world markets” (*Financial Times*, July 9, 2010).¹⁴⁹ Moreover, the plan is to reform the tax, welfare, health and pension systems. The main aim of the current government is to benefit from its low debt, to cut the excessive deficit to below 3 per cent of GDP by 2012¹⁵⁰ and have a balanced deficit by 2016. As for euro adoption, nothing really changed since the argument is still no need to rush and the Czech Republic joins when it is in its best interest (interviews with officials from MoF and CNB, June 2009).

In the Czech case, the role of the euroskeptic President Klaus¹⁵¹ is of particular importance. The President first took office in 2003 and was re-elected in 2008. He is a euroskeptic and influential figure in the Czech political scene. He appointed officials to the central bank’s monetary board, who shared his euroskeptic views and thus did not favor a speedy euro adoption process.¹⁵² Klaus argued that the main economic benefits of European integration are the trade liberalization and the flow of FDI. Any “further economic or non-economic unification will be close to zero, if not negative” since Klaus believes that the costs of adopting the euro outweigh the benefits (Klaus, 2003). Klaus, “a trained economist”, “saw the problems that a single currency would bring even before the euro was formally launched. [...] the euro would create serious problems for the countries that accepted the single currency in place of their own national currencies” (Feldstein, online edition, 2011).

¹⁴⁹ Quote by Josef Novotný, analyst at Czech Fio Banka

¹⁵⁰ It is a bit too optimistic to think the deficit will be within the 3 percent since the 2010 deficit was 5.9 per cent of GDP is expected to be 4.7 and 5.5 per cent of GDP in 2011 and 2012.

¹⁵¹ Klaus’ euroskepticism is clear through out his speeches and acts. He compared the EU to the former Soviet Union and refused to have the EU flag running on the presidency official building and argued that the Czech Republic is not a province of the EU (NEWEUROPE, February 23, 2009).

¹⁵² The current board members are either against euro project or euroskeptics (interviews with officials from CNB, June 2009).

5.3.3 Central Bank vs. Government—Cooperation or Conflict about the Euro?

The social learning process played an important role in creating a pro-EU financial epistemic community that was involved in the various Czech financial institutions (such as the CNB, Czech Ministry of Finance, Czech Securities Commission, think-tanks). This community adhered to the ideas and beliefs of the EU *acquis* and helped move the Czech Republic closer to the rest of the EU members (Johnson, 2006; Vliegthart and Horn, 2007). Moreover, there was a variety of EU programs—such as Phare programme—which aimed at providing the institutions and administrations in the Czech Republic and Poland, such as the MoF and CNB, not only with the technical assistance but also to move the Czech Republic to a new market economy similar to its fellow western EU countries and to implement the EU *acquis* (Vliegthart and Horn, 2007: 146-148). Since the Czech Republic and all CEECs wanted to move away from communism and rebuild their economies and institutions, they did not really have any other option but to accept what the EU and the International Community offered to move them to democratized, market oriented countries. One of the major things to be done was creating an independent central bank.

The establishment of this network of central bankers community led to the creation of an independent CNB in 1993 that is far from the day-to-day calculations of the government. This is something that politicians do not favor and created a troubled relation with the CNB atleast between 1997 and 2005 when the CNB board and the government had different views regarding macroeconomic policies and euro adoption.

While the CNB officials overall favored an early euro adoption, the government was against that. The continuous struggle between the CNB and the government led to an attempt to limit the independence of the CNB through passing an amendment to the CNB act (No. 442/2000). The European Commission and several financial institutions—such as the ECB and the IMF—criticized these changes. In 2001, the Czech Constitutional Court ruled the amendment unconstitutional and annulled it.

In its attempt to secure the “price stability” and stay politically independent, central banks affect the “entire macroeconomic development, including GDP and wage growth” (Geršl, 2006: 18). This plays a crucial role in the failure or success of the political parties involved in the government. In case the electorates do not like the outcome of such policies, they will blame the ruling party and will not vote for them in the next elections. This situation creates tension between the government and the central bank. The pro-euro position of the CNB (between 1997 and 2005) got it into troubles with not only the government but also the public and labor unions (Geršl, 2006: 38)—with 42 per cent of the population wants the euro accession to be as late as possible compared to only 18 per cent who want it to happen as soon as possible (European Commission, 2008a).

The struggle between the CNB and the political leaders kept pushing the euro adoption date forward, from its initial 2007 target date to 2009-2010 and even to 2013-2014—which are optimistic accounts (at the time of writing, euro adoption is not going to happen anytime soon). The CNB failed to influence the decision of the government to implement more restrictive policies so as to cut the deficit, thereby meet one of the important Maastricht criteria and thus join the euro fast. Moreover, all the board members

were changed during Klaus presidency periods and were appointed for a six-year term. The new board members I interviewed hold views similar to those of the president. Therefore, three out of the seven-member boards who ended their six-year term in February 2005 had been replaced (see CNB Website; also Economic Intelligence Unit (EIU), February 23, 2005).¹⁵³ Following this appointment, three other members were changed in 2006 and 2008.¹⁵⁴ Some of these appointees, even if they did not share the same euroskeptic views as the president, they were indebted to him.¹⁵⁵ In addition, Kamil Janáček¹⁵⁶ was appointed as a CNB board member and chief executive director starting from July 1, 2010.

These board members' changes caused the CNB's independence to be indirectly undermined since the board lost its coherence, having a similar vision regarding EMU and members will listen more to the euroskeptic president. By listening to a lot of the interviews and reading the articles published by several CNB board, one can draw a conclusion that there is a strong euroskepticism and a *no rush* policy regarding the euro. There is a general belief among the current CNB board members that the Czech economy is still converging and therefore one day the euro will be good but not any time soon since the Czech economy will be vulnerable to shocks (interviews with CNB officials,

¹⁵³ Robert Holman (advisor to the President since 2003), Miroslav Singer and Pavel Řežábek were appointed on February 11, 2005. Singer replaced Governor Tuma on July 1, 2010. For more information, check: http://www.cnb.cz/en/about_cnb/bank_board/bank_board_members/index.html

¹⁵⁴ More appointments took place with the term of other three board members ending in 2006 and 2008. Vladimír Tomšík and Mojmir Hampl (from 2008 serving as Vice Governor) on December 1, 2006 and Eva Zamrazilová was appointed on March 1, 2008. The term on the board is six years.

¹⁵⁵ For more information on the appointment and the appointees, check Czech National Bank, November 26, 2003, available at:

http://www.cnb.cz/en/public/media_service/press_releases_cnb/2006/061128_jmenovani_clenu_br.html

¹⁵⁶ Janáček has been against a fast euro adoption for a long time. He shares Klaus' view and believes there is no rush to adopt the euro. In a co-authored article with Stanislava Janáčková (works at the office of President Klaus), they highlighted the problems resulting from losing the monetary and exchange rate policy tools once adopted the euro. The "no hurry" policy regarding euro adoption is crucial for the Czech economy. To implement a strong economic policy that guarantees growth, one needs the independent monetary policy and exchange rate policy tools (Janáček and Janáčková, 2004; see also Laca, 2010).

June 2009; check also CNB website for other interviews and articles). According to one key informant, who is involved in the EU projects, euroskepticism among CNB board is mainly political and less about the costs and benefits of euro adoption (interview with key informant from Euro Team, June 2009). Officials from both the CNB and MoF confirmed this view when they argued that having the euro is a good thing but is a highly political matter and not vital. The Czech Republic will join the euro once it is ready and when it is in the best economic interest of the Czech Republic (interviews with officials from CNB and MoF, June 2009).

The CNB incurred reputational costs because it had pushed and failed to secure an early euro adoption. It seems to me that this struggle and the lack of cooperation between CNB and the government in part explain the delay in euro adoption. The CNB gradually changed its stance. When it refrained from pushing hard for an early adoption, it allowed for more cooperation with the MoF. The two (MoF and CNB) subsequently published joint documents similar to the one approved by the Government of the Czech Republic on December 16, 2008.¹⁵⁷ The report set out the intention of the Czech Government to join the euro area once the economic conditions are right. The renewed positive relationship between the government and the CNB in first instance contributed to the Czech Republic in 2006-2008 almost meeting all the convergence criteria. However, with the changes in the central bank board, the overall stance towards euro adoption turned negative.

Furthermore, due to the financial crisis and the slowdown in the economy in 2009, CNB forecasts that growth of 3.6 per cent will not be achieved—rather the annual growth of real GDP stood at -4.7 per cent in 2009 and increased to 2.7 per cent in 2010 (Eurostat, see Table 5.2). Former CNB governor Tuma announced on October 12, 2008 that the

¹⁵⁷ See CNB, 2008a, 2008b.

Czech Republic needs a break until the markets settle down and the financial crisis is sort of resolved (*EUobserver*, October 13, 2008). The current governor Miroslav Singer (replaced Tuma on July 1, 2010) announced that with the Greek crisis and euro zone sovereign debt problem, there is no plan to consider adopting the euro for the time being (*Handelsblatt*, 2010: 53).

The CNB position regarding euro adoption is highly political and affected by the structure of the monetary board. The previous monetary board that was appointed by former president Havel was not as critical of the euro as the current monetary board (appointed by president Klaus) (interview with key official at CNB, June 2009).

5.3.4 Public Opinion and the Media

The CNB faced considerable political pressure regarding euro adoption because half the population, various opinion makers and labor unions did not see the merit of euro adoption (Geršl, 2006: 38; European Commission, 2008b: 38). Eurobarometer data for 2009 show that 54 per cent of the population was dissatisfied with the fact that the euro will replace their currency while only 37 per cent was content with that prospect. In 2010 the dissatisfied portion increased to 58 per cent with a slight increase among the satisfied (39 percent) (see Table 5.3).

According to the same Eurobarometer data, 47 per cent of the population wanted euro accession to be as late as possible compared to only 17 per cent that preferred fast euro adoption. A majority of the population (51 per cent) believed that euro adoption would not ensure sound finances compared to 38 per cent who thought that by joining the

euro, sound finances are guaranteed. Moreover, the Czechs tend to think more in economic terms when it comes to euro adoption. 89.9 per cent of the population thought about the costs and benefits from adopting the euro with respect to their salaries, pensions and personal accounts take priority over other issues (see Table 5.3).

Table 5.3 Czech Republic Public Opinion in 2009 and 2010

| Czech Republic's Public Opinion | | |
|--|-------------|-------------|
| % of Population | 2009 | 2010 |
| Agree that euro adoption ensures sound public finances | 30 | 38 |
| Disagree that euro adoption ensures sound public finances | 45 | 51 |
| Dissatisfied with the fact that the euro will replace their currency | 54 | 58 |
| Content with the fact that the euro will replace their currency | 37 | 39 |
| Want euro accession as late as possible | 47 | 47 |
| Want euro accession as early as possible | 14 | 17 |
| Well informed about the euro | 52 | 44 |
| Not well informed about the euro | 45 | 54 |
| Think the euro will have positive consequences | 41 | 39 |
| Think the euro will have negative consequences | 46 | 55 |
| Form their opinion based on its effect on salaries, pensions and personal accounts | 87.2 | 89.9 |
| Television is the main source of information | 81 | 82 |
| Using the euro makes people feel more European | 67 | 61 |

Source: European Commission (2009b; 2010b).

The role of the media in the Czech Republic is a cyclical. Media interest and coverage depends strongly on whether the koruna/euro exchange rate fluctuates. When the euro appreciates or depreciates considerably, the media's discussion of the euro increases but when the currency stabilizes media coverage all but disappears. But overall, there is no real political or public debate regarding euro adoption. One issue that triggered a larger public debate was the onset of Slovakia adopting the euro in January 2009 (interviews with officials from the CNB and MoF, June 2009).

Following the intention of the previous government to announce a target date for adopting the euro, a STEM poll for the Czech TV showed in early 2009 that 64 per cent of the Czechs were in favor of setting a date for euro accession during that year while 36 per cent were against. According to the Economic Chamber, local firms and businesses are in favor of joining the euro soon. Those who are keen to adopt the euro (domestic export firms, industrialist lobbies, foreign investors) are motivated in part because the Czech koruna is quite strong relative to the euro and other currencies (interview with CNB official, June 2009; see also *Prague Daily Monitor*, January 2, 2009).

Independent of their opinion, overall Czech citizens have not felt the euro adoption issue to be all that important and do not view it as a priority or cause of stability (interviews with officials from the MoF, June 2009). Compared to other NMS, the Czech Republic is the most euroskeptic country of all those that joined the EU in the 2000s. According to one CNB official, the public in the Czech Republic does not care about the euro since in comparison to other EU members, the country has low inflation, low interest rates and the koruna is strong and more stable than other currencies (interview with a senior official from the CNB, June 2009).¹⁵⁸

The attitude of the Czechs regarding the euro can be understood as a mix of the three main explanations (political, economic and historical-ideational) highlighted in chapter 2. The individual cost-benefits' calculations matter a lot (89.9 per cent of the population) (economic explanation). The lack of salience is one of the main reasons the major parties were not using euro adoption as a tool to attract voters in May 2010 parliamentary elections. Moreover, there is a division among the elites regarding the euro

¹⁵⁸ The discussion focuses on the period prior to the financial crisis of 2008-2009 and the sovereign debt crisis.

(political explanation). As for the symbolic role of the euro and feeling more European, it is not significant in the Czech case. For Czechs, EU accession was a signal of returning to Europe and not the euro. So the symbolic effect of the euro is absent in the Czech case (interview with officials at CNB and MoF, June 2009). The Czechs are proud of the koruna and the Czech sovereignty (interview with key informant from Euro Team, June 2009). The Czech Republic have had a strong koruna and given the problems of the euro (weakened after its launch) and now the sovereign debt crisis, this situation increased the national symbol of the Czech koruna which makes it harder for people to accept another currency (historical-ideational explanation).

5.4 Financial Crisis Effect on Euro Adoption Position

Due to the current financial crisis (2008-2009), the slow down in the economy and the sovereign debt crisis, the Czech Republic is more skeptic regarding the euro. Therefore, the Czech Republic needs to wait regarding the euro and not rush until the financial crisis is over according to CNB former Governor Tuma (*EUobserver*, October 13, 2008). The position of the Czech Republic has been a “wait and see” policy until the crisis is over with a more skeptical view regarding euro adoption (interviews with officials from CNB and MoF, June 2009).

The real GDP growth for 2009 was negative (-4.7 per cent) after being 3.2 per cent in 2008. The growth for 2010 increased to 2.7 per cent and is expected to be 2.0 per cent in 2011. The decrease in GDP in 2008 and 2009 (it was 6.8, 7.0 and 6.1 per cent in 2005, 2006 and 2007 respectively (see Table 5.2 and Eurostat, 2011) is mainly because of

the financial crisis that has affected the Czech industry negatively—especially the automobile industry. Most countries that the Czech Republic trade with were influenced negatively by the crisis and entered into recession. The negative effect of the crisis on the Czech main trade partners has had its implications on the Czech Economy. After October 2008, the industry witnessed a decrease in its production, dropping to over 20 per cent by February 2009 and in July it dropped further by another 18 per cent (*Prague Daily Monitor*, September 7, 2009). In addition, with the Banks not giving any loans or decreased them to the minimum, companies were struggling to survive. Thus they were forced to cut expenditures—mainly by firing employees. The survival tactics taken by the enterprises resulted in the unemployment rates going from 4.7 per cent in 2008 to 9.2 and 9.6 per cent by the end of 2009 and 2010 respectively, and by January 2011 unemployment rate reached 9.7 per cent¹⁵⁹ (Czech Statistical office, 2011).

Moreover, the deficit went back into being excessive exceeding the 5 per cent of GDP since 2009. The high deficit is not only due to the financial crisis but also to some structural problems and failure of the “Czech public finances”. According to David Marek (Patria Finance Chief Economist), the problem “is not a cyclical matter but a deep structural problem that has been neglected for more than a decade by all cabinets that have been at the helm of this country” (*Prague Daily Monitor*, September 7, 2009).

At the same time, the inflation rate dropped to 0.6 per cent in 2009 before increasing again to reach 1.5 per cent in 2010 (see Table 5.2). The public debt also is increasing but still below the Maastricht criteria (35.4 per cent and 39.2 per cent in 2009 and 2010 respectively). However, as I mentioned earlier, a pension and health care

¹⁵⁹ This is not an increase or decrease in employment, rather it is the percentage of unemployed in the total labor force.

reform is needed if the debt is to remain under the 60 per cent reference value. The interest rate is one of the most stable rates in the Czech Republic and will maintain this stability even with the crisis where until 2009 it was within the 4-5 average before dropping down to 3.88 per cent in 2010.

All these indicators show that the crisis affected the Czech Republic negatively, though not as bad as other countries (such as Hungary). It pushed Czech Republic performance on the convergence criteria away from the levels needed to be ready for euro adoption, thereby giving the euroskeptic group a good argument against the fast accession. The only interest of the Czech authorities at the moment is to get out of the crisis with the least possible damages and to have the pre-crisis momentum. This view is even supported by the euro-enthusiasts who agree that before talking about euro accession, the crisis should be over and it should be stable for some time. So the financial crisis followed by the sovereign debt crisis of the euro area has strengthened the position of Klaus and the euroskeptics. For them, the crisis has proven that the euro area is not a safe haven and it is better to stay away at least for now. The Czech Prime Minister Petr Nečas (ODS) in his address to the *Active European Policy* Conference on January 14, 2011 mentioned that joining the euro zone is out of question at the moment not only because the Czech Republic does not meet the convergence criteria yet, but also due to the euro crisis. The Czech will adopt the euro “when there will be a stabilisation of the eurozone, and when it will also be true that the costs for joining the euro will be lower than the costs for maintaining an independent currency” (Nečas, 2011).

The crisis supported the long-standing position of ODS and the government that the Czech Republic will join when it is in its best interest. The population generally

supports his position—they agree that joining the euro at the moment is a bad idea. *Medea Research* (in the Czech Republic) conducted an opinion poll in January 2011, which showed that 77 per cent of the Czechs are against euro adoption compared to 15 per cent who are in favor. The poll also showed that 57 per cent “strongly disagree with joining the euro zone” (*Prague Daily Monitor*, March 4, 2011). Although the support for the euro has been falling over the past years, however, this time it is a very sharp decrease in the support due to the problems faced by the euro area members. These results show the “sceptical mood of people” according to *Medea Research* Chief Executive Jan Matejka (*Prague Daily Monitor*, March 4, 2011).

5.5 Conclusion

This chapter discussed the road taken by the Czech Republic regarding euro accession. It looked at reasons behind moving from a country seeking euro entry soon, and being among the pacesetters, to pushing it away and becoming a laggard. Lack of political will combined with euroskeptics in power is delaying the process further. Even with the institutional development and having an independent central bank, cutting ties with the communist past, and moving rapidly toward market economy, all this was not enough because no political consensus, and no public enthusiasm towards the euro existed. In addition, domestic factors played a crucial role in the policy choices regarding reform strategies. These choices were not the most rational ones, but in some instances nothing else could be done (as we have seen in the case of the voucher privatization). The reforms

during the transition period showed that the domestic calculations of the policy-makers and their ideology are crucial.

Europeanization and cost/benefit analysis are unable to explain why the Czech Republic turned into one of the laggards. Focusing on the domestic players showed that domestic politics is crucial to understand euro adoption strategies. The relation between the CNB and the government, appointment of CNB board by President Klaus, having Klaus as a president, lack of public support, in addition to the financial crisis and the euro problems, all these factors play a role in understanding why the Czech is not pushing for adopting the euro.

With respect to *hypothesis 6* regarding the historical legacy, although it showed the early confusion among the elites regarding the reforms' choices and the status of Czechoslovakia at that time, however, it did not matter much in understanding the elite's choices and euro adoption delay later on. The elites tried to do a total reform of the system (political, economic, social, constitutional and institutional) based on international support and domestic needs. The new elites (oppressed under communism), in addition to the public, wanted to cut all ties with the communist past. The fall of communism played the role of a critical juncture to launch the post-1989 transition, but this was not possible without the external support and internal will to rebuild the country on the basis of democracy and market economy. Moreover, the communist past cannot tell us why the Czech Republic has not adopted the euro yet. Despite the oppression and ineffective institutions under communism, the Czech Republic managed to reform its institutional, economic and political systems and be among the most developed countries in CEECs.

Although the country was close to meeting the convergence criteria, but no political will existed for moving on regarding the euro.

With respect to the *first hypothesis* regarding elections and using the euro issues in campaigning, the findings in this chapter showed that neither the government nor the opposition campaign on euro adoption issues. The reason for that, according to the second part of *hypothesis '1'* (*Government and opposition use the euro as a tool in their election campaigns if the public is interested*), is that overall Czech citizens do not view euro adoption as a priority or cause of stability (interviews with officials from the MoF, June 2009). Moreover, the majority of the public is euroskeptic and does not care much about the euro (interview with a senior official from the CNB, June 2009).

According to *hypothesis 2* (*Ideology of the government and sound policies (good governance) have a significant positive effect on euro adoption in CEECs*), the ideology of the ruling party and the role of the president turn out to be an important factor in pushing against the euro despite the sound policies adopted. This shows that even with sound policies, if the ruling party is not pro-euro, then this cannot happen. The existence of veto points, as highlighted in *hypothesis 3*, is the Czech president who is against adopting the euro—even prior to the financial crisis.

Furthermore, as indicated in *hypothesis 4* (regarding the role of the central bank and its relation with the government), the relation between the CNB and the government proved to be crucial. During the late 1990s and early 2000s, the troubled relation between the government and CNB pushed euro adoption further away. Even with the harmonious relation between the government and the CNB with the change in the board members, euro adoption is still not on the agenda in the near future. The main reason for that, as

stated in the second part of *hypothesis 4*, *the good relations are necessary but not sufficient* since both the government and CNB share the same euroskeptic view.

Finally, the role of the media in the Czech Republic supports *hypothesis 5 (inconsistent and weak)* by not being influential since there is no real political debate regarding the euro and no public support. The media addresses the euro adoption issue when the koruna depreciates against the euro, but then it disappears almost totally from the news.

The financial crisis acted as an intervening factor that diverted the entire attention away from euro adoption. Prior to the crisis, the Czech Republic only missed two of the Maastricht criteria (inflation rate and the exchange rate). In the aftermath of 2007/2008 financial crisis, macroeconomic conditions worsened. The entire effort of all major players in the Czech Republic is to face the crisis and its aftermath—not euro accession. Finally, in order to sustain the debt levels over the next few years, the Czech Republic needs to focus on pension and health care reform—a step necessary to maintain the public debt below 60 per cent reference value.

With the president's second term ending in January 2013 and the recovery of the economy moving ahead, joining ERM-2 could be a logical step in 2014—provided there is public support for this step. Monetary officials suggested that the intention is to join ERM-2 for the shortest possible period (interviews with CNB and MoF officials, June 2009), and only once the euro area sovereign debt crisis is solved. Given these conditions, we might see the Czech Republic in the euro area no earlier than 2016/2017.

CHAPTER VI: HUNGARY—THE FAST TRACK TO THE BOTTOM

6.1 Background

Hungary, just as the Czech Republic, was planning to adopt the euro soon after joining the EU. Hungary's intention was to stay for the shortest period in ERM-2 and join the euro area in 2006. However, the failure to meet the convergence criteria (high deficit and inflation, debt close to the 60 per cent reference value) pushed the government to announce January 1, 2008 as the new euro entry date (Magyar Nemzeti Bank (MNB), 2003: 18). Since then, the consecutive governments announced few dates for euro adoption but kept postponing, which caused Hungary a credibility loss. The financial crisis that hit Europe in the fall of 2008 caused difficulties for Hungary. Even prior to the crisis, Hungary had been behind on meeting most of the convergence criteria during the entire period since having joined the EU.

The Europeanization and social learning process in Hungary did not lead consecutive governments to implement sound fiscal and monetary policies, which were needed if the elites were serious about wanting to adopt the euro. The questions this chapter tries to answer are: What has Hungary done to adopt the euro? Why did Hungary move away from meeting the convergence criteria and adopting the euro?

Following this brief introduction, the first section analyzes the early institutional reforms regarding the transition towards democracy and market economy. It is important to understand the status of the country on the way to join the EU and how its situation

changed following EU accession. This analysis allows us to understand the changes in the domestic environment and how it affects euro adoption and European integration. The second section deals with the main domestic factors. After a discussion of the macroeconomic policies and status of Hungary, I analyze the relation between the government and opposition, followed by a discussion of the central bank and its relation to the consecutive governments and a study of the role of the public and the media. Then I discuss the effects of the financial crisis on the perceptions of the different actors involved in euro adoption strategies. The final section concludes.

6.2 Europeanization, Social Learning and the Early Institutional Developments

On March 31, 1994, Hungary officially submitted its application for EU membership. The negotiations for EU accession started in 1998 and major reforms had to be taken by the consecutive Hungarian governments¹⁶⁰ to meet the *acquis communautaire*. The EU supported the reforms and efforts taken by Hungary through the Phare Program (since 1989). The EU, other western countries and international organizations were involved in helping Hungary move towards democracy and market economy.¹⁶¹

¹⁶⁰ Although during the time of EU membership application and the accession, the government changed and the ruling coalitions changed, however, there was a consistency in the accession progress, which shows that there was a major support by the political parties and the public for EU membership.

¹⁶¹ As in the cases of the Czech Republic, the effect of Europeanization should not be exaggerated since many of the reforms taken by the Hungarian regime took into consideration the domestic situation. In some cases, the consecutive Hungarian governments practiced trial and error and used different reform methods such as in the privatization process.

The April 12, 2003 referendum in Hungary on EU accession indicated a few things: the permissive consensus of the Hungarians for the EU and the low intensity of preferences of EMU membership. Of the 45 per cent of eligible voters who turned out in the referendum (one of the lowest turnouts in NMS referendums on EU accession), 83.76 per cent voted in favor of EU accession while 16.24 were against (National Election Office, 2003; also Fowler, 2004: 624).¹⁶² The major political parties were in favor of EU accession and there was no division among them either regarding the EU or the euro. Even the communists accepted the democratic rules and had no intentions of going back to the pre-1989 period (Endre, 2004: 89).

In comparison to other CEECs, the transition to democracy and market economy was “without blood and revolution” (Endre, 2004: 85). However, it did not mean the transition was without costs, because the entire system that had been implanted since the end of the Second World War had to be changed. In this section the focus is on two major themes: first, political and institutional change; and second, the economic development and move to market-based economy in post-1989 transition period.

6.2.1 Political and Institutional Change

In the second half of the 1980s the communist leaders in Hungary carefully read what was going on in the Soviet Union. Recognizing that the Soviet power was deteriorating and the communist regimes in CEECs were weakening, the Hungarian elites at that time decided to maintain their position. The government decided to move towards

¹⁶² For a discussion of the low turnout in the referendum in Hungary, see Fowler, 2004.

“liberalization instead of totalitarian dictatorship” (Endre, 2004: 85). The iron control over the country started to loosen which enabled the opposition to play a more important role in political life. The ruling party took a major part in the reforms and the elimination of the “party-state”—which enabled the party to be “far less marginalized” later on (Grzymała-Busse, 2002: 107). In addition, the ruling party took the initiative and “preempted and dampened opposition demands for reform, [...] personal ties formed between the party reformists and the democratic opposition” (Grzymała-Busse, 2002: 107). The regime change in Hungary was smoother than in former Czechoslovakia or Poland because of the developments that took place in Hungary during the communist times, as we have seen in chapter three.

The domestic situation supported by the international events at that time led to taking a different approach in Hungary than that in the Czech case. Instead of the clash between the opposition and the ruling party, Roundtable talks took place between the opposition and the ruling regime from June 13 until September 18, 1989—making the regime change softer. This transition pushed some scholars such as Bruszt to label the Hungarian transition as a “negotiated revolution” (Bruszt, 1990). The Hungarian Socialist Working Party—*Magyar Szocialista Munkáspárt (MSZMP)* did not give up its position until it recognized that it was impossible for the regime to continue and had to enter into negotiations with the opposition. The ruling party insisted that the Roundtable talks were to be not only between the MSZMP and the opposition (Opposition Roundtable),¹⁶³ but

¹⁶³ Opposition Roundtable had the following participants: “Endre Bajcsy-Zsilinszky Friendship Society; Alliance of Young Democrats; Independent Small Holders’ and Farmers’ Civic Party; Christian Democratic People’s Party; Hungarian Democratic Forum; Hungarian People’s Party; Hungarian Social Democratic Party; Alliance of Free Democrats; and Democratic League of Independent Trade Unions as observer” (Békés and Kalmár, Document 4, 2001: 80).

also with the *Third Side* which included “mass organizations and civil associations”,¹⁶⁴ which were either leftist in their ideology or supported the MSZMP (Békés and Kalmár, Document 4, 2001: 79).

The poor economic performance and its negative effect on the people were the main reason that the MSZMP accepted entering into negotiations with the opposition. However, the discussions during the Roundtable negotiations were highly political and less about the economic situation. The discussions concentrated on “constitutional questions, legislation on political parties, and rules governing the electoral system”, because the opposition did not want “to share responsibility for the MSZMP’s economic failure” (Bartlett, 1997: 144).¹⁶⁵ The main goals of the negotiators at that time were to move as fast as possible towards a Western system of governance and ruling, to adopt all the institutional reforms necessary to build a democratic system and a functioning market economy, to amend the constitution and reform the legal system so that it would be suitable for a new democratic system based on respect for human rights and civil liberties, and to rebuild an active civil society (The World Bank, 2008: 3).

Although there was an agreement on these goals, this harmony disappeared when the discussions dealt with the details regarding the constitutional question and form of

¹⁶⁴ The following associations participated: “Left Wing Alternative Union; the Patriotic People’s Front; Hungarian Democratic Youth Association; the Association of Hungarian Resistance Fighters and Anti-Fascists; the National Council of Hungarian Women; the Ferenc Münnich Society and the National Council of Trade Unions” (Békés and Kalmár, Document 4, 2001: 80).

¹⁶⁵ The absence of the economic and social discussions from the Roundtable talks was considered “good politics but poor statesmanship” (Tökés, 1996: 86). This situation reflected the weak statehood view among the negotiators at that time. Moreover, many important figures (unions, some youth and women’s organizations, and “representatives of local governments” were not represented in the “elite pacts of 1989-1990” (Tökés, 1996: 86). Tökés nicely summarizes the situation during the roundtables: “Hungary’s old and new political elites had much in common. Both came from the top layer of the new middle class, both had inherited or acquired status, privileges, and distance from the nonelites to protect and preserve. In terms of group interests and political priorities, the negotiators represented but a partial spectrum—skewed heavily in favor of the old regime’s intellectuals and midlevel professionals, of the mid-1980’s mainly meritocratic, nomenclature elites. Their institutional blueprint for the new house of democracy made no provisions for the care and feeding of its inhabitants” (Tökés, 1996: 86-87).

government. The MSZMP and five members of the opposition wanted to follow the Polish example in which a presidential elections would take place first and the president have strong constitutional powers. Following the presidential elections, parliamentary elections take place under a new electoral law. This scenario faced strong resistance from the rest of the opposition participants in the Roundtable talks because, on one hand, they feared that MSZMP had interest in empowering the communist rule and have their candidate Imre Pozsagy as a president, while, on the other hand, they did not want to repeat the Polish mistake.¹⁶⁶ Moreover, they called for democratic parliamentary elections that would be followed by presidential elections by the newly elected parliament (Bartlett, 1997: 144-145).

In addition to the presidential election's issue, the Hungarian Civic Union (FIDESZ—Magyar Polgári Szövetség), the Alliance of Free Democrats-Hungarian Liberal Party (SZDSZ-Szabad Demokraták Szövetsége—a Magyar Liberális Párt), and the Democratic League of Free Trade Unions emphasized that no agreement could be reached as long as the following issues are not solved: “dissolution of the workers’ militia, [...] the accounting by the MSZMP over its properties, and the removal of *party* cells from the workplace” (Bayer, 2005: 139). With this division, the opposition in the Roundtable negotiations did not sign the concluding agreement, as it insisted on a referendum to solve the presidential election's debate.

On November 26, 1989, Hungary held its first referendum, which resulted in a narrow victory for having the parliamentary elections prior to presidential elections (Kis,

¹⁶⁶ The opposition wanted to have the elections based on two ballots: an individual constituencies ballot and the other ballot is for the multi-seat “party list”. This electoral system was “to prevent the occurrence a year later in Hungary of an electoral landslide such as that of the Polish Solidarity in June 1989 (all in individual district)” (Tökés, 1996: 85).

1991: 15). This success pushed Hungary in the direction of a parliamentary democratic system with “a powerful prime minister” (Bartlett, 1997: 145). One of the reasons for having a powerful prime minister is the adoption of “the German structure of non-confidence vote” in the 1990 constitution (Ágh, 1996: 17) in which his removal is too complicated and has “limited accountability to the Parliament” (Tökés, 1996, 91).¹⁶⁷

The Roundtable Agreement established the building block for the nonviolent transition to multiparty democracy and market economy. The new system is based on freedoms (such as freedom of religion, ownership, competition, media and press), civil liberties and respect for human rights, the supremacy of the rule of law, separation of powers and “the creation of a social market economy” (Pogany, 1993: 338). This new democracy was built on two main “pillars: the principles of Hungarian traditions displayed in the former century before the communist regime and the European Charter of Local Self-governments of the Council of Europe” (Szegvári, 2002: 140). The agreement also foresaw the submission of the suggested laws to the parliament in order to amend the 1949 constitution and create all the necessary institutions for a functioning democratic system. The new constitution discusses the organization of the parties, their financing and the election process. A new criminal code and criminal procedure were implemented and a Constitutional Court was created to guarantee that the laws implemented respect the constitution. The National Assembly adopted the new

¹⁶⁷ Article 39/A (1) states that: “A nonconfidence motion may - with the designation of the preferred candidate for Prime Minister—be launched against the Prime Minister on the written proposal of at least one fifth of the Members of Parliament. A nonconfidence motion against the Prime Minister is to be regarded as a nonconfidence motion against the Government. If the majority of the Members of Parliament have expressed nonconfidence in the motion, the candidate named as the choice for the new Prime Minister must be regarded as elected” (The Republic of Hungary Constitution).

constitution on October 18, 1989, which entered into force on October 23, 1989 (Pogany, 1993: 338; and Bayer, 2005: 141).

On March 22 and April 8, 1990, Hungary had its first and second round of the free parliamentary elections. The elections resulted in the conservative Hungarian Democratic Forum (MDF-Magyar Demokrata Fórum) winning the largest number of representatives. MDF, together with the Independent Smallholders' Party (Független Kisgazdapárt) and the Christian Democrats, was able to form the first free coalition government under the leadership of József Antall. The different parties had only a year and one month (from February 1989 until March 1990) to construct certain ideas and ideologies and get ready for the elections. So the early years after 1989 were characterized by: "the predominance of amateurs in public life" and the "incongruence in political status, economic aspirations and ideological convictions" (Csaba, 1992: 952).

Following the 1990 elections and the formation of the new government, an agreement for further constitutional amendments was concluded between MDF and the largest opposition party SZDSZ. Although criticized by other parties (those who did not participate in the agreement), this agreement was necessary to continue the series of reforms and be able to govern. As mentioned earlier, the system moved more into the direction of the German system with a strong prime minister. The parliament elects the president—who has limited powers now. The laws and decisions that need two-third majority in the National Assembly were reduced. In order to guarantee the approval of SZDSZ, MDF agreed that SZDSZ name the first president of Hungary (Árpád Göncz) after the fall of communism (Bayer, 2005: 144).

One of the significant reforms carried out was the creation of autonomous and democratic local governments. The old centralized system, which was dominated by the ruling party before 1989 “was replaced by a new [decentralized] institutional arrangement that was intended to be more democratic and efficient and capable of counter-balancing the power of the central government” (Soós, 2002: 1) in 1990 and then modified in 1994. According to Article 42 of the Constitution, “The enfranchised citizens of the villages, towns, of the capital city and its districts, and of the counties are entitled to the right of local self-government. Local self-government means autonomous and democratic management of local affairs by the communities concerned and exercise of local public authority in the interest of the population” (The Republic of Hungary Constitution). The first local elections took place in the fall of 1990 and resulted by: “over 3000 communities formed autonomous institutions” (Bayer, 2005: 145).

Antall’s government took the task of continuing the agreed reforms in the Roundtable talks to move the country into a democratic and functioning market economy state. Among Antal’s new government goals were “Euro-Atlantic integration, good relations with other countries of East Central Europe” in addition to the “conclusion of an association agreement¹⁶⁸ with the EC to ‘provide foundations for future full membership’” (Batory, 2002: 2). The reconstruction of a capitalist system proved to be costly and required painful reforms for the population. The result was an increase in unemployment, corruption and crime. The socioeconomic standard of living worsened and inequality among the population increased to high levels. Antal cited the communist era as the reason for the deteriorating situation while his successor Gyula Horn used the external involvement in the country, such as the IMF, as the cause of the difficult

¹⁶⁸ The Association Agreement was signed in December 1991 and entered into force on February 1, 1994.

economic and social situation (see Tökés, 1996: 92). As we will see in the next section, the difficult situation was a mix of both in addition to the choices and decisions taken by the elites.

6.2.2 Economic Development—Choosing the Turtle’s way (Small and Gradual Steps)

The fall of communism indicated the beginning of a new era of institutional and economic reforms that would not be easy. Since then, Hungary had to move into market economy, which required reforming and restructuring the socialist-based institutions to be more oriented to the market economy. Although the shock therapy was the trend for economic reform at that time, its supporters in Hungary were a minority (see Oblath and Valentinyi, 1993: 7-10). The gradual reforms that Hungary had to implement were not a clear cut with the communist era, since Hungary (as mentioned earlier) started its reforms with the Goulash Communism. Hungary’s post 1989 reforms were a continuation of the policies taken under communism.

The communist elites during that time made tiny reform steps, which initiated the foundations for a market economy. The reform of the banking system started already in 1987 with the “separation of the functions of the central bank and those of the commercial banks” thus leading to a “two-tier banking system” (Oblath and Valentinyi, 1993: 5). In 1988, the Hungarian taxing system was similar to the western countries since the government introduced the value added tax (VAT) and “the personal income tax”, which was followed by the launch of the “liberalization and demonopolization of foreign

trade” in 1989 (Oblath and Valentinyi, 1993: 5). In addition to the reforms in the tax and banking systems, the company law was also modernized starting in 1988 (USAID, 1999: 10). By 1990, almost 84 per cent of the prices were liberalized with only 16 per cent being set by the government (USAID, 1999: 10).

Since the 1970s, Hungary enjoyed a higher living standards and better economic conditions in comparison to other CEECs including the Czech Republic. Although, Hungary started from a relatively good economic position in 1989, the country suffered from serious problems regarding its external economic balance. During the communist era, Hungary borrowed from the West to implement reforms. This borrowing caused Hungary to have the largest foreign debt per capita in CEECs with its external indebtedness reaching USD 21.5 billion (around 75 per cent of GDP) in 1989 (Oblath and Valentinyi, 1993: 4; see also USAID, 1999: 10). The high foreign debt, which tied the government’s policy choices and alternatives,¹⁶⁹ was mainly due “to official borrowing for the purpose of boosting reserves and servicing debts” during communist times (Kiss, 1994: 54).¹⁷⁰ In addition to that, in its attempt to gain legitimacy during the second half of the 1980s, the Kadar’s government increased its spending by providing “consumer goods and raw materials” to Hungarians. The increase in spending required more finances that pushed the country to rely more on foreign borrowing (USAID, 1999: 10-11).

Unlike Poland, Hungary refused to reschedule its foreign debt and wanted to respect its commitments regarding the payments. Antall’s government hoped that by

¹⁶⁹ This does not mean that the policies’ outcomes (success/failure) were due to these restrictions, rather “policy outcomes were ultimately the result of deliberate *choices* made by political leaders operating under institutional constraints” (Bartlett, 1997: 167).

¹⁷⁰ The sharp increase in foreign debt was not “gradual” and occurred mainly over two periods: the first was in 1973 until early 1980s and the second started in the mid 1980s. According to Oblath, the increase in foreign indebtedness could be attributed to two main factors: “mistaken policy responses and unfavourable changes in the external environment” (Oblath, 1992: 194-195; for a detailed summary of Hungary’s foreign indebtedness, see Oblath, 1992: 193-223).

respecting its commitments regarding debt service, credit agencies will give Hungary better rating that “will maintain Hungary’s access to international capital markets and encourage foreign direct and portfolio investment” (Kiss, 1994: 70). Another problem that faced Hungary in the early 1990s was the decline in its hard currency reserves. The currency reserves fell to USD 300 million causing a liquidity problem (Csaba, 1992: 953; see also Oblath and Valentinyi, 1993:4-5). The liquidity problem would have led to bankruptcy if international organizations such as BIS, IMF, the World Bank and Group of seven (G-7) had not rushed to help Hungary (Oblath and Valentinyi, 1993: 5).

As for the other macroeconomic indicators, Hungary was performing well in the first few years following the fall of communism. The deficit was low by the end of the 1980s and early 1990s (1.7 and 0.5 per cent of GDP in 1989 and 1990 respectively), before it jumped to 11.7 per cent of GDP in 1993. The unemployment rate was very low in 1989 (0.2 per cent) and it increased slightly in 1990 (1.6 per cent) before it jumped to 8.7 per cent in 1991. As for the inflation and public debt, although they were high in the early 1990s (inflation 34.79 per cent in 1991 and the public debt 74.6 per cent of GDP), by the mid 1990s, the numbers started to decrease (inflation reaching 10 per cent and public debt 59.8 per cent by 1999) (see Table 6.1).

Table 6.1 Economic Indicators (per cent)

| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|-------------------|-------|-------|-------|-------|-------|-------|------|-------|------|------|------|
| GDP | 0.2 | -3.5 | -11.9 | -3.1 | -0.6 | 2.9 | 1.5 | 1.3 | 3.9 | 4.8 | 4.1 |
| Inflation | 16.89 | 28.57 | 34.79 | 22.84 | 22.42 | 18.83 | 28.3 | 23.47 | 18.5 | 14.2 | 10.0 |
| Deficit* | -1.7 | -0.5 | -4.7 | -7.0 | -11.0 | -9.8 | -3.6 | -3.8 | -4.3 | -7.8 | -5.4 |
| Public Debt | - | - | 74.6 | 79.0 | 90.4 | 88.2 | 85.4 | 71.4 | 62.0 | 59.9 | 59.8 |
| Unemployment Rate | 0.2 | 1.6 | 8.7 | 9.8 | 11.8 | 10.5 | 10.0 | 9.6 | 9.0 | 8.4 | 6.9 |

* When there is a negative sign (-), it means deficit, otherwise surplus.

Source: Eurostat, Economic Intelligence Unit, OECD, IMF

Although Hungary started its reforms earlier than the rest of CEECs, and it had a liberalized economy (in comparison to CEECs at that time), its reform pace was significantly slower. Hungary's stabilization program included: "tax increases, expenditure cuts, a devaluation of the Forint and tighter monetary policies" (USAID, 1999: 11). As for Hungary's Act XLIX of 1991 on Bankruptcy Proceedings, Liquidation Proceedings and Voluntary Dissolution (the "Bankruptcy Act"),¹⁷¹ it resulted in forcing many small and uncompetitive businesses to close with over 5000 enterprises "filing for bankruptcy" in 1992-1993 (USAID, 1999: 11).

Antall government's reluctant and gradual economic reform and its failure to conduct a comprehensive privatization approach served in the economic troubles in the first half of the 1990s. Besides, even after delaying the macroeconomic reform until 1995, Hungary could not escape the "transformational recession" syndrome (see USAID, 1999: 11) (accompanied by increase in public spending): the growth declined while the inflation, debt, deficit and unemployment increased significantly as we can see in Table 6.1. With the economic recession, worsening of the economic situation, public overspending, delayed and reluctant privatization policy and the sudden death of Antall, Hungary went through new elections in 1994 that resulted in the return of the communists to the government. Magyar Szocialista Párt (MSZP), which was the successor of MSZMP, won 54.1 per cent of the seats in the parliament.

The new socialist government did not address the economic problems during its first year in office. It was until 1995 when a stabilization and reform package was

¹⁷¹ The Bankruptcy Act of 1991 was amended by the 2006 Act VI on the Amendment to the Act XLIX on Bankruptcy Proceedings, Liquidation Proceedings and Voluntary Dissolution (the "Amending Act"), "the provisions of which entered into force on July 1, 2006 and January 1, 2007, respectively" (for more information, see Tamás and Turóczy, 2007)

introduced known as the Bokros package (named after the finance minister at that time Lajos Bokros) to deal with the economic crisis and put Hungary back on the track of economic growth. The unpopular austerity measures included in the Bokros package dealt with lowering the budget deficit and public spending, devaluing the forint and introducing a crawling peg regime, revising, accelerating and expanding the privatization agenda to cover banking and energy sectors, in addition to income reform (USAID, 1999: 12; EIU, 1997 and Buss, 2000: 18). These reforms were welcomed by international organizations such as the IMF and the World Bank. Moreover, a State Treasury was established in 1996 leading to the merger of almost 3000 accounts into a “single treasury account” in addition to the creation of a State Debt Management Agency that “was incorporated with the State Treasury” (USAID, 1999: 12). Although the reforms started to pay off slowly in 1996-1997 (see Table 6.1), the permanence of the economic recession and the discontent of the public by the austerity measures led to the failure of MSZP in the 1998 elections.

Following the 1998 elections, a coalition government was formed (FIDESZ-MDF-Independent Smallholders’ Party) under the premiership of Victor Orbán. The Orbán government’s period was characterized by better economic performance than previous periods. Fiscal measures were taken to face the international recession and to improve the “domestic output and consumption” (Greskovits, 2008: 282). The government raised minimum wages twice and implemented some programs and reforms in various sectors such as: tourism, infrastructure and transportation. The government increased the “subsidized loans for residential construction and renovation for middle and upper-middle class home builders” (Greskovits, 2008: 282). Moreover, the Orbán

government introduced a stimulus package ‘Széchenyi plan’ to develop the economy. The plan indicated certain areas that need to be developed to increase the competitiveness of the Hungarian economy. Among those areas was the energy sector—particularly the renewable energy. The plan introduced new incentives “for domestic small and medium-sized businesses, local communities and individuals” (Greskovits, 2008: 282).¹⁷²

Before turning to the discussion of Hungary’s retreat to the laggards’ group and its failure to meet all the convergence criteria necessary to adopt the euro, it is important to discuss briefly the privatization process. Privatization in Hungary was among the main pillars required for economic development and a crucial step on the road to create a functioning market economy. My intention is not to offer a detailed discussion of the privatization process. Rather, I seek to show the importance of the domestic situation and calculations of the elites, as well as the various methods tried regardless of the advices from other western countries and international organizations. Privatization in Hungary went through clinical trials, as we will see in the following section.

6.2.2.1 Hungarian Privatization—Trial and Error

Since the 1970s, Hungarian scholars (such as Tardos, 1972; Sárközy, 1981; Bauer, 1984 and Liska, 1984) have already recognized the negative effect of inefficient state enterprises on the economic development of the country (Major, 1994: 110). During

¹⁷² The Széchenyi Plan became part of the National Development Program that was related to the EU accession in 2003. In 2010 a New Széchenyi Plan was launched by the Fidesz government to help boost the economy, create new jobs, and develop wide range of sectors (infrastructure, health, green economic development, transport, knowledge economy and enterprise promotion) (for more information on the New Széchenyi Plan, see: Ministry for National Economy Hungary, 2010).

1987-1992, several important regulations were passed, which formed the legal basis to prepare for privatization. Among these measures were: the creation of a two-tier banking system resulting from the separation of commercial banks from the central bank in 1987, “the act regulating foreign direct investments in Hungary (1988)”, “the act on the conversion of the state-owned enterprises into corporations (1989)” (Major, 1994: 111) and the “law on ‘company transformation’ and ‘corporatization’ defined all the legal forms of business ventures—joint stock, limited liability, individual, partnership, state-owned and municipal company—that are common in advanced market economies” (Major, 2003: 427-428).

As for the privatization method, although the market-based method was favored, Hungary was not able to apply one method and tried a variety of methods, as we will see in this section. What played role in the choices of the privatization methods were the conflicting interests and different calculations of the elites in addition to the electoral cycles. The various political parties were trying to build a strong constituency so they were very careful in not taking any decision that would cause them to lose supporters. The main disagreement was related “to questions as to who should be the beneficiaries of privatisation and what layers of society should enjoy preferential treatment in the privatisation process” (Galgóczy, 2001: 45).

The first attempt to privatize was during the spring of 1988 and 1990—the so-called *spontaneous privatization*. On the basis of the transformation and company law and the late 1980s regulations, many large state-owned ventures (those facing financial difficulties) “divided themselves into groups of companies” (Voszka, 1999: 13). As for the “majority shareholder”, it remained in the hands of “the central enterprise

implementing the restructuring” that changed their names into “holding companies” while maintaining the “traditional enterprise form and remained in state hands” (Voszka, 1999: 13). One can conclude here that even labeling the process as *spontaneous privatization* is debatable since there was no serious privatization and the ownership remained in the hands of the state (Voszka, 1999: 13; see also Major, 1994: 113). The outcome of such approach was not promising because it failed to “attract fresh capital and tap new markets” and only provided a “temporary relief”—as most ventures that went through this process “degenerated or disappeared from the market” (Voszka, 1999: 13).

With the fall of communism, there was confusion among the elites on how to move towards democracy and market economy. The reason for this was the absence of a plan ready for use by the new democratic elites “describing how to replace the collapsing economic system with a viable and efficient one within tolerable period of time” (Major, 2003: 428). After some discussions, there was an agreement that a comprehensive privatization process needed to be launched. As a result, a State Property Agency (SPA) was created for the privatization purpose and fell under the Hungarian parliament’s supervision prior to the January 1990 elections (Major, 2003: 428; also Grosfeld and Hare, 1991). With the newly elected government, the SPA fell under the government’s jurisdiction with the intention to sell the state-owned enterprises (Major, 2003: 428). However, this centralized privatization was not that productive and was very slow. Only small number of companies was privatized by this way. The centralized privatization method was considered to be a “complete failure in Hungary” (Major, 1994: 115). This method of privatization was too bureaucratic, “ownership rights are often unclear” and the responsibilities of the various governmental players were confusing (Járai, 1993: 80).

Another important factor was the international recession, which had significant effect on companies (especially medium- and large-size). Western markets were getting tighter and “potential buyers” were facing “financial and marketing difficulties” (Járai, 1993: 80).¹⁷³

In order to speed up the progress and profit more, the government began its decentralization of the privatization program¹⁷⁴ (or self-privatization) in the second half of 1991—with special focus on “medium-sized companies” (Galgóczi, 2001: 45; see also Major, 1994: 115; Voszka, 1999: 14). The new methods existed along with the other methods already used. Self-privatization was directed first towards smaller companies and then was expanded to cover larger enterprises in mid 1992. Large portions of “the seller’s rights were assigned to consulting firms selected and deemed to be reliable by SPA” (Voszka, 1996:185). Privatization in this stage rested on “contractual basis between the company being privatized and a consulting company” (Galgóczi, 2001: 47). These consultants were keen on getting the task done quickly with the best results in order to benefit from the incentives and compensation given to them. Accordingly, and because of the limited number of concerned companies, the results were better than previous privatization since “most enterprises covered by the program were sold” mostly to Hungarians (Voszka, 1999: 14; also Voszka, 1996).

The aim of building and strengthening “a property-owning middle class was mentioned for the first time” in the privatization plans (Canning and Hare, 1996: 6). There was a shift in the focus from pure economic benefits to other socio-political interests. Due to the corruption and property scandals, the ruling party needed to improve

¹⁷³ All these difficulties do not change the fact that about “90 per cent of the privatisation revenues of the SPA came from foreigners” (Járai, 1993: 80).

¹⁷⁴ Both privatization methods (centralized and decentralized) fall under “market methods, as they are characterized by sales on competitive bases and price plays an important role in negotiations” (Voszka, 1996: 187).

its image and gain more supporters in order to win the elections (Canning and Hare, 1996: 8), so they used privatization as a tool to accomplish these interests. During 1993-1994, privatization was directed mainly towards Hungarians through *preferential privatization* methods, which was based on “Existence loan” (Galgóczi, 2001: 47). Hungarian managers, employees and industrialists had access to cheap loans with very low interest to be able to buy state-owned property (Galgóczi, 2001: 47). The first stage of the *Small Investors’ Privatization Program* was launched in 1993 in which credit vouchers were made available for all Hungarian citizens up to 100,000 forints with no interest. The aim was also to allow Hungarian citizens to have easy access to state-owned enterprises (Major, 1994: 117).¹⁷⁵

The second half of the 1990s (1995-1998) witnessed a massive privatization program referred to as the “big privatization” (Voszka, 1999: 15). Foreigners’ role in this stage was remarkable. Thirty per cent of revenues came from selling major commercial banks and enterprises (such as gas and electricity providers, power plants, telecommunications) to foreign investors (Galgóczi, 2001: 47 and Voszka, 1999: 15). During the same period, among the privatization methods used was “floating shares on the stock exchange” in which major pharmaceutical, chemical, oil, and machinery industries “were listed on the stock exchange” (Voszka, 1999: 15).

By the end of the 1990s, the government privatized more than 85 per cent of the state-owned enterprises. It could be concluded here that the privatization process in Hungary used a variety of methods. The period of the 1990s witnessed corruption at different stages; privatization methods were sometimes used for election purposes.

¹⁷⁵ Although the focus during this period was on the domestic players, but foreigners were able to compete. The only advantage for the citizens were the loans and vouchers provided for them by the government.

Although the privatization process was gradual, it proved to be faster and more effective than most other CEECs (Brown, Earle and Telegdy, 2005: 8). Despite the importance of Europeanization and the involvement of the EU and international organizations in democratization and the process of building a market economy, however, it should not be exaggerated in the privatization process. The various privatization methods used, showed that the domestic environment was more important in directing the reform process.

By the end of the 1990s and early 2000s, Hungary was still among the pacesetters regarding its economic performance. The intention was still to adopt the euro as soon as Hungary joins the EU, so what happened to make Hungary fall into the laggards camp? Answering this question brings us to the domestic politics' discussion.

6.3 Role of Domestic Politics in Understanding Euro Adoption Strategies—The Main Factors and their Interactions

As we have seen in the previous two sections, despite the economic problems in the early years of reforms, Hungary's reform strategies and move towards market economy and democracy were successful and placed Hungary among the pacesetters regarding economic reforms and euro adoption after joining the EU. Hungary, like all NMS, benefitted from the EU assistance and aid, the support from western countries and other international organizations, yet the fast reform lane taken by Hungary could not last long and the move to the slow lane dominated the 2000s period. In this section, I address the reasons for Hungary's fall into the laggards' camp regarding euro adoption. After discussing the macroeconomic policy, I analyze the perceptions of the main actors and

their interaction with each other in addition to the factors influencing their attitudes regarding euro adoption.

6.3.1 Macroeconomic Indicators—Irresponsible Monetary and Fiscal Policies

At the outset, Hungary was among the most enthusiastic of all NMS to join the euro as early as possible. The reform project was moving forward and Hungary was performing well economically. In the early 2000s, euro entry was projected for the year 2006.

Ironically, in 2004, the year Hungary joined the EU, the country did not meet any of the criteria for adopting the euro, except for the public debt that was slightly below the 60 percent reference value (57.6 per cent).

Table 6.2 Performance of Hungary on the Convergence Criteria (per cent) (2004-2010)

| Hungary | | | | | | | | |
|----------------|------------|----------------------------|-------------|----------------------------|-------------|----------------------------|-------------|----------------------------|
| | 2004 | 2004 Reference Value | 2008 | 2008 Reference Value | 2009 | 2009 Reference Value | 2010 | 2010 Reference Value |
| Inflation Rate | <u>6.8</u> | 2.4 | <u>6.0</u> | 3.2 | <u>4.0</u> | 1.0 | <u>4.7</u> | 1.0 ^a |
| Interest Rate | <u>8.1</u> | 6.4 | <u>6.9</u> | 6.5 | <u>9.1</u> | 6.0 | <u>7.3</u> | 6.0 ^a |
| Public Debt | 57.6 | 60 | <u>73.0</u> | 60 | <u>78.4</u> | 60 | <u>80.2</u> | 60 |
| Deficit | <u>6.2</u> | 3.0 | <u>3.8</u> | 3.0 | <u>4.5</u> | 3.0 | <u>4.2</u> | 3.0 |
| GDP Growth | 4.9 | NA | 0.8 | NA | -6.7 | NA | 1.2 | NA |

* When there is a negative sign (-), it means deficit, otherwise surplus.

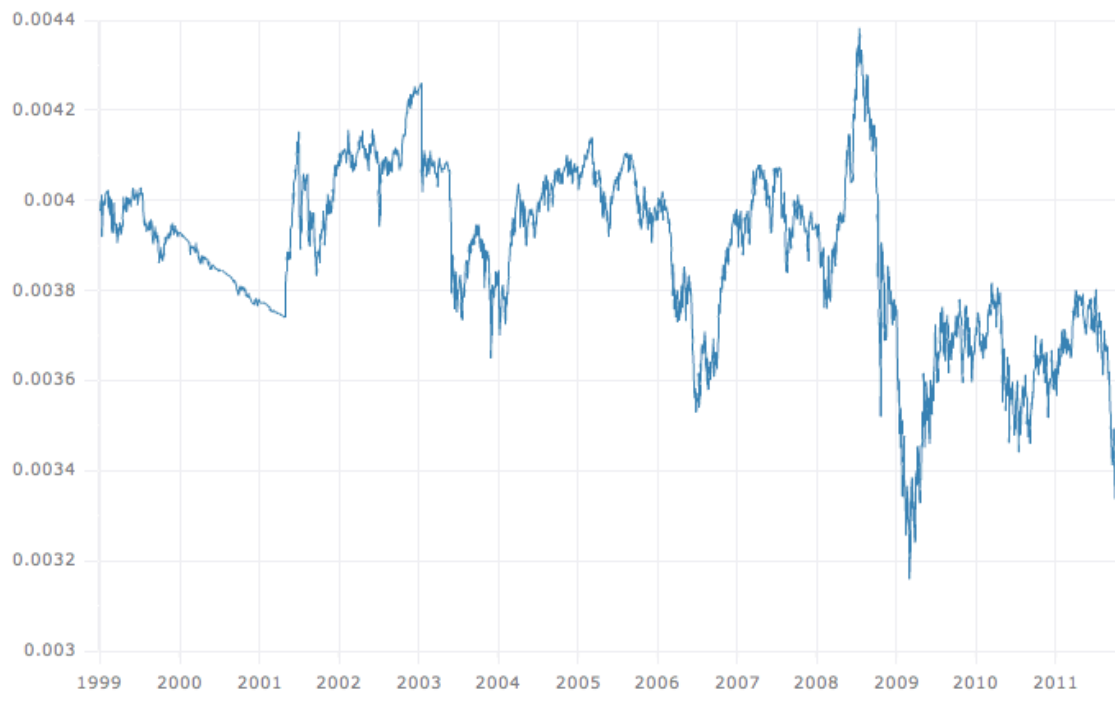
a. Reference value refers to the period April 2009 until March 2010.

Source: European Commission (2004; 2008b; 2010a); Eurostat 2010-2011; Government of the Republic of Hungary, 2011; and ECB 2010.

As we can see in Table 6.2, in 2004, Hungary's inflation rate was 6.8 per cent, the budgetary deficit stood at 6.2 per cent and the interest rate was 8.1 per cent—far above the threshold. Since that time, the situation has not improved. Although the numbers have changed, three things are still stable: the existence of an excessive deficit, a high debt and thus that Hungary still fails to meet all of the Maastricht criteria. In addition, public spending exceeds the 50 per cent of GDP while it is below 40 per cent “in most other central European countries” (Darvas, October 29, 2008).

In terms of its exchange rate, Hungary adopted a policy of “ERM-II shadow” or a crawling peg to the euro with a \pm fifteen per cent band and inflation targeting of three to five per cent by 2005 (Dean, 2004: 763; also Loli, 2003). It fluctuated a bit over the period January 1, 1999 through mid May 2008 though the fluctuations evened out. For example, in January 2003, the forint was strong in comparison to the euro and reached “the upper limit of the fluctuation band” (Jankovics, 2003: 6). The MNB played an important role (such as responding by buying around 5 billion euro within 48 hours) in upholding the value and stability of the forint (around 245 forint/euro) (see Figure 6.1). However in the second half of 2003, the MNB decided to “withdraw from the foreign exchange market and restore its former practice of influencing exchange rate movements primarily via interest rate changes” (Jankovics, 2003: 6). Another measure taken by the government and the MNB to stop the appreciation of the forint and increase the international competitiveness of the Hungarian exports was the depreciation of the “intervention band by 2.26 per cent” (Jankovics, 2003: 6).

Figure 6.1 Exchange Rate—Hungarian Forint/Euro (1999-2011)



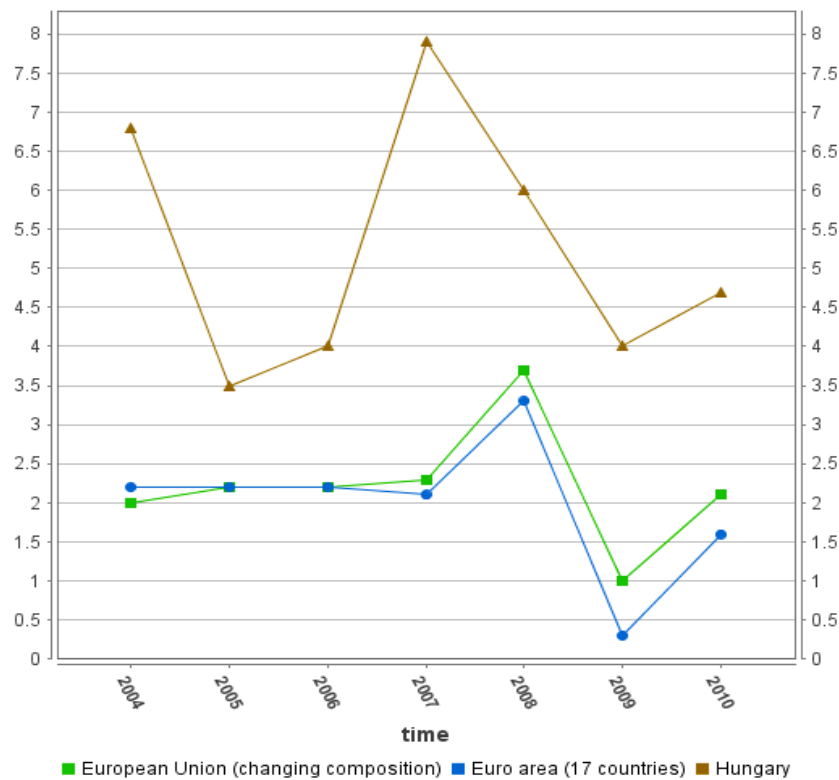
Source: ECB

In the first half of 2006, the forint weakened sharply in relation to the euro (around 10 per cent depreciation), “amidst a receding risk appetite affecting emerging markets globally and also reflecting concerns among investors about the development of Hungarian fundamentals, in particular the fiscal situation” (European Commission, 2006: 15). The second half of 2008 and the first half of 2009 saw a gradual decline of the Hungarian currency by about twenty per cent (ECB, 2009; also see Figure 6.1). Moreover, the GDP contracted by 7.5 per cent to reach -6.7 per cent in 2009 after having showed growth of 0.6 per cent in 2008 before picking up again in 2010 to reach 1.2 per cent. Unemployment stood at 11.7 per cent by the end of 2010 (Eurostat, 2011). The interest rate reached 9.1 per cent in 2009 before being reduced to 7.3 per cent in 2010 (although lower, it was still higher than the reference value). The interest rate is higher than most CEECs countries, which suggests the existence of “risk perception in the

markets” (European Commission, 2006: 16). Hungary was still running an excessive deficit of 4.5 and 4.2 per cent of GDP in 2009 and 2010 respectively. For Hungary, these numbers are relatively low, since the deficit usually goes high whenever there are elections, as we will see later.

As for the inflation rate, which is identified by both the government and the MNB, it has one characteristic that has not changed since 2004: it is always higher than the average of the euro area and the EU. The inflation rate increased sharply in 2007 reaching 7.9 per cent (EU average was 2.3 per cent) before it started decreasing to reach 4.0 per cent in 2009 (reference value 1 per cent and the euro area average was 0.3 per cent) (see Figure 6.2). This decreasing trend did not last long since the inflation rate increased again to reach 4.7 per cent (reference value 1 per cent).

Figure 6.2 Annual Average Inflation Rate in Hungary



Source: Eurostat

The public debt is still high and exceeds the reference value (78.4 and 80.2 per cent of GDP in 2009 and 2010 respectively). The public debt has been increasing systematically since 2001 (52 per cent) by 1-3 per cent until 2007. After 2007, the debt jumped from 66.1 per cent in 2007 to 72.3 and 78.4 per cent in 2008 and 2009 respectively (see Table 6.2). According to May 2010 ECB Convergence Report, Hungary does not meet any of the convergence criteria and in order to achieve a suitable environment for “sustainable convergence”, Hungary needs to implement “stability-oriented monetary policy and the continued strict implementation of the fiscal consolidation plans” (ECB, 2010: 49).

The main reason for the gloomy financial outlook is that the consecutive governments’ fiscal and monetary policies are pushing the country away from meeting the convergence criteria. Despite their interest in the euro, the consecutive governments since 2001 have not been able to adopt sound and responsible financial and monetary policies in addition to the fact that corruption still prevails (interviews with MoF and MNB officials, June 2009). The current government led by Viktor Orbán (Fidesz) (following the 2010 elections) has announced its intention to join ERM-2 soon after meeting the criteria, but the macroeconomic indicators suggest Hungary is not yet moving in that direction. Hungary is the long-lasting outlier among CEECs since it is the only country that failed to meet all or almost all of the criteria consistently since EU accession in May 2004.

After seeing the current macroeconomic status of Hungary, it is important to understand how Hungary reached such a situation. Although, the historical legacy could help us partly understand the early economic progress, however, it falls short in

explaining why Hungary's performance declined and why the country is far removed from adopting the euro compared to other CEECs. Other explanations are needed to understand why Hungary that was more advanced than CEECs under communism turned out to be behind regarding euro adoption.

6.3.2 Government, Opposition, Electoral Cycles and the Euro

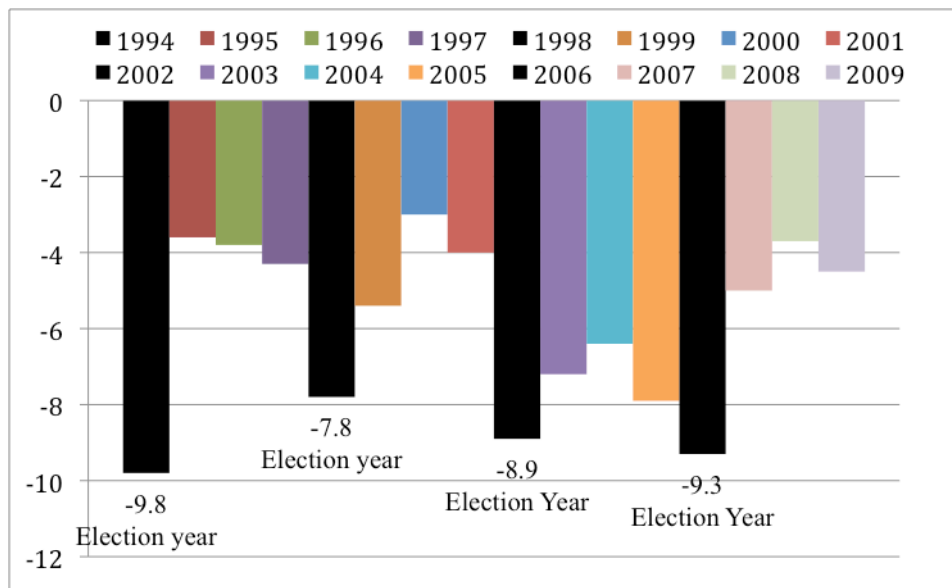
In the post-Cold War era, the Hungarian political system is characterized as a multiparty system. There are two major parties (FIDESZ, the main conservative party, and MSZP, the main social democratic party), but neither can form a majority without a coalition partner. MSZP has had a minor coalition partner SZDSZ, a neoliberal party (in power between 2002 and 2008). In 2002 elections, the Left-Liberal coalition had a minor victory over the FIDESZ-MPSZ (Hungarian Civic Alliance) coalition. The losers responded not only by questioning the legitimacy of the government but also by raising accusations of corruption and cheating during the elections—which eventually led to some riots. These circumstances increased the political instability in the country.

Another important factor that contributed to the domestic political landscape was the fact that welfare spending and euro adoption strategy “became heavily politicized” (Greskovits, 2008: 283). The opposition did not only criticize the government for failing to adopt the euro on the target date (2006) but also on the types of policies implemented to meet the Maastricht criteria in order to adopt the euro. With the exception of some insignificant extreme right and left parties, the major political parties are homogeneous in their stance on the euro since they are pro euro adoption (interviews with MoF and MNB

officials, June 2009). Thus, when political tensions were high, political parties quarreled over healthcare and privatization rather than the euro (see Economic Intelligence Unit (EIU), 2008).

Moreover, during election years the spending of the governments increases significantly in an attempt to attract voters. These promises and increase in spending beyond the country's means put more pressure on the budget and increased the deficit significantly. There is a significant relation between electoral cycles and increase in the deficit (interviews with MNB officials, June 2009). During election years, the deficit skyrockets reaching 9.8 per cent, 7.8 per cent, 8.9 per cent and 9.3 per cent in 1994, 1998, 2002 and 2006 respectively (see Figure 6.1).

Figure 6.3 Electoral Cycles and Deficit Increase (Year/Deficit as % of GDP)¹⁷⁶



Source: For Deficit data, see Eurostat.

Hungary's 2002 elections witnessed hefty competition among the various political parties to attract voters. According to the interviews conducted with some key informants

¹⁷⁶ The figure is based on data I retrieved from the eurostat dataset. There is a similar figure in Jankovics (February 2, 2008: 2) with slightly different data.

at the MNB and MoF, in the heat of the campaign each of the political parties pledged more and more funding to various societal groups. The increase in social spending put a lot of pressure on the deficit and caused fiscal problems that the consecutive governments had to deal with following each parliamentary election (interviews with MoF and MNB officials, June 2009). Pensioners' payments increased (paying out 13 instead of 12 months) and the salaries of public employees increased up to 50 percent as promised in the 2002 campaign (interviews with MoF and MNB officials, see also Greskovits, 2006: 186; EIU, 2008: 31; Horvath, 2009). All these efforts were directed to increase the popularity of the political parties and attract more votes.

One of the targets of PM Péter Medgyessy's socialist government (prime minister from May 27, 2002 until September 29, 2004) was to provide funds to inactive citizens because a large part of the economy was inactive (Fazekas, 2004; Horvath, 2009). The introduction of the huge welfare measures by the Socialist government led to a sharp increase in the budget deficit (almost 9 per cent of GDP) (*Euractiv*, April 21, 2005; see Figure 6.1). These measures that increased spending did not take into consideration the macroeconomic indicators nor the euro adoption target, which caused a poor macroeconomic performance—putting Hungary at the end of the NMS' macroeconomic indicators' continuum.

Between 2002 and 2006, the fiscal conditions worsened and the credibility of the Hungarian government was undermined due to the continuous missing of the euro adoption targets set in the various convergence reports. In the 2006 election campaign, “social welfare and the appropriate policy strategy for euro adoption” (Greskovits, 2008: 283) were used as tools to gain more electoral support. The budgetary problems,

especially the size of the deficit, did not disappear. Even with the “fiscal adjustment package” that was introduced following the 2006 elections, the deficit stood at 9.3 per cent in 2006 (Eurostat, 2010; see Darvas, 2008; and Figure 6.1). By 2006, the 2010-euro adoption date was dropped due to problems with the budget indicators (interview with MoF officials, June 2009; see also *Euractiv*, February 22, 2007) caused by the overspending during previous years. Eventually, the Hungarian government abandoned the idea of having a euro adoption timetable. Until 2006, and mainly because of the absence of political will, no public sector reforms took place in Hungary that was suffering from oversized staff. In 2007, the efforts to downsize the public sector succeeded—60,000 public servants were fired (Greskovits, 2008: 291).

The 2010 parliamentary elections that took place on April 11 and 25 resulted in the victory of the conservative party FIDESZ winning around 53 per cent of the votes. FIDESZ along with the Christian Democratic People’s Party (*Kereszténydemokrata Néppárt*, KDNP) formed a new coalition government. The two parties together secured a two-thirds majority that allowed them to take important decisions such as major laws and constitutional amendments without the need to bargain or negotiate with other parties. The austerity measures taken by the government were directed towards lowering the excessive deficit, cutting the public spending and wages for public servants by an average of 15 per cent, reduction of taxes on small enterprises to 10 per cent (originally 19 per cent), introducing a “new 16 percent flat tax on incomes” (Wagstyl, 2010), and introducing a bank tax (*EUbusiness*, September 13, 2010).

The current government faces the challenge of avoiding a sovereign debt crisis, as experienced by Greece, Ireland and Portugal in 2010-2011. As for euro adoption, it

remains well out of reach. The government has not announced any euro adoption timetable. Adopting the euro or even setting a possible date is difficult; as Mihály Varga¹⁷⁷ argued, Hungary would not be able to meet the convergence criteria before 2014 or 2015 (*EUBusiness*, September 13, 2010). In addition to that, the current ruling party (FIDESZ) is pro European integration and the euro; however, it is at the same time populist and nationalistic. According to *Nomura International*,¹⁷⁸ despite the euro support, “populism, combined with the impact of the current crisis, has dashed any hopes of its adopting the euro in the near future, notwithstanding its determination to be a strong voice within the EU” (Montalto, 2011: 100). Therefore, the possible date for euro adoption in Hungary would not be before 2018 (Montalto, 2011: 100).

In Hungary, several factors led to the deteriorating fiscal situation, which rendered impossible the government’s initial fast-track euro adoption strategy. These factors included competition between political parties to win voters, the fiscal profligacy of governments in power, lack of political will, and the inexperience of governments with public finance. Moreover, the fact that Hungary is still an immature democracy and lack of experience with governing caused parties to focus on short-term political gains. The electorates also are not as aware of elections’ strategies and advertisements for the sake of winning elections as they are in more advanced democracies (interviews with MNB officials, June 2009).

Even though the fiscal behavior of the government was not immediately penalized by the markets, due to the global savings glut, it was still clear that the policies pursued by the government of the day were very far removed from those needed so that the

¹⁷⁷ Former Minister of Finance (2001-2002) and currently the state secretary of the Prime Minister’s office.

¹⁷⁸ Nomura is a London-based company that provides market services in investments and merchant banking across the globe.

country would start meeting the convergence criteria. Politicians who were mainly seeking domestic political gains were not at all focused on taking the necessary steps that would lead eventually to euro adoption. Instead, government policies were inconsistent with a fast-track euro adoption strategy. These policies were contradictory to the needed plans to adopt the euro that the consecutive governments were interested in. Not being able to fulfill the previous announced dates regarding euro adoption caused the governments to be hesitant in announcing any new date and resulted in a credibility loss (interviews with MoF and MNB officials, June 2009). These irresponsible policies caused Hungary to suffer more than any of the central European countries from the global financial crisis of 2008.

6.3.3 Central Bank vs. Government—Cooperation or Conflict about the Euro?

According to Article 1(2) of the Act LVIII of 2001 on the MNB, which was adopted by the parliament, the Hungarian central bank and its decision-making bodies are to be independent in their decisions and do not receive any instruction from the government or any other institution except for the ECB. The main goal of the central bank is achieving and maintaining price stability (Article 3(1)). Since then, and especially following the EU accession, the MNB Act has been amended by the Parliament couple of times to be in line with EU requirements. However, some attempts to amend the MNB Act were based on the poor relations between the Bank and the government during the 2002-2007 period and aimed at reining in the MNB's independence.

The troubled relations between the government and the MNB, especially under governor Zsigmond J rai (2002-2007),¹⁷⁹ threatened the independence of the MNB. In an act that was considered a “political provocation” against Medgyessy (and the MSZP government),¹⁸⁰ who was favoring lower interest rates and requesting a devaluation of the currency and a reduction in the fluctuation margin during the 2002 elections, the MNB raised the interest rate. J rai’s views were strongly influenced by the official 2006 target date to adopt the euro and he was critical of the government’s unrealistic promises to increase wages and benefits for employees regardless of its effect on increasing the inflation and public deficit (interviews with MNB officials, June 2009). It is important to highlight that the Medgyessy government was still in favor of adopting the euro soon but the macroeconomic policies implemented and the increase in spending and wages was not in favor of their announced target (interviews with MNB officials, June 2009).

The forint had a \pm fifteen per cent fluctuation band against the euro and the MNB adopted an inflation targeting policy in which “the exchange rate was used as a tool of disinflation” (Greskovits, 2008: 282). MNB policies were criticized of being too tight. Governor J rai, who was supported by FIDESZ-MPSZ, made it clear that monetary policy would not be relaxed until “fiscal tightening” policy were accepted (Greskovits, 2008: 283). However, the parliament amended the MNB act regardless of the opposition of FIDESZ and MPSZ who considered it to be a violation of the central bank’s independence (Greskovits, 2006: 186).

¹⁷⁹ J rai was the Minister of Finance during 1998-2000.

¹⁸⁰ Although P ter Medgyessy was independent, the MSZP nominated him to be the Prime Minister after the 2002 parliamentary elections. However, due to conflicts with the SZDSZ (which was the coalition party in the government with the MSZP), he resigned in August 2004 and was succeeded by Ferenc Gyurcs ny from MSZP.

The MNB policies were not only criticized by the government, but also by industries and exporters. Dissatisfaction with the MNB policies and governor Járαι reached its peak in the second half of 2004 due to the different policies taken by the central bank affecting the exchange rate and fluctuation of the currency. The discontent with the MNB policies resulted in a government bill (Bill T/12192) sent to the Hungarian parliament to amend the MNB Act (EIU, 2008: 32). The proposed bill suggests changing in the rules and composition of the Monetary Council by increasing its number and giving the government more influence in appointing its members so as to change monetary policy stance of the MNB. The ECB proclaimed that this amendment affected the independence of the central bank and there was no need for it (MNB, 2004).

Following the 2006 parliamentary elections, MSZP won the majority and continued its coalition with SZDSZ to govern. The disagreement and conflict between the government and the MNB was alleviated with the end of Járαι's term. The political reason for the conflict disappeared in March 2007 with the appointment of Andras Simor as the new governor of the MNB. Cooperation between the government and MNB strengthened. Simor convinced the government to abandon the ± 15 per cent fluctuation band target of the forint with respect to the euro. The abandonment of the 15 per cent fluctuation band supported the MNB efforts to reduce inflation (EIU, 2008: 33). The development in the relation between the MNB and the government eases the way for working harder to meet the criteria for adopting the euro.

In order for Hungary to join the euro area, it does not only have to work hard to meet the convergence criteria on the interest rates, exchange rates, debt and deficits, but also has to comply with the central bank independence requirements as well as a few

other legal requirements. Indeed, according to the ECB 2010 Convergence Report, Hungary “does not comply with all the requirements for central bank independence, the prohibition on monetary financing, single spelling for the euro, and legal integration into the Eurosystem” (ECB, 2010: 49).

6.3.4 Public Opinion and the Media

In 2007, only 49 per cent of Hungarians were excited about the prospect that a strong euro would eventually replace their forint (Gallup Europe, 2007). Eurobarometer data of 2009 and 2010 confirmed that Hungarians are on whole positive about the euro (see Table 6.3). However, this support is not based on deep understanding of the issue partly because of the lack of public discussion regarding euro adoption (interviews with MoF and MNB officials, June 2009). Hungarian public support of the euro is different from that of the Czech Republic—the latter are more skeptical about euro adoption.

The vast majority of the population forms its opinion on the euro based on its effect on salaries, pensions and personal accounts, though not everyone feels well informed about the euro (interviews with MoF and MNB officials, June 2009). In the case of Hungary, we can see the dominance of the economic aspect based on the calculations of the citizens regarding the personal costs and benefits from adopting the euro. The percentage of those who consider the consequences of euro adoption to be negative is increasing: only 30 per cent prefer speedy euro adoption compared to 22 per cent who prefer late adoption. As for the other explanations regarding public opinion such as the political expectation (values and citizens’ preferences) and the attitudes

regarding the national identity and symbolism of the currency, these are not as important as the economic explanation. Only 36 and 38 per cent of the population are dissatisfied the euro will replace their currency in 2009 and 2010 respectively (see Table 6.3).

Table 6.3 Public Opinion in Hungary in 2009 and 2010

| Hungary's Public Opinion | | |
|--|-------------|-------------|
| % of population | 2009 | 2010 |
| Agree that euro adoption ensures sound public finances | 62 | 70 |
| Disagree that euro adoption ensures sound public finances | 22 | 20 |
| Dissatisfied with the fact that the euro will replace their currency | 38 | 36 |
| Content with the fact that the euro will replace their currency | 54 | 54 |
| Want euro accession as late as possible | 24 | 22 |
| Want euro accession as early as possible | 34 | 30 |
| Well informed about the euro | 38 | 42 |
| Not well informed about the euro | 62 | 58 |
| Think the euro will have positive consequences* | 49 | 57 |
| Think the euro will have negative consequences** | 37 | 29 |
| Form their opinion based on its effect on salaries, pensions and personal accounts | 88 | 90.8 |
| Television is the main source of information | 78 | 81 |
| Using the euro makes people feel more European | 30 | 32 |

* This has been increasing since 2004 when it was 32 percent.

**This has been decreasing since 2004 when it was 54 percent.

Source: European Commission (2009b; 2010b).

As for feeling more European, and the sense of belonging to Europe, the data shows that this criterion is not significant. In 2009 and 2010 respectively, only 30 and 32 per cent of the population think that by adopting the euro, they will feel more European. EU membership rather than adopting the euro is more important in this respect (symbolism and belonging to Europe) since it was sort of a declaration of the return and belonging to Europe (interviews with MoF and MNB officials, June 2009). For the Hungarians, their opinions are formed based on the economic perspectives more than the political explanations. Hungarians think in terms of their cost-benefits calculations and

the forint has been volatile for a while and weaker than other currencies in CEECs (in addition to the euro). Regarding the political explanation, Hungarian elites are not really divided on euro adoption, yet the public support for the euro is not based on that but more on having a stronger currency and sound finances.

Due to the lack of trust of the people in the financial and economic policies of the consecutive governments, 70 per cent of the population in 2010 believed that adopting the euro ensures sound finances, compared to 20 per cent who thinks otherwise.¹⁸¹ Among the issues that affected the public opinion and increased its interest in the euro was Slovakia adopting the euro, which put some pressure on the government. The public was questioning why Hungary is still outside the euro area while Slovakia joined in 2009 (interviews with MoF and MNB officials, June 2009).

These high rates of support are expected to change following the sovereign-debt crisis in different euro members (mainly the Greek crisis). The view that the euro provides monetary and financial security is doubted now in Hungary. Skepticism is increasing in Hungary regarding if the euro will be good for the economy. The scandals regarding wrong data and corruption in Greece raised questions among the Hungarian public regarding the transparency of the euro members and “regulatory side of the euro” (Monetary Policy and Euro, April 17, 2010). Hungarians are questioning the credibility of the euro since its members can get away for long time by providing wrong data as in the case of Greece. The Greek case, in addition to the problems of other euro members (Ireland and Portugal), is having negative effects on the positive view of the Hungarians regarding the euro.

¹⁸¹ We have to keep in mind that the 70 per cent is decreasing due to the euro crisis as we will see later.

Although 81 per cent of Hungarians consider the television to be the main source of information, the media is not that focused on euro adoption issues. The main reason for that is that there is no real public debate on the euro or on the costs and benefits of adopting the euro. Even in the elections, prior to the financial crisis, to attract voters the focus was on increasing wages and social benefits (interviews with MNB officials, June 2009). In the latest elections (April 11 and 25, 2010), the focus was directed to face the crisis and implement sound macroeconomic and fiscal policies to develop the economic situation. So the issue of euro adoption has not been highlighted much in the media. For Hungarians, euro adoption is about economic costs and benefits; the currency is not a source of identity or symbolism (interviews with MoF and MNB officials, June 2009).

6.4 Financial Crisis Effect on Euro Adoption Position

In Hungary, the 2008-2009 financial crisis played a role in pushing the politicians to correct their bad fiscal and monetary policies over the past years. Hungary had to negotiate a rescue package with the EU, IMF and the World Bank in order to face the deterioration in its fiscal and monetary indicators and “to bolster confidence in its economy” (*Financial Times*, October 28, 2008a). The 25.1 billion dollars’ rescue package intended “to shore up Hungary’s current account deficit and restore international confidence in its capital markets reflects a determination to head off market panic before it is allowed to spread to the rest of central and eastern Europe” (*Financial Times*, October 29, 2008).

The crisis served as a wakeup call for Hungarian politicians to implement sound fiscal and monetary policies and correct the problems that have been accumulating over the years because of the irresponsible policies. The current government has plans to meet the convergence criteria and adopt the euro by 2014 or 2015. To do so, the government has to meet its commitments and have a deficit below 3 per cent in 2011, inflation within the convergence criteria limit and a debt below the 60 per cent threshold. Meeting the convergence criteria is doubtful in the foreseen future unless sound monetary and fiscal policies are implemented. The questions here are not about the future rather about what caused Hungary to suffer from the financial crisis? And what effect has the crisis had on the position of the elites?

Among the things that contributed significantly to the severe crisis in Hungary is that “massive government debt was foreign-owned. These foreigners wanted to sell their Hungarian forint-denominated bonds but no new buyers appeared on the market” (Darvas, 2008). With no buyers on the market, the long-term interest rates reached as high as 12 per cent and “the government bond market dried up” (Darvas, 2008). Hungary’s “banking system is heavily exposed to foreign financing at a time when investors are pulling back from developing economies worldwide” (*Financial Times*, October 28, 2008a). According to the then IMF chief Dominique Strauss-Kahn, the Hungarian government has committed in a “comprehensive policy package” to strengthen “the economy’s near-term stability and improve its long-term growth potential” (*Financial Times*, October 28, 2008a; also *EUobserver*, October 29, 2008).

This reform package will also help “restore investor confidence and alleviate the stress experienced in recent weeks in the Hungarian financial markets” according to Strauss-Kahn (*Financial Times*, October 28, 2008a; also *EUobserver*, October 29, 2008).

The rescue package helped in lessening the “pressures on the Hungarian currency” which depreciated sharply between spring 2008 and March 2009 (ECB, 2010: 48). Following the financial crisis, “the exchange rate of the forint against the euro showed a high degree of volatility” (ECB, 2010: 48) and the interest rate was really high (over 9 per cent in 2009). Hungary faced a liquidity problem which made the government take “enhancing measures such as the reduction of the reserve ratio (from 5% to the 2% applied by the ECB), the expansion of the range of eligible collateral, as well as purchase of government bonds in the secondary market” according to János Rékasi¹⁸² (*The Baltic Course*, February 24, 2010). Among the things that caused Hungary to suffer more than other CEECs from the crisis were the high debt, excessive deficit (see Table 6.2), bad monetary and fiscal policies over the past decade, most enterprises and households’ debt was in foreign currencies (mainly euro and Swiss Franc), in addition to the economic slowdown in the rest of EU countries that affected the flow of FDIs to Hungary.

Domestically, the package deal and the austerity measures¹⁸³ taken by the government were not that popular and received a lot of criticism. The centre-left government led by PM Ferenc Gyurcsany (MSZP) “received fierce criticism in the Hungarian parliament for accepting the international package, mainly those parts covered

¹⁸² Counselor, Hungarian Embassy of Economic Affairs in Latvia and Estonia; and vice-president of the Diplomatic Economic Club.

¹⁸³ In July 2010, during the country’s program review, the IMF and the EU asked Hungary to take more austerity measures to get the deficit under control. However, the FIDESZ government “insisted on a new financial sector tax this year and ruled out further austerity measures at talks with international lenders that were suspended” (*Reuters*, July 19, 2010).

by the IMF, with the centre-right opposition calling for his resignation” (*EUobserver*, October 29, 2008). The package deal and the problematic economic situation pushed Gyurcsany to resign from the premiership on March 21, 2009 and from the MSZP leadership a week later. An early election was called in which the opposition party (FIDESZ) won the majority.

Even with the 2010 change in the government, the position regarding euro adoption did not change since both the opposition and the government are in favor. So the financial crisis did not have major effect on the positions of the parties regarding the euro. As mentioned earlier, the public is now questioning the security and the sound monetary policy the euro used to provide prior to the euro area sovereign debt crisis and thus they are less attracted to the euro.

6.5 Conclusion

This chapter has provided an overview of the institutional, political and economic developments in Hungary on its way to EU accession. Hungary’s reforms were mainly elite-driven and vertical (top-bottom). The public took on a passive role in the development of democracy and market economy. The elites who ruled under communism were not excluded from leading the country afterwards and they were involved in the Roundtable talks along with other elites from the opposition. Moreover, the socialists (after reforming their party and naming it the Hungarian Socialist Party (MSZP)) were able to win the 1994 elections.

Hungary started from a more privileged situation than all CEECs post-1989. Reforms in Hungary started well before the fall of communism and the transformation was more peaceful than in other CEECs. Thus, Hungary's road to market economy and democracy was a continuation of the reforms that started prior to the fall of communism as we have seen in chapter three. This situation should lead us to conclude, as suggested in *hypothesis 6*, that Hungary should have been among the pacesetters not only regarding EU accession but also euro adoption. The reality, however, reflects a totally opposite story. The pacesetter Hungary, which benefitted from its privileged position in comparison to the Czech Republic and Poland, in addition to the international and European support (case of all CEECs), could not remain among the pacesetters. Starting from early 2000s, Hungary moved to the laggards' camp and became the furthest removed from meeting the convergence criteria and adopting the euro. This reality brings us to conclude that although the communist legacy in the case of Hungary could tell us part of the transition story in post-1989 period, it falls short of explaining why the consecutive Hungarian governments were not able to take decisive decisions regarding reforms. So while the communist legacy could explain the late 1980s and early 1990s peaceful transition in power, however, it cannot tell us why this developed country under communism turns out to be at the end of the spectrum when it comes to the transition and euro adoption. The Hungarian case refutes the second part of *hypothesis 6* regarding being *the pacesetter and the closest to meet the convergence criteria and adopt the euro*.

Europeanization and learning from the West did not stop domestic calculations, bad governance, irresponsible fiscal and monetary policies and giving priority to winning elections instead of sound finances and strong institutions. The economic cost-benefit

analysis could not tell us why the consecutive governments have been taking such policies, which have short-term benefits for themselves but not for the economic prosperity of the country. The Europeanization literature and symbolism also fall short in explaining the decisions of the governments regarding reforms. For example, in the privatization case, Hungary tried different ways and methods in attempt to see what is most suitable. In addition to that, the decision to take a gradual strategy of reforms is also based on the domestic calculations of Hungary and is not related to the social learning process and the cost-benefit analysis.

The macroeconomic data in Table 6.2 showed that Hungary is far from meeting the convergence criteria. Hungary could have had a macroeconomic situation that could have facilitated the easy adoption of the euro, if its government had pursued policies to that effect. In the Hungarian case the government followed totally opposing policies that sought to appease the electorate. In the Hungarian case we observed a political battle among the main political parties to try to win over the voters, which manifested itself in major electoral commitments at considerable cost to public coffers. The government handling of public finances showed a high level of irresponsibility and inexperience that could be a result of the communist era. The result of this bidding process was a mounting budgetary deficit and public debt. The deficit was skyrocketing whenever it is an election year (see Figure 6.1). So regardless of the fact that there is no disagreement among the elites regarding adopting the euro (although the difference is mainly about: how to adopt the euro?), and they are pro-euro, but the economic policies followed were irresponsible. This finding shows that, as suggested in *hypothesis 2*, the combination of government's pro-euro ideology government and sound policies are crucial for adopting the euro.

As for *hypothesis 1*, it suggested that *elections do matter and affect the entire euro adoption process*. However, the euro was not used in the elections as a tool to attract the electorates since the focus was on other issues that were considered more important to the electorates such as salaries, pensions, social benefits, etc. This finding also supports the second part of *hypothesis 1* regarding using the euro as tool in case it was the main interest for the public.

The role of the opposition in influencing the government's policies and negotiations, as highlighted in *hypothesis 3*, is not applicable in this case except in as mentioned earlier: pushing the country away from euro adoption due to irresponsible policies caused by elections' promises to win voters. This situation and irresponsible policies pushed Hungary further away from the prospect of adopting the euro. The Hungarian case proved that the second hypothesis raised in the thesis is true: favorable ideology by the government regarding the euro is not enough without sound and responsible policies. The unsound fiscal policies and overspending created tension between the MNB and the government (especially when Jarai was the governor). This situation led to few attempts to change the MNB law and by that influencing its independency. The unfriendly relations and tension pushed euro adoption even further (*hypothesis 4*). Even now with the harmonious relation between the MNB and the current government, euro adoption is still far removed as a consequence of the previous economic policies in addition to the financial crisis.

Although the support for euro adoption in Hungary is higher than in other CEECs (such as Czech Republic), however, it is not a large majority. Furthermore, euro adoption is almost absent from talk shows, political debates and election campaigns, and therefore

the media's role is almost insignificant (as argued in *hypothesis 5*). Hungarians as we have seen think more about the personal costs and benefits from adopting the euro and less in matters of the currency as a symbol of identity (interviews with MoF and MNB officials, June 2009). May be if the forint were as strong as the Czech koruna for example, the support for the euro might have declined (see the literature on historical-ideational explanations in Allam and Goerres, 2008: 8; also Carey, 2002; Luedtke, 2005). The public is a bit hesitant now regarding euro adoption because of the euro countries' problems (mainly Greece).

With the financial crisis, Hungary had to turn to the EU and IMF for help. A rescue package was prepared and Hungary was asked to take tough unpopular measures causing a change in the government with the conservatives (FIDESZ) winning a majority. Although this crisis acted as an intervening factor, but it did not change the stance of the politicians who still hope to meet the criteria and join ERM-2 by 2014 and may then adopt the euro by 2017-2018.

CHAPTER VII: POLAND—KEEP CHANGING LANES

7.1 Background

Hard work, commitment and a difficult road of reforms were taken by Poland on its way to joining the EU. Finally, it was time for the Poles to have their say: on June 7-8, 2003, 58.85 per cent of the eligible voters turnout in the referendum on EU accession. As much as 77.45 per cent of the voters said ‘yes’ to EU membership. Accession to the EU implied that Poland had accepted to join EMU at some point. Prior to joining the EU and even right after becoming EU member, Poland had the intention to join ERM-2 as soon as possible and stay there for the shortest possible time (approximately 2 years). Yet, due to political conflicts and divisions among political parties, Poland moved from being among the pacesetters regarding early euro accession to what Zubek called a “semi-permanent outsider” (Zubek, 2008: 292). What caused this shift? Why is Poland still among the CEECs that have not yet adopted the euro?

That Poland is still not part of the euro area is due to various reasons. First of all, it has not met all the convergence criteria, but other important reasons are the political situation and the readiness of people. Although PM Tusk’s government has argued that joining the euro is in the interest of Poland, however, not all political parties and political players (such as and the Law and Justice Party-*Prawo i Sprawiedliwość* (PiS)) share this belief—especially in recent years as the sovereign debt crisis rages in the euro area.

With the spill-over of the financial crisis to Europe in 2008, the pro-euro Polish government (coalition of the Civic Platform—Platforma Obywatelska: PO and the Polish People’s Party—Polskie Stronnictwo Ludowe: PSL) announced its intention to join EMU by 2012. According to the Ministry of Finance policy outline to join the euro at that time, Poland should be able to meet the convergence criteria and join ERM-2 by 2009 and then join the euro as of January 1, 2012 (see Polish Ministry of Finance, October 2008; *Irish Times*, October 29, 2008). However, during the fourth quarter of 2008 and early 2009, the government became more aware that meeting the convergence criteria and convincing the opposition (PiS) to support euro adoption were unachievable. Therefore, the 2012-euro adoption date evaporated.¹⁸⁴

Following this short background and overview, the next section analyzes the political and economic developments that moved Poland to its current economic, political and institutional situation. It is important to understand the reforms undertaken by Poland towards European integration and how it changed after EU accession. The analysis of the reforms allows us to better understand the relation between the changes in the domestic environment and euro adoption and European integration. The next sections deal with euro adoption strategies in Poland from the perception of the domestic actors. These sections discuss the attitudes towards the euro and what influences them. The final section concludes with some findings about euro adoption in Poland.

¹⁸⁴ Although the recent target date for the Tusk’s government was 2012, but with the financial crisis and not meeting most of the convergence criteria, the 2015 became more possible. However the sovereign debt crisis and the problems facing the euro area countries caused some hesitancy among the Poles regarding the euro accession.

7.2 Europeanization, Social Learning and Early Institutional Developments

After more than a decade of struggle and underground movement, the communists were forced to enter into negotiations with the Solidarity leaders in the Roundtable talks that took place in Warsaw from February 6 to April 4, 1989. The road was long and hard for Poles, but at the end they managed to win against the communists. Solidarity was recognized legally, and the first semi-free election,¹⁸⁵ which was held on June 4, 1989, resulted in a large victory for Solidarity.¹⁸⁶ For many Poles, Poland's fast developments in the 1988-1989 led to the collapse of the communist regime not only in Poland but also in the rest of CEECs (Kenney, 2002: 2; see also *The Economist*, May 28, 2009).

With the end of the communist era, Poland and other CEECs had three urgent and related issues to deal with: “to restore macroeconomic stability”; to privatize the large public sector; and “to create laws and accompanying institutions [...] that would sustain a macro-economically stable market economy” (Rostowski, 2007: 7-8). The launch of the reform project (the move towards democracy and market economy) was accompanied with a broad Europeanization process that was taking place affecting the various institutions at all levels. EU accession, followed by euro adoption was present in the Polish decision makers' plans since the reform revolution was launched in 1989. The return to Europe through EU membership represented an important driving force for democracy building and economic liberalization. The EU membership served in uniting a large portion of the Polish elites and Poles who shared the same ideas and supported the

¹⁸⁵ Competition in this election was only over 1/3 of the seats in the lower chamber, as for the 2/3^{rds}; they were reserved for the communist party who wanted to keep the power in its hands.

¹⁸⁶ Solidarity won most of the seats allowed to compete for: 99 out of 100 in the lower chamber (the Senate) and all the 161 contested seats in the Sejm.

necessary reforms. Gradually, policies were aimed at meeting the *acquis communautaire* and getting closer to join the EU.

These developments and reforms in Poland (economic, political, institutional and legal reforms) and the socialization process were based on this cooperation between the international institutions, different western countries such as the US, EU elites, EU member states and the different EU institutions. Former Polish Foreign Minister Meller emphasized the importance of this cooperation by arguing: “It is via the EU we are going to realize our political and economic aims. We should build the European identity and work on the strategic vision of Europe” (Meller 2005 cited in Kaminska, 2007: 4). Those elites were going through training not only at their home institutions by foreign experts, but also they attended conferences and training sessions abroad (see Johnson, 2002, 2006). Poland moved on with creating new institutions and/or reforming the old institutions in ways that adhere to the EU laws. This development has not been possible in case the political elites were not supportive to the EU and shared similar views and ideas like the EU member states.

Despite the importance of joining the EU, we have to keep in mind that the institutional development and policies implemented were not only embarked on to meet the EU requirements but were also necessary for the liberalization of the Polish economy and the movement away from the communist centralized economy. This interest in economic reform and moving forward with economic development and democratization, pushed policymakers to adopt most of the EU *acquis*’ elements in the legal and institutional system (not only financial institutions), which were clearly visible in the 1990s laws, acts and amendments (Polański, 2004a: 16; also 2004b).

As for Poland's contacts with the European Union (European Economic Community (EEC) at that time), they started before the economic and political reforms were launched with the fall of communism. Poland's diplomatic relations with the EEC date back to September 1988 following the signing of the Joint declaration between CMEA and the EEC on June 25, 1988 to establish official relations between the two groups. Poland filed an official application to have normal diplomatic relations with the EEC on August 22, 1988 (Borkowski, 2001: fn. 3; Hunter and Ryan, 2009: 6), which resulted by establishing a Polish mission to the EEC in July 1989 (Hunter and Ryan, 2009: 6).

On September 19, 1989, another agreement was signed between Poland and the EEC dealing with economic cooperation in addition to trade and commercial relations. On August 8, 1996, the Polish government established the Act on Committee for European Integration. The Committee was responsible for policy-making and issues related to European integration (Ministry of Foreign Affairs of Poland, May 15, 2010). At the start of 1997, Poland approved the National Integration Strategy—which “systematized integration responsibilities and tasks to be completed in the period preceding EU membership” (Hunter and Ryan, 2009: 7). As for the necessary changes and modifications for EU membership, they “were carried out under the National Program of Preparations for EU membership, adopted June 23, 1998” (*Warsaw Voice*, online edition, November 5, 2008).

In the next two subsections, I discuss the political and institutional reforms on the way to European integration followed by the economic developments. This section helps understand the reforms taken by Poland and lays down the foundations for answering the

question why Poland moved from being enthusiast to adopt the euro soon to being an outsider. It also seeks to examine the effect of the communist legacy on the post 1989 reforms and euro adoption.

7.2.1 Political and Institutional Change

The consequences of the reforms should not be viewed from an economic angle only since the domestic political environment played an important role in such an outcome. The economic reform was characterized by the political structure of the country through the “nature and behavior of collective political actors” (Kochanowicz, Kozarzewski and Woodward, 2005: 7-8). The political actors had to be institutionalized in political parties and groups based on democratic values and principles. Even the communist party had to be reformed and accepted democratic values and beliefs, human rights and civil liberties, and a functioning market economy. The creation of those parties helped move Poland from a one party system to a multi-party democratic country.

In order to establish a functioning democratic system, institutions had to be created and/or reformed. The serious institutional project started in 1992 in which “more permanent institutional structure” was established (Rostowski, 2007: 14). Following the 1989 elections, the first non-communist government in CEECs was formed under the premiership of Tadeusz Mazowiecki (Solidarity) in September 1989. The first thing to be done was the constitutional amendments to replace the earlier controversial amendments of 1976. The 1989 April constitutional amendments revived the separation of power concept with having two chambers in the parliament. The two chambers became

responsible for electing the president, which changed again with December 1989 amendments to make it direct elections. On December 29, 1989, the Sejm passed a bill omitting the 1976 addition regarding Poland as a *socialist country* and replacing it by a *democratic country*. The introduction and first two chapters regarding the role of the communist party were dropped. The name of the country was changed to the *Republic of Poland* instead of *People's Republic of Poland*. In 1990, Wojciech Witold Jaruzelski (communist) resigned as the president of Poland and Lech Wałęsa succeeded him after winning the first direct presidential elections. On October 27, 1991, the first free Polish parliamentary elections took place since World War I. With all these progressions, Poland's economic and political reforms for democracy and market economy in addition to returning back to Europe strategy were launched.

In the early period (post-1989), all the necessary measures were taken to build new institutions and reform some of the old ones, in addition to have a new constitution based on democratic values, respect for human rights and civil liberties, that would move Poland closer to the EU countries. During the early years of reform (1989-1992), reformers borrowed from the French Fifth Republic's constitution such as the president's powers and responsibilities (Rostowski, 2007: 11). However, from 1992 onwards, Poland starting borrowing more from Germany and to a lesser extent from the EU to reform and build its institutions to meet the EU requirements (Rostowski, 2007: 14). During 1992-1997, the focus was on building the Small Constitution of 1992¹⁸⁷ in order to write a new constitution for Poland. On April 2, 1997, a new constitution (the Constitution of the

¹⁸⁷ The 1992 Small Constitution had the basic legal and institutional foundation for the government of the state during 1992-1997. The Small Constitution was based on the separation of powers and organizing the relationship between the executive and the legislative. It also clarified the tasks and responsibilities of the president and the prime minister.

Republic of Poland) was adopted by the National Assembly and approved in a referendum on May 25, 1997. The 1997 constitution took into consideration democratic values, respect of human rights, civil liberties and freedoms. It detailed the separation of powers' concept between the executive, legislative and judiciary. The constitution also discussed the relation between the president and the prime minister and the role of the president and his veto powers. So the constitution was based on democratic values and was a significant step to move Poland closer towards joining the EU.

Poland benefitted much from the policy transfer from the EU and its influence via different programs such as the Phare program to support the economic, political and institutional reforms. From 1989 until 1997, Phare was more of a tool used by the EU to help Poland and Hungary (at a later stage other CEECs were included) to reconstruct their economies and institutions. The funding via Phare was directed at strengthening the enterprises, developing, reforming and privatizing the industry in order to increase the exports. Moreover, agriculture, regional development and decentralization were given important focus too. In 1998, the Phare program was transferred into a pre-accession tool for getting CEECs to meet the EU *acquis communautaire*.

Another important EU program was the Special Accession Programme for Agriculture and Rural Development (SAPARD) that focused on developing the agricultural sector, rural areas and agricultural exports and products. The Instrument for Structural Policies for Pre-accession (ISPA) focused on the transportation and environment sectors (see Bański, 2002). All these programs and support from the EU (in addition to the support from other international organizations and western countries) accompanied by the favorable domestic political and public environment helped Poland

with its institutionalization process and the move towards a stable democracy and a functioning market economy. This last point brings us to discuss a good example regarding policy transfer and the importance of favorable domestic environment for successful reform—the Narodowy Bank Polski (National Bank of Poland-NBP).

Among the important institutions that went through significant reform was the NBP. The NBP witnessed a deep institutional reform under the effects of Europeanization, *acquis*' conditionality, role of epistemic community of central bankers and social learning (see Schimmelfennig and Sedelmeier, 2004; Epstein, 2006; Johnson, 2006; Epstein and Sedelmeier, 2008 and Zubek, 2008). The reforms and amendments to the NBP led to the establishment of an independent central bank in Poland that adheres to the EU requirements and was given the “right to formulate and implement monetary policies” (Zubek, 2008: 298). The NBP's laws were also “modeled after the German law on the Bundesbank” (Johnson, 2002: 20). The NBP has enjoyed its independency as set down in the constitution and mainly in *The Act on the National Bank of Poland* of the year 1997.¹⁸⁸ According to this act, the NBP's mandate was almost a replication of the ESCB basis and provisions (Polański, 2004b: 281). The main task for the NBP as mentioned in the August 1997 Act is the maintenance of price stability as in most Western central banks.¹⁸⁹

As of 1997, the Sejm¹⁹⁰ selects the president of the NBP upon a presidential request for a six-year term. As for monetary policy, the ten members of the Monetary

¹⁸⁸ The Act on the National Bank of Poland of August 29, 1997 as published in Dziennik Ustaw (the Journal of Laws) of 1997 no 140, item 938.

¹⁸⁹ Article 3, § 1 of the *Act on the National Bank of Poland of August 29, 1997* states “The Basic objective NBP activity shall be to maintain price stability, *and* it shall at the same time act in support of Government economic policies, insofar as this does not constrain pursuit of the basic objective of the NBP”.

¹⁹⁰ The lower chamber of the Polish Parliament.

Policy Council (MPC) are responsible for that. They also cannot be accused of any charges related to their decisions related to the monetary policy (Polański, 2004a: 8). However, the NBP was not fully independent and fulfilling the EU legislation until the NBP act was amended in 2003 and the auditing of the NBP had to be conducted by an independent external auditor and not a commission assigned by the government (Polański, 2004a: 9).¹⁹¹ Creating an independent central bank has been crucial not only for joining the EU but also for adopting the euro in the future.

As we have seen, the Europeanization and socialization process have led to remarkable developments in Poland. However, some of the developments were driven back because part of the political elites was euroskeptic. This caused the socialization process to be blocked several times, which has affected the progress of the country especially towards the euro adoption. There were two opposite schools of thought on the road to economic development and the role of reform therein, to which I now turn.

7.2.2 Economic Development—The Big Bang Approach

Poland was among the first CEECs to move towards a market economy. This move towards a market economy was not costless since it resulted in economic, social and political problems “that differed greatly from those prevalent in Western Europe” (Buras, 2005: 88). At the beginning of the reform period, Poland took the “German concept of the ‘social market economy’” that was “seen as the most successful combination of a ‘hard’ capitalist economy and a welfare state” (Buras, 2005: 88-89). Before discussing

¹⁹¹ This does not mean that some incompatibilities do not exist (Zubek, 2008: 298; see also ECB Convergence Reports for 2004 and 2006).

the reforms, it is important to have a look at the starting point of the Polish economic and financial situation that was inherited from the communist times and that could have led partly to the post 1989 problems.

Poland started from a relatively poor economic and financial situation: economic stagnation, hyper inflation reaching three digits in 1989 and 1990 (see Table 7.1) and a large public sector which was inefficient and poorly managed (*The New York Times*, March 19, 1989). Poland had a large deficit, “foreign reserves were nearly depleted” and the country lacked basic resources to run “factories, and even hospitals” (Sachs, 1991: 3). The economy was suffering a heart attack and needed an urgent shock. Therefore, Poland took the way of shock therapy or big bang reform to its economy. In his address to the Sejm, the first PM after the fall of communism, Tadeusz Mazowiecki, said that the current Polish government “will undertake steps initiating the transition to a modern market economy, tested by the experience of developed countries” (Domarańczyk, 1990: 148 cited in Przeworski, 1993: 141). The finance minister at that time Balcerowicz announced at the IMF and World Bank annual meeting in September 1989 the intention of the Polish government to transfer the economy from a centrally planned economy to a market economy similar to the advanced western countries (Przeworski, 1993: 141).

The members of the Sejm did not appreciate Balcerowicz’s step since they heard about the plan from the media before being consulted and even before they could study the plan. Balcerowicz defended his position by arguing that with the bad economic situation and the hyperinflation, there was no time to think twice and some essential policies had to be taken rapidly (Przeworski, 1993: 177). According to Balcerowicz, moving Poland to a market economy should be done very fast if the economic problems

were to be solved since what was used previously as solutions “such as price controls, ration coupons and centralized distribution would only worsen the problems and delay the cure” (*The New York Times*, online edition, October 7, 1989). The transition to a market-based economy could be attained through macroeconomic stabilization, liberalization of prices and eliminating price control, restructuring of the institutions (mainly financial and monetary), privatization and attracting FDIs to Poland (see Belka and Krajewski, 1995; Poznanski, 1996). By the end of 1989, the *Balcerowicz Plan*, which was supported by the IMF, the World Bank and other international and European institutions, was adopted.

To show its support to the plan, the IMF granted “relief to ease the burden of Poland’s \$37 billion in foreign debt. The United States and Western Europe have pledged more than \$1 billion in food aid and financial aid” (*The New York Times*, online edition, December 26, 1989). This plan gained from the policy transfer from the western countries and international institutions in the form of ideas, financial and technical support. Several players were involved in policy learning and diffusion of ideas regarding the reform of the economy such as “representatives of the Polish government, Polish expatriate advisors and Western advisors or technical ‘experts’ from Harvard university, the IMF, World Bank, ERBD, [United States Agency for International Development] USAID-sponsored consultants and the European Union” (Angresano, 1996: 88).

Policy makers needed the support of international organizations and western countries, which pushed them to implement certain policies that they would not have otherwise favored. The IMF opinion showed some “bias toward attributing excessive resource costs to high inflation” and ignoring that sometimes this strategy might not be

the best option for a country (Gomulka, 1995: 321). Portes (1994) was very critical of the IMF focus on the macroeconomic stabilization and on dealing with the inflation problem.¹⁹² With this position of the IMF, other international organizations such as G7, Group of twenty-four (G24), the EU, and the World Bank made their support “conditional on agreement to a stabilization programme with the Fund and thereby to put its priorities at the top of policy-makers’ agenda”—which is a “wrong” decision (Portes, 1994: 1184). The US for example made it clear that any aid to CEECs cannot be made unless these countries come to an agreement “with the IMF on a credible reform plan” (Greenberger, February 11, 1992: A2).

Balcerowicz reforms were hard to be realized and controversial. The bankruptcies of main state-owned enterprises served in the increase in unemployment rate and public deficit, while the GDP growth and real wages decreased (see Table 7.1). Some considered the failure of the plan to attain its goals proved that the economic reforms that Poland took in the early years were not successful (Bratkowski, 1993). These reforms brought political attacks on Balcerowicz. Some political parties, such as Self-Defense (Samoobrona) and its leader Andrzej Lepper, were very critical of Balcerowicz and asked him to leave.

Economic Experts and the people expected the recovery of the economy to be quick. Experts thought that targeting inflation, rapid privatization and restructuring or getting rid of most of the public enterprises would lead to more investments and that “new private enterprises [would...] offset the loss of output, income and employment”

¹⁹² The reason for focusing on the inflation was not only international (pressure from the IMF and other international organizations) but also due to domestic public pressures. The inflation was increasing while the wages were lagging behind. The increasing gap between wages and inflation pushed the policy makers to fear a possible unrest. Therefore, policy-makers put the inflation issue as a priority on the agenda.

(Angresano, 1996: 89). The early years of reforms proved costly. Aside from the inflation that dropped from three digits to two (from 249.3 per cent in 1990 to 46.1 and 37.0 per cent in 1992 and 1993 respectively); and stabilizing the currency which “helps bring expectations of inflation” (*The New York Times*, February 12, 1990); the deficit increased to 6 per cent of GDP in 1992; unemployment kept increasing reaching 16.4 per cent in 1993 in comparison to 6.5 per cent in 1990; and the GDP declined reaching -7.5 and -7.0 per cent in 1990 and 1991 before it started picking up speed (see Table 7.1).

Table 7.1 Economic Indicators (per cent)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|-------------------|-------|------|------|------|------|------|------|------|------|------|------|
| GDP | -7.5 | -7.0 | 2.5 | 3.7 | 5.3 | 7.0 | 6.2 | 7.1 | 5.0 | 4.5 | 4.3 |
| Inflation | 249.3 | 76.8 | 46.1 | 37.0 | 33.0 | 28.0 | 19.8 | 15.0 | 11.8 | 7.2 | 10.1 |
| Deficit* | - | -3.8 | -6.0 | -2.8 | -2.7 | -2.6 | -2.5 | -1.8 | -2.6 | -3.2 | -3.0 |
| Public Debt | - | - | 85.2 | 86.0 | 72.4 | 49.0 | 43.4 | 42.9 | 38.9 | 39.6 | 36.8 |
| Unemployment Rate | 6.5 | 12.2 | 14.3 | 16.4 | 16.0 | 14.9 | 13.2 | 10.3 | 9.6 | 12.0 | 14.0 |

* When there is a negative sign (-), it means deficit, otherwise surplus.

Source: Eurostat, Economic Intelligence Unit, OECD, IMF

By the end of 1994 and early 1995, the economy started to pick up speed and the recession that Poland suffered from in the early 1990s proved to be only temporarily—which was the case of most CEECs. Despite the shock therapy short-term costs, Poland managed to tackle its hyperinflation (which was the highest in the region), its GDP did not fall in the same percentage as other CEECs (such as the Czech Republic, Hungary and Slovakia), and its liberalization and move towards the market economy did succeed at the end and placed Poland ahead of a lot of CEECs (see Poznanski, 1996: 194).

Among the things that helped the economy to develop and address the debt problem was the increase in FDIs starting from 1994 and significantly in 1995.

Moreover, “the devaluation of the zloty and the decline in domestic demand produced by the austerity policies resulted” in an increase in the trade ruble hard currency surplus

(USD 3.8 billion) (Slay, 1993: 240). This improvement convinced the Paris Club “to agree to conditional forgiveness of 50% of Poland’s publicly held foreign debt” in 1991 (Slay, 1993: 240-241). Starting from 1994-1995, the ratio of public debt to GDP declined significantly (see Table 7.1) as a “result of the implementation of the second stage of the Paris Club agreement and of the cancellation of close to half of the net present value of Poland’s liabilities to commercial banks by the London Club” (OECD, 1997: 43). The agreement with the London Club opened the way for further economic development and increase in FDIs (interview with NBP official, April 2009).

The 1990s reform period could be divided into three stages (Slay, 2000: 67). The first phase was the first two years after the fall of communism (1990-1991) and the implementation of the shock therapy to move Poland towards a liberalized market economy. This period was witnessed some short-term costs characterized by the drop in GDP, increase in unemployment, debt and deficit. The second phase witnessed vast institutional, policy and structural reforms, which resulted in an increase in GDP and a slight recovery from the recession. Inflation kept decreasing but without reaching the OECD average. During this period, reforms were still lagging with respect to the financial system, which was dealt with during the third stage. A “loan consolidation program” and a bankruptcy system and law were introduced accompanied with an increase in “the breadth and depth of instruments for financial intermediation (Slay, 2000: 67-68). This phase witnessed an increase in FDIs and exports that served in increasing the growth, with the inflation continuing its declining mode to below 20 per cent in the second half of the 1990s (see Table 7.1; also Slay, 2000: 68).

In evaluating these stages or early developments, a large portion of the literature focuses on the early years of the shock therapy and the success or failure of Balcerowicz plan. The evaluation is mixed ranging from “highly positive to highly negative” (Hausner, 1995: 4; cited in Angresano, 1996: 100). For the proponents of the Balcerowicz plan, the argument was that within two years of implementing the shock therapy, the economy would stabilize and develop. Although the economy did not develop as anticipated, for the supporters of Balcerowicz plan, they argued that without the shock therapy the development of the Polish economy in the second half of the 1990s would not have been possible and Poland would not be able to be among the pacesetters (with respect to economic development) during that period. After three years of implementing Balcerowicz plan, the economy did not develop as was anticipated by its architects. Although the hyperinflation decreased, other macroeconomic indicators increased significantly (Bryant, 1994: 61-62). The Balcerowicz plan could not prevent the early 1990s recession¹⁹³ along with the significant increase in unemployment. The increase in unemployment rate to two digits is partly due to the privatization process and the bankruptcy of many state-owned enterprises—which I will turn to now.

7.2.2.1 Economic Development—The Privatization Process

Reform without privatization was not an option for the early reformists in Poland in 1989. With only 15 per cent contribution of the private sector in the GDP (“non-

¹⁹³ We cannot blame the Balcerowicz plan totally for the economic recession since it “was mostly fueled by external factors such as the decline of the Soviet economy, the disappearance of the East German market after German reunification, and the Persian Gulf conflict, which cost Poland many trade contracts and elevated oil prices” (*Warsaw Voice*, online edition, December 16, 2009).

agricultural output”) (OECD, 1992: 42), it was a necessary step to reform and privatize the state-owned enterprises. Therefore, privatization of the 8,453 state-owned enterprises was a main pillar for the transformation towards market-economy. This step was encouraged by the IMF, the World Bank and other western countries who believed that privatization will create more jobs and will take away a large administrative and financial burden of the government (Rondinelli and Yurkiewicz, 1996: 145-146; see Sachs, 1992). Among the first steps taken in that regards (post-1989) were passing the July 13, 1990 Act on Privatization of State. The act was too broad, “reflected the confused state of affairs” and was designed to be more of a “general framework that could accommodate a variety of strategies” (Lipton and Sachs, 1991: 238).

At the outset of the reform program, the Polish government did not have a coherent strategy for privatization, rather a trial and error method. The Polish privatization “followed a multi-track course” that would allow the government to adjust the program according to the needs and difficulties (Kolodko, 2000: 37). Privatization was to be implemented through various methods such as voucher privatization and selling public shares to employees at low-cost rate (Lipton and Sachs, 1991: 240).¹⁹⁴ The plan was to start with what is referred to as *indirect* or *capital* privatization, which is based mainly on attracting foreign buyers to buy the large state enterprises.¹⁹⁵ This method was

¹⁹⁴ Before privatization could start, the Polish government had to deal with the claims of the Poles who lost their enterprises and properties during the communist era because of its confiscation (compensation and/or restitution). The government’s reprivatization program and compensations was limited to the claims for lost properties between 1944 and 1960 and not the properties lost during the various periods of nationalization since this will lead for huge costs on the government and put extra burden. The government’s restitution plan was already under threat to be jeopardized due to the pressure put on state budget with over 70,000 claims filed by 1991 for compensation regarding confiscated properties (Rondinelli and Yurkiewicz, 1996: 149; Harper, 1999: 419). The Polish government compensated the former owners through capital bonds that would allow them “to purchase shares in state enterprises undergoing privatization, and guaranteeing priority in purchasing shares of their former enterprises” (Harper, 1999: 419).

¹⁹⁵ There are two stages for capital privatization: The first is the commercialization (incorporation) stage in

not costless and proved to be slow, which was not an option for the policy makers who wanted to implement a fast, massive privatization. Therefore, another form of capital privatization (mass-privatization) was implemented that would lead to fast massive privatization within the first years of the 1990s (Kolodko, 2000: 37). The early period of centralized spontaneous privatization was not that successful and Poland was falling behind regarding its privatization objective. Only 225 out of the offered 8453 public enterprises were privatized by 1991. In its effort to trigger the privatization plan and make it easier, the State Privatization Agency took several measures to help privatize over 400 small enterprises and “giving private consultants [...] free rein to sell medium-sized state enterprises” (Poznanski, 1996: 236).

The public was discontent with the consequences of the economic reforms, which caused governments to change few times during 1990-1993. The slow progress and the failure of the consecutive Polish governments to apply a massive privatization program by the end of 1993 pushed Poland to adopt new strategies since the rapid privatization attempts were not successful and the “economic transformation owes far more to the creation and expansion of small- and medium-sized enterprises than to the rapid privatization of large” public enterprises (Rondinelli and Yurkiewicz, 1996: 146).

Among the common and popular methods used to privatize public-owned enterprises was “liquidation” or *direct* privatization in order “to create an avenue for the dismantlement of state enterprises and the sale of their valuable property [...] to new companies or, alternatively, its lease with option to buy” (Poznanski, 1996: 235-236).

which the enterprise is “transformed into a joint-stock or limited liability company”; and the second stage is making “the shares in the newly established companies [...] available to private investors through public offers, tenders or negotiations following a public invitation” (Górzyński, Stanchev, Stoev, Pańków, Walewski and Yonkova, 2000: 15).

The targeted enterprises were the small and medium size, which had “good financial standing” (Górzyński *et al.*, 2000: 15). This method involved managers, high employees and other investors who could buy the assets of the liquidated companies. In the liquidation method, the priority was given to employees of the public enterprises. Whereas in the commercial privatization, employees were given preferential treatment regarding 20 per cent of their enterprise’s shares since they could buy it at fifty per cent of the non-preferential price offered to other Poles (Górzyński *et al.*, 2000: 15).

With all the different ways used to move ahead with privatization, the outcome was still limited. In April 1993, the government passed a new Act establishing a National Investment Fund (NIF) in its effort to move forward with the Mass Privatization Program (MPP).¹⁹⁶ However, things were not moving according to the government’s desires since the mass privatization kept being delayed. Plenty of reasons played role in delaying the privatization process such as the political situation and calculations, underdeveloped institutions, in addition to the economic situation and the increase in unemployment rate, which pushed the Poles to be critical of the reforms. This situation caused Solidarity to lose the September 1993 elections and to be succeeded by the alliance of the Socjaldemokracja Rzeczypospolitej Polskiej (Social Democracy of the Republic of Poland) (SdRP)¹⁹⁷ and Sojusz Lewicy Demokratycznej (Democratic Left Alliance) (SLD). The new government promised to implement some reforms that will increase the employment rate, lower taxes, increase wages, increase the pension and the support for

¹⁹⁶ The Ministry of Ownership Transformation developed the MPP in mid-1991. Then the government created the NIF to accelerate the MPP (that was negatively influenced by the “lack of domestic capital”) and move it forward in the mid 1993; attract FDIs, face the decrease in public support for privatization; increase the number of “private shareholding ownership” (Rajski, 1994: 775). However, due to all the political, social and economic problem that I discuss in the same paragraph, the MPP was further delayed.

¹⁹⁷ SdRP was the successor of the PZPR that was created in 1990 right after the fall of communism. In 1999, SdRP and SLD became one political party.

the unemployed, etc. However, when they came to power, they could not fulfill all their promises but only “modified some Solidarity programs, including plans for mass privatization” (Rondinelli and Yurkiewicz, 1996: 153).¹⁹⁸ In addition to the change in the government priorities, privatization was also influenced by the status of the public enterprises that were almost bankrupt and in debt, in addition that their efficiency was very low causing more losses to the economy.

Seeing that the 1990 Privatization Act was not effective, a new privatization act was adopted in 1996, which gave the employees a preferential position regarding buying the shares of their enterprises. The new Act created “special privatization procedures for indebted enterprises and those of strategic importance” (Błaszczyk and Woodward, 1999: 10). Although the new Act did not have much influence, but the administrative reforms carried out during the same year (October 1996) were important since some of the government’s institutional reforms were directly related to privatization. Among the institutional changes was the replacement of the Ministry of Privatization by a new Ministry of Treasury, which took the responsibilities of the former ministry. Under these reforms, a more decentralized approach was taken in which regional governments were in charge of small-sized enterprises’ privatization (Błaszczyk and Woodward, 1999: 10-11; see also Balcerowicz, Błaszczyk and Dąbrowski, 1996).

The second half of the 1990s and early 2000s witnessed a better performance of the economy generally and the privatization process moved forward. Among the sectors that benefited from the acceleration of privatization was the banking sector. The banking

¹⁹⁸ The new government formed by the coalition of SdRP/SLD (1993-1997) did not really carry any serious economic and social reforms. However, it came at a turning point when the short-term costs of the shock therapy reforms started diminishing and “the economic situation had started to improve” (Buras, 2005: 93).

sector witnessed an increase in foreign investments reaching “US \$9.2 billion, which equaled about 70% of all assets of the sector” (Wojnicka, 2001: 313). With the exception of the largest bank in Poland (PKO Bp S.A.), which is still Polish owned, the majority of the large and successful banks (13 out of 15) had either a dominant foreign capital in their assets or had “foreign participation” (Wojnicka, 2001: 313).

As we have seen, the slow economic liberalization in the first half of the 1990s and the short-term costs were replaced by a faster growth and economic progress in the second half of the 1990s. While macroeconomic conditions, political, institutional and social reasons pulled back the reform process in the early 1990s; things were more in favor of reforms with the progress of the economic conditions later on. The institutional reforms implemented and the more favorable domestic environment in the second half of the 1990s pushed Poland to be among the most prosperous countries in CEECs and very close to meeting the convergence criteria and adopt the euro at a later stage. The question that needs to be answered is: If the economic conditions were moving in the direction of meeting the convergence criteria, and Poland showed interest in adopting the euro, what pushed Poland to be among the countries that have not adopted the euro yet?

7.3 Role of Domestic Politics in Understanding Euro Adoption Strategies—The Main Factors and their Interactions

Poland’s early years of reforms are very similar to Hungary since both countries went through economic difficulties and had tough start. Despite the early economic problems in the first half of the 1990s, the anti-inflationary focus of the government led to limiting

the hyperinflation but at the expense of employment, deficit, debt and growth. With the reform agenda moving on, the second half of the 1990s showed that the early hardships did turn out to bring Poland closer towards functioning market economy and stable democracy. These reforms were the outcome of the hard work of consecutive governments, the domestic environment, other social factors, in addition to the support of the EU, Western countries and the IMF¹⁹⁹ and the World Bank.

The Polish case differs from both the Czech and Hungarian cases regarding euro adoption. While in the Czech Republic it is more of a euroskeptic country led by a euroskeptic president; in Hungary it is the opposite since the euro is important for almost all parties, but the irresponsible policies of the consecutive governments pushed the country away from adopting the euro. Poland, as we will see in the following sections, has a division among the elites (euroskeptic and euroenthusiast camps that have been ruling it consecutively) towards the EU and the euro. This division, as well as the change in government, has led to the oscillating euro adoption stances of the Polish government.

7.3.1 Macroeconomic Indicators

Poland is the largest NMS of those who joined the EU in 2004. During that year, Poland did not fulfill the convergence criteria (see Table 7.2). In fact, it was further removed from meeting them than other CEECs. As we will see later, this trend continues over the years for variety of reasons. The only criterion that Poland has been consistently meeting so far is the public debt—although it has been increasing over the years, reaching 55 per

¹⁹⁹ The IMF role was significant and influential in Poland's reform strategy since the US and other western countries conditioned their support on Poland following the anti-inflationary treatment suggested by the IMF to revive the economy.

cent of GDP in 2010. In 2004, Poland missed the inflation target by 1.2 per cent,²⁰⁰ the interest rate was higher than the reference value by 0.5 per cent (standing at 6.9 per cent); and the deficit was higher than the 3 per cent reference value by 1.8 per cent of GDP. In 2004, the only criterion Poland met was the public debt criterion by having a public debt of 43.6 per cent of GDP (see Table 7.2).

Table 7.2 Performance of Poland on the Convergence Criteria (per cent) (2004-2010)

| Poland | | | | | | | | |
|----------------|------------|----------------------------|------------|----------------------------|------------|----------------------------|------------------------|----------------------------|
| | 2004 | 2004 Reference Value | 2008 | 2008 Reference Value | 2009 | 2009 Reference Value | 2010 | 2010 Reference Value |
| Inflation Rate | <u>3.6</u> | 2.4 | <u>4.2</u> | 3.2 | <u>4.0</u> | 1.0 | <u>2.7</u> | 1.0 ^a |
| Interest Rate | <u>6.9</u> | 6.4 | 6.1 | 6.5 | <u>6.1</u> | 6.0 | <u>6.1^b</u> | 6.0 ^a |
| Public Debt | 43.6 | 60 | 47.2 | 60 | 50.9 | 60 | 55.0 | 60 |
| Deficit* | <u>4.8</u> | 3.0 | <u>3.7</u> | 3.0 | <u>7.3</u> | 3.0 | <u>7.9</u> | 3.0 |
| GDP Growth | 5.3 | NA | 5.1 | NA | 1.6 | NA | 3.9 | NA |

* When there is a negative sign (-), it means deficit, otherwise surplus.

a. Reference value refers to the period April 2009 until March 2010.

b. Average Annual Interest Rate. Data for 2010 refers to the period April 2009-March 2010.

Source: European Commission (2004; 2008b; 2010a); Eurostat 2011; ECB, May 2010.

Since mid 1999, Poland has had a floating exchange rate regime. Poland became the first NMS with a floating exchange rate regime with the NBP not interfering “on the foreign exchange market” (Polanski, 2004: 284). Although this exchange rate regime has certain characteristics among which are the “frequent movement of the state of

²⁰⁰ With respect to the inflation rate, it is important to highlight the fact that Poland succeeded in lowering its inflation over the past 14 years (1990-2004). In 2006, Poland’s inflation was among the lowest three-performing EU countries (1.3 per cent). Between November 2005 and February 2008, Poland had an average inflation rate “below or at the reference value” before it started increasing again (European Commission, 2008b: 20).

undervaluation to the state of overvaluation of the currency” which is a system that does not generate the right exchange rate (interview with former NBP official and current chief economist at INVEST Bank, April 2009). This situation is clearly visible in Poland because Poland has “relatively liquid foreign exchange market and relatively liquid bond market” in comparison to the Czech Republic and Hungary for example (interview with former NBP official and current chief economist at INVEST Bank, April 2009). The investors are eager to come and invest in the country and when they decide to come in or leave the country, this causes significant effects on the exchange rate. So having such exchange rate is considered a blessing and curse at the same time since it is very volatile and causes negative effect on the trade and investments (interview with former NBP official and current chief economist at INVEST Bank, April 2009).

Polish officials intend to join ERM-2 for the shortest time needed, and their aim was to join some time before July 1, 2009 (interviews with MoF and NBP officials, April 2009). In May 2009, that date was delayed due the financial crisis and the resulting economic and currency turmoil. The Polish zloty fluctuated over the period January 1, 1999 through the end of July 2008 but showed upward appreciation trend over this period of close to thirty per cent. However, with the onset of the major difficulties in the financial markets in the summer and fall of 2008, the zloty depreciated. From the end of July 2008 to mid July 2009, the zloty tumbled around 30 per cent against the euro (European Commission, 2010a: 168; see Figure 7.1).

Figure 7.1 Exchange Rate-Polish Złoty/Euro (1999-2011)

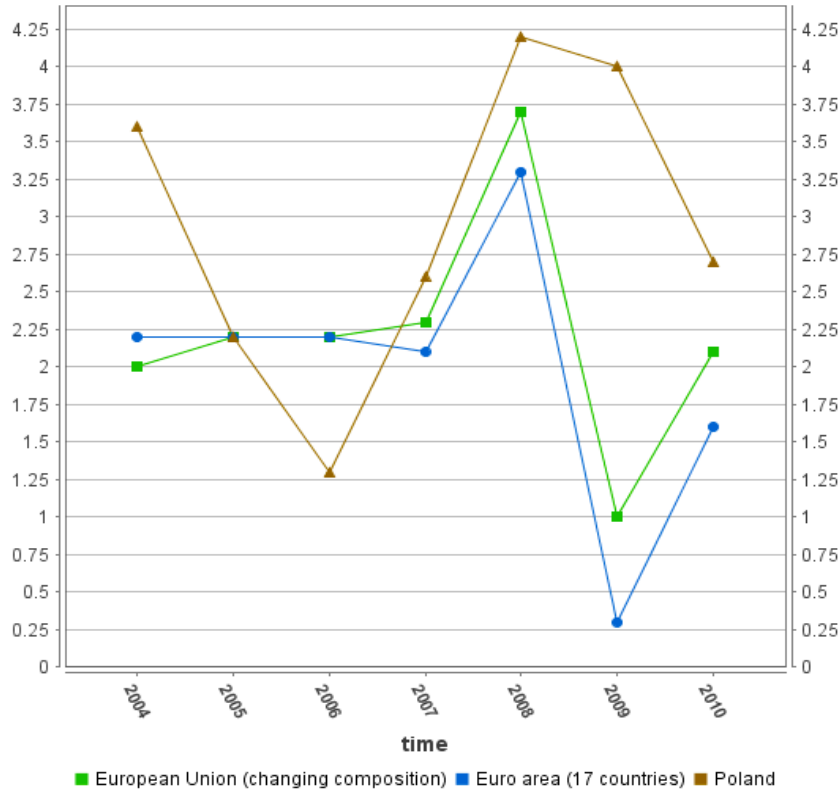


Source: ECB

After the sharp depreciation of the złoty, by the end of the first quarter of 2009, the złoty started recovering supported by the NBP policies that focused on supplying the market with bonds that was met with “high demand from foreign investors” (European Commission, 2010a: 168). However, the fast appreciation of the złoty created some fears among NBP and MoF officials in mid 2010. The appreciation of the złoty pushed the NBP to take some measures to slow this appreciation and slightly weaken the złoty. The NBP intervened “on the foreign exchange market for the first time” in almost a decade—when it adopted a floating exchange policy in 2000 (European Commission, 2010a: 168).

As for the inflation, which has been the focus of the Polish governments in the early 1990s, it went below the three-digit figure to less than two-figures and even below the EU and the euro-zone average between 2005 and 2008 (see Figure 7.2).

Figure 7.2 Annual Average Inflation Rate in Poland



Source: Eurostat

The inflation in Poland did not last long within the reference value, partly because of the financial crisis that affected the Polish economy and the domestic political situation (as we will see in the next section). The inflation went up again reaching 4.2 per cent, 4.2 per cent and 2.7 per cent of GDP in 2008, 2009 and 2010 respectively (reference value for the same period was 3.2 per cent in 2008 and 1 per cent in 2009 and 2010). The increase in inflation also reflected the “sharp increase in prices of processed food in conjunction with the global shock to agricultural commodity prices” (European Commission, 2010a: 160). Moreover, there was an increase in pressure on prices influenced by the high domestic demand. The depreciation of the zloty in 2009 and the increase in “administered prices and excise taxes” counterbalanced “the dampening effect

(notably on market services) stemming from weakening demand. However, the latter effect gained some strength in the last months of 2009 and early 2010” (European Commission, 2010a: 160).

In 2009 and 2010, Poland missed many of the convergence criteria (except for the public debt which is high in 2010 but at 55.0 per cent still within the limit). As for the GDP, although growth declined in 2009, it still stayed positive (1.6 per cent). The GDP increased to reach around 3.9 per cent over the year 2010 and is expected to be 4.0 per cent in 2011 (Table 7.2 and Eurostat, 2011). The positive and strong GDP following EU accession in 2004 and up until the end of 2007 helped lowering the public deficit. In 2008, the deficit increased again over the reference value by 0.7 per cent, which put Poland in an excessive deficit position. The financial crisis and its influence on the domestic environment in Poland (mainly the decrease in the growth rate) did not help the situation since the deficit jumped to 7.3 and 7.9 per cent of GDP in 2009 and 2010 respectively. The unemployment rate has increased to reach 10.0 per cent in December 2010 (compared to 9.1 per cent in December 2009). Although Poland managed to lower the interest rate below the reference value between 2005 and 2009, by the end of 2009 and in 2010 the interest rate went slightly above the reference value by 0.1 per cent.

Among other issues that put considerable pressure on the Polish macroeconomic condition (mainly debt and deficit) is the pension spending. The government is trying to find ways to reform its pension and is studying different scenarios for that. The Polish government does not want to follow the Hungarian scenario and end up in troubles with its debt and deficit, which would increase sharply, and then they would end up needing the IMF and EU help. According to Krzysztof Bielecki (PM Tusk head of economic

advisors), the “pension reform is where the big numbers are” and Poland has to cut its borrowings “by almost 30 percent in 2011 by halting some transfers to the funds” (*Bloomberg*, December 7, 2010).

As we will see in the next section, among the major reasons for this swinging in Poland’s situation back and forth regarding the convergence criteria is because of the Polish elites’ different opinion on the costs and benefits of speedy euro adoption. These differences have been playing role in pushing the country away from euro adoption.

7.3.2 Government, Opposition, Electoral Cycles and the Euro

Parliamentary elections during the early years of reform showed dissatisfaction with the economic policies. The parties (mainly from Solidarity) affiliated with the Balcerowicz plan lost a lot of their supporters. In September 1993 elections, parties that were born from the Polish Communist Party won the parliamentary elections. This result was considered a sign of Polish discontent with the various economic and political policies taken by the government. The political scene affected the entire reform process and slowed it down. This political instability and division continued even after joining the EU and has been reflected in the disagreement among the Polish elites and parties regarding euro adoption. The division in the Polish society created two kinds of conflicts: the first between the NBP and the government (in particular when Balcerowicz was the NBP governor from 2000-2006)²⁰¹ and the second between the government and the opposition.

²⁰¹ The conflict got worse when Solidarity lost the 1993 elections and the communists got back into power.

The two leading political parties in Poland are PO and PiS. Both parties are center-right but PO falls within the Christian democratic, liberal conservative category and is predominantly pro-European. PiS is more neoconservative and generally more euroskeptic. In the parliamentary elections of September 25, 2005, the ruling center-left coalition government of the SLD and Unia Pracy (Labor Union Party) (UP) led by PM Marek Belka was defeated following a turbulent political period tainted by scandals and during which time the ruling coalition disintegrated and new parties were being created. The 2005 elections resulted in a major victory for two parties of the center-right, PiS and the liberal-conservative PO, together winning more than sixty percent of the votes (460 seats), with the SLD left with 11 percent of the seats. PiS won 155 seats while PO won 133, making PiS the winner. PiS leader, Jarosław Kaczyński, declined the opportunity to become prime minister so as not to compromise the position of his twin brother Lech Kaczyński's chances in the Presidential race. PiS instead nominated Kazimierz Marcinkiewicz for the post. In the October 2007 elections the tables turned when PiS won 32 per cent and PO won 42 per cent of the vote. A new government was formed under the leadership of PM Donald Tusk.

As far as the euro adoption strategy is concerned, the left-leaning government of the early 2000s (SLD-UP-PSL) prepared a well-developed plan to adopt the euro by 2007. This plan failed in mid-2003 and did not gain support from labor unions and other business organizations—in part because it was launched during a time of relatively low economic growth (Zubek, 2008: 299-300). PiS government was much less favorable to euro adoption. PM Jaroslaw Kaczynski has continuously uttered suspicions about fast euro adoption. He argued that Poland has to join the euro “but there’s no fixed deadline,

so we can do it when the levels of economic development in Poland and the euro zone are closer than they are now” (*Deutsche Welle*, online edition, January 13, 2007).

Following the 2007 elections PM Tusk was once again more favorable to euro adoption and aimed to join the euro sooner rather than later. However, to do so it needs to pass a change in the constitution in order to replace the zloty with the euro and to transfer the power of issuing money and implementing monetary policy to the ECB. Currently Chapter X, Article 227 paragraph 1 of the Polish Constitution gives the NBP “the exclusive right to issue money as well as to formulate and implement monetary policy. The National Bank of Poland shall be responsible for the value of Polish currency” (Polish Constitution of 1997). The constitutional amendment requires a two-thirds majority (see Chapter XII, article 235) of the 490 Sejm members. With the current seats in the parliament, a decision to amend the constitution needs the votes not only of the ruling party, but also the opposition (especially PiS). The opposition and some left-leaning politicians do not favor adopting the euro with the beginning of 2012 (interview with NBP official, April 2009).

On September 10, 2008, PM Tusk made his announcement to aim at joining the euro by 2011 (*Financial Times*, September 11, 2008). This announcement was preceded by approving the 2009-budget, which intended “to slash the budget deficit, cut taxes and sell off 12bn zlotys (\$5bn) of state-owned companies and trim the bloated early pension system” (*Financial Times*, online edition, September 29, 2008). Following this announcement, the government approved the MoF detailed plan on adopting the euro—*The Roadmap For Poland’s Euro Adoption* (Polish Ministry of Finance, October

2008).²⁰² This euro adoption plan is ambitious and not realistic since it requires significant reforms (mainly cutting the deficit) that are not easy to achieve—especially with the fall-out of the financial crisis.²⁰³ There were also larger domestic obstacles that frustrated the government’s ambitious plan. PiS made it clear that the only possible way to accept the constitutional amendment is if the government calls for a referendum and has the decision be approved in a popular referendum. Without a broad political agreement leading to a constitutional change, then euro adoption cannot be foreseen (interviews with NBP officials, April 2009). However, going the route of a referendum is very tricky because according to the Polish Constitution a referendum is valid only if there is a turnout of at least 50 per cent, which is unlikely to happen. Furthermore, it is unclear what question would have to be posed to the electorate in such a referendum.²⁰⁴

The former euroskeptic President Lech Kaczyński at first sent positive signs (while meeting with Tusk’s cabinet) driving Tusk “to believe that this project will be accepted, or at least be seriously treated by the president” (*Financial Times*, online edition, October 28, 2008b). Nevertheless, the president changed his mind and it seemed that his initial consideration for the plan was mainly not to be blamed for vetoing it before careful consideration. In addition, regardless of the solid majority that the coalition has in the parliament in terms of seats, it is not enough to turn over any presidential veto nor pass a constitutional amendment without the support of the opposition parties. All

²⁰² Later on, the MoF published a report detailing the prerequisites for implementing the next stages of the Road Map (Polish Ministry of Finance, April 2009).

²⁰³ I do believe that the reasons for setting a date for euro adoption were: First, to deal with the criticisms to PM Tusk for not implementing any reforms since he became the prime minister (*Financial Times*, September 10, 2008); second, the announcement “breathed new life” into Tusk and the “ruling Civic Platform” (*Financial Times*, online edition, September 29, 2008); and third, “to help calm spooked investors who have been retreating from the Polish zloty as emerging market currencies are buffeted by the global financial crisis” (*Financial Times*, online edition, October 28, 2008b).

²⁰⁴ When Poland joined the EU, it committed to joining EMU, so effectively Poland has already committed itself to adopting the euro at some point.

these issues affect the capability of the government to take a major policy such as a euro adoption policy. Even Tusk himself declared later on that there might need to be a delay to the 2012 date – quoting the need to avoid a referendum demanded by PiS. This likely delay was further signaled in spring 2009.

The sudden death of the Polish President²⁰⁵ among other high-ranking officials required having new presidential elections.²⁰⁶ The first round of the popular presidential elections was held on June 20th, 2010. Since no candidate won the majority of votes, a second round took place on July 4th, 2010. The results of the elections marked a major change in the position of the presidency, which moved from the hands of PiS to the PO party—Bronislaw Komorowski (PO) defeated Jarosław Kaczyński (PiS). The Sejm approved the appointment of Marek Belka²⁰⁷ as the new president of the NBP on June 10, 2010 (*Financial Times*, June 10, 2010).

The October 9, 2011 parliamentary elections resulted by PO winning, while PiS came second. It is the first time in the post-1989 Polish history that a party managed to win the elections consecutively. According to the Polish Electoral Commission, the turnout reached 48.92 per cent. PO won 39.19 per cent, followed by its rival PiS with 29.89 per cent. As for PO's ally and current government partner PSL; they won 8.24 per cent of the votes while SLD won 8.36 per cent and Paliku Movement (Ruch Palikota-RP)²⁰⁸ (see the Polish National Election Commission (Państwowej Komisji Wyborcza-

²⁰⁵ President Lech Kaczynski died on April 10, 2010 with his wife, the President of the central bank, and many of the major official delegation and advisors in a plane crash in western Russia.

²⁰⁶ Under Poland's constitution, the speaker of the parliament (Bronislaw Komorowski) takes over the presidential duties until new presidential elections are held within 60 days.

²⁰⁷ Belka was the Prime Minister of Poland in 2004-2005. He also served as a Deputy Prime Minister and Minister of Finance in Włodzimierz Cimoszewicz government and in Leszek Miller's government in 2001-2002. He is a technocrat who does not belong to the party system (for more information on Belka, please check the National Bank of Poland website at <http://www.nbp.pl>).

²⁰⁸ RP was founded in October 2010 by a former PO member Janusz Palikot.

PKW), 2011). Even with PO and PSL continuing their coalition, they still do not have the two-third majority to make any constitutional amendment to be able to adopt the euro.

Although Poland now has a pro euro president, a neutral NBP president who replaced the euroskeptic Sławomir Skrzypek and pro-EU and euro government following 2011 parliamentary elections, it is not likely that euro adoption has come much closer. With all these domestic changes, the veto regarding constitutional change (that PiS and the rest of the opposition has) still exists since it does not seem that the position of PiS has changed. PiS head Jarosław Kaczyński argued earlier in 2011 that Poland should not adopt the euro anytime within the next twenty years and that the złoty should become the third reserve currency along with the euro and dollar in central Europe (*The Wall Street Journal*, January 31, 2011).

7.3.3 Central Bank vs. Government—Cooperation or Conflict about the Euro?

The legal framework of today's NBP dates back to August 1997. With the new statutes a new ten-member body was created—the Monetary Policy Council—responsible for monetary policy. Maintaining price stability, supporting government policies, and looking after the Polish national currency, the złoty, and guarding the stability of the financial system were other objectives of the NBP. With these changes the NBP followed the structure of many national central banks in Europe and across the globe and was in line with the ESCB basis and provisions (Polański, 2004a: 281). However, the NBP was not fully independent and fulfilling the EU legislation until its act was amended in 2003 and the auditing of the NBP had to be conducted by an independent external auditor and

not, as previously, by a commission assigned by the government (Polański, 2004b: 9).

Over the past decade, the NBP has been split over whether the euro should be adopted fast or slow. The euroenthusiastic group has as a focal advocate the former NBP governor Leszek Balcerowicz (2000-2006), some financial institutions and current coalition government. As for the euroskeptic group (mainly PiS and the SLD), they prefer the slow track. Following the Tusk government announcement in fall 2008 to target 2012 for euro adoption, the former euroskeptic governor Sławomir Skrzypek²⁰⁹ (2007-2010)²¹⁰ had had reservations about its wisdom. Over the course of the spring and summer of 2009, others in the central bank also became convinced that the government's fast-track simply was not sustainable. Moreover, Poland is a large country and needs more time to get ready institutionally and prepare all the technical issues from printing money, to minting coins and setting Automated Teller Machines (ATMs) etc. (interviews with MoF and NBP officials and INVEST BANK, April 2009).

The Polish road to EMU was delayed due to conflicts within the NBP over euro adoption. The NBP was blamed for causing an economic slowdown due to its monetary policy. The SLD-UP-PSL coalition government entered into conflict with the NBP accusing it of adopting bad policies leading to slow growth (Zubek, 2008: 298). The Miller government blamed the NBP and its governor Balcerowicz (see Zubek, 2006, 2008). The government publically called upon the NBP to assist with increasing growth. Following the failure of the Kolodko plan for fast euro entry, Jerzy Hausner (Economic and Labor Minister at that time) proposed an alternative plan in which the viable date for

²⁰⁹ He was appointed while PiS was in power in 2007.

²¹⁰ Sławomir Skrzypek died on April 10, 2010 in the plane crash in West Russia while going with the president and his official delegation to participate in the 70th anniversary of the massacre of Polish prisoners of war in the village of Katyn near Smolensk during the Second World War. Around 20,000 Polish officers and soldiers were executed.

euro entry was postponed to 2009. While the plan helped the government absorb the EU pressures, the domestic implementation of the plan was not successful. The main reasons behind that were the problems within the SLD ruling party resulting from PM Miller's support to Hausner. Political calculations were more important for SLD than the overall benefits. One of the SLD leaders stated at that time that the *Hausner plan* is beneficiary for Poland but harmful for SLD (Zubek, 2008: 301).

The struggle between the government and NBP increased following the 2005 parliamentary elections. The PiS, Samoobrona RP (SRP) and the League of Polish Families (LPR) coalition appointed a committee in the Sejm (Polish parliament) to inspect the actions of the NBP regarding the financial institutions' privatization process that started in 1989, in addition to the actions of the Komisji Nadzoru Bankowego (Polish Banking Supervision Commission) (KNB). This act by the new government was clearly considered an attack on the NBP governor at that time (Balcerowicz) (*Warsaw Voice*, March 22, 2006; Zubek, 2006; 2008). The relations between the government and NBP progressed following the appointment of Slawomir Skrzypek as the NBP governor by former president Lech Kaczynski (both belonged to PiS and shared same views).

Now with Marek Belka as the head of NBP, the relations with the PO government are very good and the coordination between both NBP and the government continues to be strong. The position of NBP regarding euro adoption is related to the political sphere. Even if the NBP supports euro adoption and considers it to be positive in the long run, this support is not enough as long as there is no political agreement among the various parties. This political agreement is the crucial for getting Poland closer to adopting the euro (interviews with NBP officials, April 2009).

7.3.4 Public Opinion and the Media

The zloty was strong prior to the financial crisis. This situation gave Poles a feeling of satisfaction with their own currency and dampened enthusiasm for a rush towards adopting the euro. According to 2009-10 Eurobarometer reports, almost the same percentage of Poles was dissatisfied/satisfied with the overall prospect that the euro will eventually replace their currency (see Table 7.3). As can be seen in Table 7.3, although almost all Poles care about the implications of the euro with respect to their salaries, pensions, and bank accounts, 63 per cent of Poles feel they lack knowledge about the euro. Almost half of the Poles (48 per cent) think the euro eventually will have positive effect rather than negative effect.

Table 7.3 Public Opinion in Poland in 2009 and 2010

| Poland's Public Opinion | | |
|--|-------------|-------------|
| % of Population | 2009 | 2010 |
| Agree that euro adoption ensures sound public finances | 44 | 42 |
| Disagree that euro adoption ensures sound public finances | 32 | 33 |
| Dissatisfied with the fact that the euro will replace their currency | 44 | 45 |
| Content with the fact that the euro will replace their currency | 45 | 45 |
| Want euro accession as late as possible | 39 | 38 |
| Want euro accession as early as possible | 18 | 15 |
| Well informed about the euro | 37 | 36 |
| Not well informed about the euro | 62 | 63 |
| Think the euro will have positive consequences | 52 | 48 |
| Think the euro will have negative consequences | 37 | 38 |
| Form their opinion based on its effect on salaries, pensions and personal accounts | 87 | 91.1 |
| Television is the main source of information | 96 | 96 |
| Using the euro makes people feel more European | 59 | 53 |

Source: European Commission (2009b; 2010b).

As for the symbolic factor that the euro brings, the percentage of those who would feel more European because of euro adoption has been declining year after year reaching 53 per cent in 2010. The age plays role in the support for the euro and the European integration. The older generation feels more Polish, more nationalistic and hesitant with respect to open more towards Western Europe. As for the younger generation, they feel more European and more supportive of the euro, which they consider it “an element of European normality” (interview with NBP official, April 2009).

Following the crisis, there was some pressure from some Poles, especially from those who have loans in foreign currencies, for speedy euro adoption. They were concerned about the depreciation of the zloty (interviews with MoF and NBP officials, April 2009). These advocates of early euro adoption, however, only constituted a minority—only a small percentage of Poles want the euro to be adopted as soon as possible (15 per cent) compared to 38 per cent who want it as late as possible. As for sound finances, in 2010, 33 per cent do not think that adopting the euro will ensure sound finances compared to 42 per cent who think otherwise.

As a result of the financial crisis, more Poles (albeit not the majority of the population) have become more enthusiastic regarding the euro due to the depreciation of the zloty and the subsequent volatility. Most new euro-enthusiasts have loans and mortgages in foreign currencies—mainly in euro or Swiss franc. However, they do not form a clear lobby or advocacy group. Moreover, when Slovakia adopted the euro in 2009, the support for euro entry increased since it was viewed by Poles to be a stabilizing factor for its members. This increase in the support for the euro could not last long because of the sovereign debt crisis—mainly the Greek crisis. The Greek crisis in

addition to the Portuguese and Irish crises showed that even euro members are in trouble and that the euro does not form a safe haven. On the contrary, being members of the euro area put limitations on the monetary tools that could be used to stabilize the economy. According to two surveys conducted by the Warsaw School of Economics in April 2010 and May 2011 the support for adopting the euro has declined in Poland from 52.2 per cent in 2009 to only 42.2 per cent in 2010 before dropping further to 40.8 per cent in 2011. As for those who are against euro adoption, the number has increased by “11.2 percentage points” reaching 38.4 per cent in 2010 (*The Wall Street Journal*, May 5, 2010) before increasing further to 41.7 per cent in 2011 (*NEWEUROPE*, May 15, 2011).

7.4 Financial Crisis Effect on Euro Adoption Position

For Poland, both the government and the opposition used the financial crisis to support their positions. When the Greek crisis evolved followed by the crises in Ireland and Portugal, things started to move in favor of the opposition under the leadership of PiS. The current government is still pro euro but is not pushing hard for an early euro adoption. As for the opposition, it is still euroskeptic and uses the euro crisis as a sign that the euro is not working properly and therefore the entire euro accession should be delayed and not even discussed in the foreseeable future.

Economically speaking, despite slower economic growth and depreciation of the złoty, the Polish economy did not enter into recession. The reason why Poland did not fall into recession according to Finance Minister Jan-Vincent Rostowski was partly because of the sharp fall of the złoty, which “kept Polish exports competitive” (*The Wall*

Street Journal, January 31, 2011). As for the political effect, while the financial crisis did not change the positions of the governments since PM Tusk and his government were still supportive of the 2012 entry date. This date proved to be impossible especially that Poland only meets the debt criterion—which is also increasing. Therefore, PM Tusk announced on July 3, 2010 that 2015 is more reasonable date for adopting the euro (without setting an official date). Even the 2015 date appears to be delayed further when the Polish Minister of Finance Jan-Vincent-Rostowski announced in May 2011 that Poland might not join the euro area in the foreseeable future, not even during the term of the new ECB president (Mario Draghi)²¹¹ who succeeded Jean-Claude Trichet on November 1st, 2011. Rostowski added later in an interview to the Polish *Gazeta Wyborcza* on August 29, 2011 that Poland will not adopt the euro until it is “resistant to earthquakes” (*Gazeta Wyborcza*, online edition, August 29, 2011).

The earlier enthusiast position regarding the euro and keeping it on the agenda of PM Tusk government have changed with the euro countries’ sovereign debt crisis. Krzysztof Bielecki (head of economic advisors for PM Tusk) emphasized in an interview on November 29, 2010 that it is not logical to discuss euro adoption now because of the sovereign debt crisis and that it is not even on the government’s agenda (*Bloomberg*, December 7, 2010). Even the merits of fast euro adoption that the current government was preaching are vanishing. The NBP Governor Marek Belka mentioned at the 2011 Annual EBRD meeting in Astana-Kazakhstan that the benefits of fast euro adoption are declining and that “immediate benefits of euro adoption seem to be less” (*Bloomberg*, online edition, May 20, 2011). Belka added that the decrease in euro benefits does not change the fact that adopting it is a “strategic goal” for Poland and the main changes that

²¹¹ Governor of the Bank of Italy since January 2006.

the sovereign debt crisis has changed is “the balance of costs and benefits of euro adoption” (*Bloomberg*, online edition, May 20, 2011).

The opposition under the leadership of PiS has become more critical of the euro following the sovereign debt crisis. PiS leader Jaroslaw Kaczynski has argued that the instead of adopting the euro, the złoty should be strengthened and made a third currency in the region alongside with the euro and US dollar. Kaczynski went further to say that the Poland should not adopt the euro at least for the coming twenty years (*The Wall Street Journal*, January 31, 2011).

While the financial crisis did not change the positions of the government and the opposition, the sovereign debt crisis pushed the government to take a more cautious approach and push for delaying the euro adoption date. Although, the sovereign debt crisis brought the current government’s position closer to the opposition, but the opposition took a harder stand on euro adoption and has been calling for a stronger support for the złoty rather than replacing it in the future.

7.5 Conclusion

This chapter looked at the 1990s reform and the euro adoption strategies in Poland. The chapter provided various reasons for the continuous delays in euro adoption in this country. Although the early institutional and economic reforms (the shock therapy approach) incurred short-term costs, in the long run, it helped the Polish economy stabilize and grow fast. The communist past left Poland with huge debt, hyperinflation, bad governance, underdeveloped institutions, etc. This situation pushed the elites at that

time to adopt a fast reform (shock therapy). Different methods of privatization were implemented. The early period of reforms (mainly economic and institutional) reflected the difficulties Poland was going through, the lack of experience and chaotic behavior among the elites. These findings, regarding the early post-1989 reform period, supports the first part of *hypothesis 6 (the different experience the Czech Republic, Hungary and Poland had under communism should be reflected in their development post 1989)*. In that sense, the communist legacy did help us understand the reasoning behind some of the reforms taken in Poland at the early transition period. However, when it comes to the choices of the elites later on and in comparison to Hungary, the communist legacy and path dependency fell short in explaining how Poland managed to be more successful than Hungary and how it dealt with the economic difficulties. The communist past also did not help us understand the sharp division among the public opinion and elites regarding euro adoption and also did not explain why Poland is still among the outsiders. Therefore, other explanations are needed. As we have seen, the second part of *hypothesis 6 (Hungary should be the pacesetter and the closest to meet the convergence criteria and adopt the euro in comparison to Poland and the Czech Republic)* is not supported in the Polish case (as in the Czech and Hungarian cases).

Poland's reform, economic growth, its stable economy (compared to other EU countries such as Hungary) even after the crisis were not enough to get Poland closer to euro adoption. The domestic political situation has played a significant role in delaying euro area accession. Elections do matter, as suggested by *hypothesis 1*, and their results could bring a euroenthusiastic or euroskeptical government. The case of Poland during the last two decades showed that there is a division among the political parties and the public

(euroenthusiastic versus euroskeptic), and the elections were changing the ruling parties every term. This situation caused the policies regarding the euro to be inconsistent. Although this situation changed with the October 2011 elections that resulted in the ruling party (PO) winning the elections, other veto points still exist as we have seen. PO and its allies still do not have the needed two-third majority in the Sejm to do the necessary constitutional amendment to adopt the euro.

Poland, which is not close to meeting the convergence criteria, currently has a government keen to try to meet the criteria so as it would be in a better position to join the euro. Although, as argued in *hypothesis 2, the ideology of the current PO government and its sound policies (good governance) are necessary for euro adoption and have a significant positive effect on the entire matter*, yet the Polish case showed that this not enough on its own to push forward the euro adoption. In Poland major obstacles have caused the delay in euro adoption, such as the relationship between various domestic actors, the difficulty of having to change the constitution to adopt the euro, and the fact that the Polish zloty is a freely floating currency (which would have to join ERM-2 and be part of it for two years before euro adoption could take place). The constitutional change is problematic since the current ruling party (PO) cannot push through any amendments without the cooperation of the opposition (mainly PiS) because it needs more than a simple majority to change the constitution. This cooperation does not seem possible and will push euro adoption even further as argued in *hypothesis 3*. The Polish case supports *hypothesis 3* regarding *the existence of veto points in the constitution*. Both the president and the opposition effectively have a veto. They could block the future euro

adoption unless the euroenthusiastic group wins the presidency²¹² and secure a two-third majority in the Sejm in order to be able to do the necessary constitutional amendments. Another thing that also pushed the country away from adopting the euro is the continuous transfer of power between the opposition and the ruling party (mainly between PiS and PO)—which have different ideologies and views on the EU and the euro. Even with PO and its current ally PSL together won 47.55 per cent of the Sejm seats in October 2011 elections, which enables them to rule another term, the obstacle that stands still is the constitutional amendment, which will need the approval of the opposition.

Another issue that pushed Poland away from the euro is the troubled relations between the NBP and the government—a finding that fulfills the argument in *hypothesis 4* regarding the role of the central bank and its relation to the government. The first bitter relation was when Balcerowicz was the governor of the NBP and the government has been very critical of the policies he adopted (not only while governor but also during the early reform years). The other troubled relation was when PO took over the government from PiS in 2007. The NBP governor and most of the monetary board were hired while PiS was in power. So the NBP former governor Skrzypek was a euroskeptic while the PM Tusk government was euroenthusiastic. The Polish case proves that *hypothesis 4* is applicable since the relation between the NBP and the government had serious effects on euro adoption. Now with the changes in the monetary board and the NBP governor, there is a better relation with the government, but as we have seen, other domestic and international factors are pushing Poland away from euro adoption.

²¹² PO won the presidency in July 2010 when their candidate Bronisław Komorowski won the elections as mentioned earlier. So the presidential veto will not block the euro adoption since both the president and the government are pro euro.

The public is divided on euro adoption and generally speaking it is not in favor. As for the media, its role is insignificant and inconsistent—as indicated in *hypothesis 5*. There is no real coverage or emphasis on the euro.

With the financial crisis, followed by the sovereign debt crisis, there is more talks about the euro adoption and if it is feasible or not to adopt it. Even the public support for euro adoption has declined recently since the costs and benefits of the euro has changed and the stability that the euro used to provide disappeared (as we have seen in the previous sections). Euro adoption date seems to be delayed according to both the government and the opposition. The opposition is even more skeptic and does not expect euro adoption before 2020 or so.

CHAPTER VIII: CONCLUSION

This study dealt with the euro adoption policies in the Czech Republic, Hungary and Poland. It outlined the historical, political and economic contexts of those three countries from the Yalta Agreement until the present. Knowing that, legally, all the NMS have to adopt the euro sometime in the future, the main questions this study sought to answer were: what have been the policies towards euro adoption of the Czech Republic, Hungary and Poland? What were the reasons behind choosing those policies? How did major domestic political factors affect euro adoption policies in the three countries, and how can we best understand them? This concluding chapter presents the main findings of the study. The remainder of the chapter is divided into five sections: The first section discusses the main theoretical findings of the thesis. The second section highlights the importance of the communist legacy and its relevance to our understanding of euro adoption in the three cases. The third section emphasizes the main findings and lessons from the case studies. The effect of the financial crisis and the sovereign debt crisis is presented in section four. Section five concludes.

8.1 General Findings

All three countries went through the socialization process and took on Western ideas on their journey towards democracy and market economy. In all three countries we saw continued movement in the direction of cutting the ties with the communist past and

transformation toward market economy and democratization, something emphasized by political scientists as explaining why euro adoption might be forthcoming. Yet, these developments were simply insufficient to secure a fast track to euro adoption.

Despite the fact that the long-term economic benefits outweigh the costs of euro adoption,²¹³ the Czech Republic, Hungary and Poland remained outside the euro area and are not likely to join any time soon. Although the economic and political science analyses offer useful insights, they fall short in explaining what actually happens in nation states regarding euro adoption strategy. The economic cost/benefit analysis is unable fully to explain euro adoption strategies in the NMS. The Europeanization literature and symbolism also cannot explain governments' reforms. For instance, this literature is unable to explain why governments pursue certain policies that might appear unreasonable for international organizations and western countries.

Symbolism does not really matter much with respect to euro adoption—after those countries became members of the EU. Literature that focuses on symbolism also fails to explain the enthusiasm or reservation regarding euro adoption (at the elite's level and the public²¹⁴)—as we have seen and was supported by the interviews conducted in the three countries. In addition, the euro adoption policies of CEECs are not yet well researched. Indeed, there are plenty of issues that could be addressed and studied to understand why some NMS have and others have not adopted the euro.

²¹³ As I indicated in chapter 2, we have to keep in mind that the types of costs/benefits of euro adoption considered for the period of the study were those considered until 2009. The short-term costs and benefits from euro adoption differ between the small states (benefits outweigh the costs) and large states (it is not certain the benefits outweigh the costs) as indicated in chapter 2. Following the onset of the financial crisis of 2008/2009 the economic crisis and the sovereign debt crisis have altered the assessment of the costs and benefits of euro adoption for those not yet in the euro.

²¹⁴ As we have seen in the discussion of the three cases, over 80 per cent of the people think about the euro in terms of costs versus benefits. They form their opinion based on its effect on salaries, pensions and personal accounts.

I argue that the main factors that explain why the three countries have not yet adopted the euro are to be found in the domestic domain. Therefore, this study adopted a domestic politics approach that focused on the institutions and policies from the perspective of those member states. As I indicated in my discussion of the domestic politics approach, I am not the first to use this approach. However, my study is unique in combining such an approach and the study of euro adoption strategies in CEECs. My contribution lies in developing the domestic politics approach and applying it to the cases of the Czech Republic, Hungary and Poland and using it as a framework to explain their euro adoption policies.

The domestic politics approach developed in this study focuses on the factors influencing euro adoption such as the historical legacy of communism and its effect, domestic economic situation, government, opposition, constitutional hindrances, public opinion and the media, in addition to the international environment. In the three cases studied, we have seen how these factors influence the decision-making process in the Czech Republic, Hungary and Poland and how these factors are influenced by other domestic factors (such as constitutional hindrances and epistemic communities). Although the focus was primarily at the domestic level, the study also examined the influence of various international and European factors such as the role of the excessive deficit procedure and the global financial crisis.

This study shows that the reasons that all three countries are still outside the euro differ significantly from one another. The factors studied are the same (government, opposition, central bank, public and media) but their interaction and degree of importance differ among the three cases. These countries have not adopted the euro for a variety of

reasons such as lack of political will (the Czech Republic), because of the lack of political consensus and the constitutional burden (Poland), or because of the irresponsible governments and policies in addition to bad governance and delays in reforms (Hungary). By unpacking the domestic political dynamics, we saw that there are differences among the three cases that have not adopted the euro and always lumped together as laggards. So we cannot deal with those countries as a one laggard group that has not adopted the euro for the same reasons as we have seen throughout the thesis. The next sections highlight the main findings of the thesis regarding the communist legacy, domestic factors and the financial crisis and sovereign debt crisis.

8.2 The Communist Legacy—Does it Matter?

The analysis of the communist legacy and a brief historical discussion of central Europe in this thesis served to show the importance of a historical institutionalist perspective on the role of institutions. That analysis served to study whether the communist legacy had any significant effects on the post-1989 developments and the subsequent euro adoption strategies. To this end, chapter 4 dealt with the communist era whereas chapters 5 through 7 had parts dealing with the post-1989 reforms.

The historical analysis was embarked on in order to understand the starting point of each of the three CEECs in 1989 and how the reforms took place. The three countries went through different kinds of revolutions against the communist regimes' policies. While the elites and leaders of the ruling party were involved in the reforms in Czechoslovakia and Hungary, the situation in Poland was different. Compared to the

brutal oppression of the Polish revolt in the mid 1950s, Poland's revolution against the communists in the late 1970s and 1980s was bottom-up in which the Solidarity movement (which enjoyed the support of the majority of the Poles) sought change—and eventually succeeded.

Yet, the reforms in the Czech Republic and Hungary started a decade or two before even Poland's Solidarity movement managed to force the communists into the Roundtable talks in the second half of the 1980s. Therefore, the degree of freedom and reforms enjoyed by actors in the three countries differed. This difference in the political situation, institutional development, role of civil society and economic prosperity during the communist era shows that by the end of the 1980, CEECs were not similar.

The sections on the major developments taken under communism examined the road to building a strong democracy and a functioning market economy. The main reason for discussing the historical background and early years of reform was to test *hypothesis 6*:

The different experience the Czech Republic, Hungary and Poland had under communism should be reflected in their development post-1989. The different experience should reflect different outcomes during the post-1989 reforms. Therefore, Hungary, which was more economically and institutionally advanced than the Czech Republic and Poland, should be the pacesetter and the closest to meet the convergence criteria and adopt the euro.

The analysis showed that the communist legacy could account partly for the economic difficulties facing the three countries during the early years of reforms. For example, elites may have lacked experience of dealing with fiscal and monetary policies, and had to deal with underdeveloped institutions, that in some instances needed to be totally reconstructed or even constructed from scratch. As proposed in *hypothesis 6*, following a historical institutionalist approach, the different experience the Czech Republic, Hungary and Poland had under communism should be reflected in their

development post 1989. As we have seen in the discussion of the cases, the different road towards institutionalization, democratization and market economy has been different. The early years of reforms reflect the difficulties those three countries had to go through—keeping in mind the advanced position of Hungary followed by the Czech Republic and Poland. Therefore, the first part of *hypothesis 6* partly could explain the early few years of confusion among the elites regarding the reforms and the different situations of the three countries after the fall of communism. However, the communist legacy fails to explain the reasoning behind the decisions and choices taken by the elites in the three countries that affected the post-1989 reform period. It also does not account for the role of the various factors involved in addition to the international influential players. However, the choices by elites regarding the different systems created in CEECs post-1989 affected euro adoption since it led to creating some domestic institutional veto points and barriers, in particular the Polish constitution and presidency, and the Czech presidency. This link between the post-1989 political systems' created and non-euro adoption in the three cases could partly be explained by the historical institutional approach.

The second part of *hypothesis 6* (*Hungary, should be the pacesetter and the closest to meet the convergence criteria and adopt the euro*) is totally rejected. The historical legacy falls short in explaining why Hungary, a country that was more advanced in its transition from communism to capitalism than both the Czech Republic and Poland, ended up behind both regarding its economic reforms and euro adoption. Hungary's reforms started as early as the beginning of the 1960s by introducing some market economy elements, developing the agricultural sector, introducing farming

technology in the 1970s, developing the competition among the enterprises, providing incentives to increase enterprises' efficiency.²¹⁵ Czechoslovakia (under communism), that tried to implement economic and political reforms in the 1950s and 1960s, was crushed brutally in 1968. Due to the nationalization of enterprises and agriculture, ignoring the specialties of Czechoslovakia and the focus on the heavy industries, the Czechoslovak economy suffered significantly. It was not until the 1980s when some attempts to reform the economy were launched. As for Poland, most of the communist era was characterized by continuous struggle and oppression. There were some attempts to renew and develop Poland's industry and living standards in the 1970s. These 1970s' reforms were based on getting loans from the West to import heavy technology, which led to a massive foreign debt. The political struggles did not allow the reforms to be fully implemented and caused Poland to have bad economic and financial situation by the end of the 1980s (economic stagnation, hyperinflation, large deficit and debt, etc.).

After 1989, both the Czech Republic and Poland adopted the shock therapy approach to reform their economies while Hungary took the gradual slow type of reform. The elites' decision to choose either way cannot be explained by the communist legacy. The economic situation resulting from the communist era could have been the cause for the choices, but the different competing ideologies regarding what methods should be used are not the result of the communist legacy. The debates and decisions of the elites are mainly due to their education in the West, the social learning process and also the financial and technical support from the International Community to implement certain policies. The Czech Republic became one of the strongest economies in CEECs and

²¹⁵ We have to keep in mind as I argued earlier that although these reforms are important but they were limited (since Hungary was still under communism) and resulted by high indebtedness by the end of the 1980s.

managed to meet most of the convergence criteria. As for Poland, it had a very strong civil society that helped in the post-1989 reforms and led Poland to have the first free elections in the region on June 4, 1989. Poland's economic performance starting in the second half of the 1990s showed that the last reformer during the communist times could overtake the more advanced countries under communism—such as Hungary.

While no strong correlation appears to exist between the communist legacy and post-1989 reforms, there is a stronger correlation between the post-1989 political, institutional and economic reforms and non-euro adoption. Moreover, the communist legacy cannot explain why the reforms were more successful in some countries than others. The historical legacy cannot tell us why a country that was very close to meet the convergence criteria and adopt the euro (such as the Czech Republic) is still an outsider. Moreover, the communist legacy does not explain why Hungary (more advanced than the Czech Republic and Poland) fell behind economically and regarding the convergence criteria and euro adoption in comparison to the Czech Republic and Poland. So the arguments that politicians sometimes use in CEECs to blame the communist era for the failures of the reform policies during the post-1989 period are invalid; legacies do not explain much as we have seen. This leads me to conclude that the facts and analysis refute the major part of *hypothesis 6*.

8.3 Lessons and Findings from the Three Cases

Other points that the literature points to for an explanation, for example, are macroeconomic analysis. In this thesis I examined a number of those macroeconomic

indicators at various time intervals. I examined the extent to which the countries are close to meeting the convergence criteria, openness of the economy, and so on. That analysis does not explain why some countries, such as the Czech Republic and Hungary, that were close to meeting the convergence criteria in the early 2000s, ended up diverging from them as the decade progressed. This analysis showed that being very close to meeting the convergence criteria, or even meeting most of them, does not necessarily mean that the country will adopt the euro (see also the case of Sweden, mentioned in the introduction). In the discussion on macroeconomic criteria, we saw that the Czech Republic at various time intervals was very close to meeting the criteria for euro adoption, but there were no signs the country was interested in adopting the euro. Other domestic actors and veto points are involved in the decision-making process as we have seen. Institutional veto points are crucial and can block euro accession.

In the case of the Czech Republic, lack of political will, combined with euroskeptic political actors block euro accession. Even with the institutional development, an independent central bank, and a rapid movement towards a market economy, all this was not enough because no political consensus or public enthusiasm towards the euro existed. Another major veto point is the role of the euroskeptic Czech president who has the power to veto euro adoption.

In Hungary there is an agreement among the political elites that Hungary should move forward and adopt the euro. Yet, the political parties differ as to what policies to implement in order to meet the convergence criteria. The one factor that has marked the policies since mid-1990s is that all the consecutive ruling parties have not been able to implement sound economic policies that would allow them to meet the criteria. For

example, whenever there are elections, the deficit increases significantly (see Figure 6.1). In comparison to the Czech Republic and Poland, the absence of veto players in Hungary is replaced by unsound economic policies, which effectively blocks the road to euro adoption, as this country thus fails to meet the convergence criteria.

By contrast, Poland, prior to the sovereign debt crisis, a country that was not close to meeting the convergence criteria, has a government keen to work towards meeting the criteria so as to be able to adopt the euro. Poland's reforms, economic growth and its stable economy, even after the financial crisis of 2008-2009, were not enough to move it closer to euro adoption. Several veto points exist in the Polish case that are causing the delay in euro adoption. The fact that the current opposition (PiS mainly) is euroskeptic, and is against adopting the euro in the foreseeable future, makes it difficult to get enough votes in the Sejm to change the constitution to adopt the euro. Moreover, the president has the ability to block major decisions; however, the 2010 presidential election resulted in the defeat of PiS candidate (Jarosław Kaczyński) by the PO candidate and current president (Bronisław Komorowski)—so the presidential veto will not be a problem now.

Let us turn now to the findings with respect to the five hypotheses. Regarding *hypothesis 1 (Elections matter and shape not only governments' euro adoption policies but also the opposition's stance on the matter. Government and opposition use the euro as a tool in their election campaigns if the public is interested)*, the three cases supported the argument that elections do matter—but for different reasons. What is common in the three cases is that euro adoption is almost absent in the election campaigns. In the Czech case, there were no public debates or discussions regarding the euro. Even the different parties have not used the euro adoption in their campaigns. The last two presidential

elections brought a euroskeptic president to power. The more euroskeptic party (ODS) is still ruling.

In the Hungarian case, elections have been used as a tool to gain more seats and led to bad finances. Whenever there is an election, the budget deficit increases sharply due to overspending by the government (see Figure 6.1). All major parties agree that adopting the euro is good for the Hungarian economy but they disagree on the necessary policies to meet the convergence criteria. In Poland, elections have been changing the ruling party consecutively. This change in the government every few years caused the policies regarding the euro to be inconsistent—since as I mentioned earlier, there is a sharp division between the two major parties regarding the euro. This situation played a role in pushing euro adoption further away. The last Polish election was the first exception in which PO managed to keep its majority. However, with the financial crisis followed by the sovereign debt crisis, euro adoption has been absent in the latest Hungarian and Polish elections. The focus is how to stabilize their economies and avoid recession. In both the Czech and Polish cases, no one among the politicians is discussing the merits of adopting the euro. Even the euro enthusiasts are very careful in their comments and in the three cases the common argument is: once the financial crisis and the sovereign debt crisis are over, then we can talk about euro adoption. The current Hungarian government is also still hoping to adopt the euro sometime in the near future but once it deals with its financial problems and once the sovereign debt crisis is solved.

The discussion of the elections brings us to another finding regarding *hypothesis 2 (the ideology of the government and sound policies (good governance) have a significant positive effect on euro adoption in CEECs)*. The three cases supported this hypothesis

that the pro-euro ideology of the government, along with sound policies, is crucial for adopting the euro. Having a euroenthusiastic government that is implementing sound policies is a necessary but not sufficient condition for adopting the euro. In the Polish case, we have seen that the government is keen to adopt the euro and the fiscal and monetary policies are sound, yet other domestic factors (such as veto points) makes it hard to adopt the euro. In the Hungarian case, the consecutive governments have been keen to adopt the euro but the bad finances and poor policies made it too difficult for them. The Czech case is opposite to the Hungarian case since although the consecutive governments have been implementing sound economic policies; its governments have been euroskeptic.

Hypothesis 3 regarding the role of the opposition and the veto points (the role of the opposition is crucial in influencing the government's policies and negotiations—especially with the existence of veto points in the constitution. The competition between the government and the opposition is usually to influence the public opinion and push the public against (or in favor of) certain policies), was supported mainly by the Czech and Polish cases. As for the Hungarian case, although as we have seen earlier, the opposition played a role in pushing the country away from euro adoption due to irresponsible policies caused by electoral promises to win voters, but there are no significant veto points to block euro adoption. In the Czech case, the veto of the euroskeptic president has been pushing the country further away from adopting the euro. In Poland, the constitutional change requires the cooperation of the opposition parties (mainly PiS) with the current PO government in order to secure the two-thirds majority to pass the necessary constitutional amendments to adopt the euro—something that is highly

unprobable. The Polish president has a veto and can block euro adoption. However with the new Polish president (Bronisław Komorowski), the presidential veto is not a problem anymore.

Another important finding is regarding *hypothesis 4 (It is impossible to understand euro adoption strategies, without understanding the role played by the central bank and its relation to the government. A good and harmonious relationship between the central bank and the government is a necessary but not a sufficient condition for euro adoption)*. The three cases also supported this hypothesis. In the Czech case, the troubled relation between the CNB governor and some of the board members on one hand and President Klaus on the other was solved with the appointment of most of the CNB board by Klaus during his two terms as president. The relationship is harmonious between the two but both are euroskeptic. In Hungary, the overspending by the government and irresponsible economic policies created tensions between the government and the MNB—especially when Jarai was the governor. The government was critical of the policies conducted by the MNB at that time. The MNB was very critical of the consecutive governments' policies, which kept pushing the euro adoption date further in the future. In Poland, the struggle between the NBP and the government during the years of Balcerowicz in addition to the struggle between the government (euroenthusiastic) and the former NBP's governor and former president (euroskeptic) played a role in postponing euro adoption. Now with a more euroenthusiastic government and a neutral NBP governor, the relations are more suitable to adopt the euro (but other domestic factors still exist as we have seen).

As for the role of the media, it has been weak and inconsistent in the three cases—as suggested in *hypothesis 5 the role of the media with respect to euro adoption and influencing the public is inconsistent and weak in general*. Prior to the euro crisis, there was no consistent coverage of the euro issues due to the lack of public and political debate. As far as the public support is concerned, I was interested in seeing to what extent a clear call from the public would influence the domestic arena. In the Hungarian case we observed a political battle among the main political parties to try to win over the voters, which manifested itself in major electoral commitments at considerable cost to public coffers. The result of this bidding process was a mounting budgetary deficit and public debt, which pushed Hungary further away from the prospect of joining. The political salience of euro adoption in the three countries is the highest in Poland, where the media and the public care more about the euro than in the Czech Republic and Hungary. In the three cases, the public is not that interested in adopting the euro. From the interviews conducted in these three countries, I understand that should the population have been more ‘needy’ and more clearly in favor or against, these circumstances would have affected the political stance of government and opposition.

There is no clear political consensus in the Czech Republic, Hungary or Poland. All three countries have had domestic problems and internal struggles. There are both similar and different reasons for having the same outcome as we have seen. The factors analyzed are the same but their interactions are different in the three cases. As we can see in Table 8.1 that summarizes the main findings, all the domestic factors discussed in the thesis (elections, government’s ideology and policies, veto points, relation between the government and the NCB and public opinion) proved to be important at different stages

and levels depending on the case. All the factors contribute to a better understanding of why the three countries have not adopted the euro yet. Finally, the role of the media was inconsistent and weak in all three cases.

Table 8.1 General Findings

| | Czech Republic | Hungary | Poland |
|--------------------------------|--|---|---------------------------------------|
| Elections | Matter (brought euroskeptic president) | Matter (overspending and increase in deficit) | Matter (keep changing those in power) |
| Government's ideology | Matter | Matter | Matter |
| Sound policies | Exist | Do not exist | Exist |
| Veto points | President | None | Law; President |
| NCBs versus governments | Matter | Matter | Matter |
| Public opinion | Majority euroskeptic | Majority pro euro | Divided |
| Media | Weak/inconsistent | Weak/inconsistent | Weak/inconsistent |

8.4 The Aftermath of the Financial Crisis and Sovereign Debt Crisis

The financial crisis of 2008-2009 and the sovereign debt crisis that has followed, are only addressed very briefly in this study, and only insofar as they affected the elites' and public's perception of the euro. Both the governments and oppositions used the financial crisis as a policy tool to promote their ideas and beliefs regarding euro adoption. As such, and perhaps surprisingly, the crisis did not change the stance on euro adoption in the three countries. Rather, it re-enforced the positions of the government and the opposition.

The Czech government used the financial crisis, and subsequently the sovereign debt crisis, as a tool to support its position of delaying euro adoption. Before the crisis, the Czech Republic only missed two of the convergence criteria (inflation rate and the

exchange rate). In the aftermath of 2008/2009 financial crisis, the economic situation has worsened. The entire effort of all groups (the CNB and both the government and opposition) is to deal with the fall out of the crisis – with euro accession not as a priority. Another matter that needs to be addressed by the elites is the reform of the pension system and the health care policies. Otherwise, there will be more pressure on the public debt and deficit which will lead the Czech Republic to lag further behind on meeting the convergence criteria. As for the public, it is even more skeptical regarding the entire European integration process in general and the euro in particular.

In Hungary, the crisis played a role in pushing the politicians to correct their bad fiscal and monetary policies over the past years. The economic situation deteriorated so much that it had to get financial assistance from both the IMF and the EU. A rescue package was prepared, and Hungary had to take some unpopular measures, which led the conservatives (FIDESZ) to win the majority. But even before the crisis, Hungary was struggling to meet the convergence criteria, as they presented themselves as farfetched goals given Hungary's point of departure. At the time of writing, the Hungarian public is more hesitant about euro adoption due to the euro crisis and the Greek debt crisis. The public believes that being in the euro area does not necessarily mean that Hungary will be in a better economic position and will benefit from the euro. The elites are still in favor of the euro, although they disagree on the best method to achieve this objective.

In Poland, the situation is different from that in Hungary or the Czech Republic since its economy did not enter into recession in 2008-2009 when most EU countries were in recession—despite the decline in the growth and depreciation of the złoty during the early period of the financial crisis. Politically speaking, the political parties are still

divided on the euro issue. The opposition (mainly PiS) is more critical of the euro and the entire idea of joining the euro area. The current government is still pro euro but with the sovereign debt crisis, the process has slowed down a little and a more cautious approach is being taken—a step that will push the euro adoption date further. Even public support for the euro adoption has declined recently due to few reasons such as the changes in the costs and benefits of the euro and the stability that the euro used to provide disappeared. So in the three cases, the crisis was used as a tool to persuade the public and to support the positions of the different parties. What is common now among the three cases is that their policies regarding the euro is a *wait and see* strategy until the euro crisis is solved.

8.5 Connecting the dots—The ‘So What?’ Question

Reflecting on these three cases, I conclude that in order to understand euro adoption strategy in each of the three largest CEEC that joined the EU in 2004, an analysis that examines the pros and cons from a cost-benefit analysis perspective is not enough. Likewise, an analysis that centres on social learning and Europeanization also does not shed much light on the matter. The latter is unable to examine the day-to-day politics, and hence misses the developments on the ground that lead to the policies that eventually determine whether a country is ready to adopt the euro or not. But different variables in different states have led to a delay in euro adoption. Although I looked at the same factors (government, opposition, central bank, public and the media), however their effect on the euro decision-making was different. In the Czech, the main factor for not adopting the euro is euroskepticism among the ruling elites, the president and even the public. In

Hungary, the situation is different because the main factors that pushed euro adoption away were the consecutive governments' irresponsible policies. In Poland, the sharp division among the elites played the major role in pushing the country away from euro adoption. Depending on the cases, we saw that the interaction among the other factors differed according to the government's ideology with respect to the euro. Two things that were consistent in the three cases were the absence of a large public support to euro adoption and lack of media influence.

The following table (Table 8.2) summarizes the key influential domestic factors in each of the three cases. It demonstrates clearly that it does not work to try to group all three countries into one category of 'laggards' as different factors lead to the same outcome.

Table 8.2 Main Domestic Factors for Non-Euro Adoption in Each Case

| | Non-euro Adoption – Main Domestic Reasons |
|-----------------------|---|
| Czech Republic | Euroskeptic elites and a publicly influential euroskeptic president (since 2003) with a veto power causing the country to be more euroskeptic |
| Hungary | Consecutive governments' irresponsible economic policies |
| Poland | Sharp division among the elites who have been ruling consecutively; constitutional veto and presidential veto |

This study helped us understand why these three countries decide to work hard or not so hard towards joining the euro area by highlighting the importance of the domestic environment and factors by offering an understanding of the decision-making processes. By focusing on the policies of the domestic actors in member states and the interaction among those actors and factors, this thesis seeks to make a contribution to the euro adoption literature. It showed that social learning, symbolism and the Europeanization literature, on their own, cannot fully explain certain phenomena. It also showed that euro

adoption decision are not first and foremost related to economic costs and benefit calculations. Rather, the role of the government, opposition, central bank and the public are more important in helping to explain euro adoption policies in these NMS.

In terms of lessons for further research, although this study focused on three cases, the findings could be projected onto other cases with a view to examining whether they would hold in those other cases and thus where there may be generalizable to the whole range of NMS. The research method used in this study (examining domestic politics variable) could easily be applied to other cases of NMS and other EU member states that have joined the euro area after 2002 or that have not joined the euro area at all.

REFERENCES

Act LVIII of 2001 on the Magyar Nemzeti Bank (MNB)

‘Action Programme of the Czechoslovak Communist Party’ (April 1968), *adopted at the plenary session of the Central Committee of the Communist Party of Czechoslovakia on April 5th 1968*, Prague: Spokesman Pamphlet No. 8.

Aczel, T. (1978), ‘Intellectual Aspect’, in B. K. Kiraly and P. Jonas (eds.), *The Hungarian Revolution of 1956 in Retrospect*, Boulder: Columbia University Press, 25-32.

Adair, B. L. (2003), ‘Interest Articulation in Communist Regimes: The New Economic Mechanism in Hungary, 1962-1980’, *East European Quarterly* 38 (1): 101-126.

Adam, K., T. Jappelli, A. Menichini, M. Padula and M. Pagano (2002), ‘Analyze, Compare and Apply Alternative Indicators and Monitoring Methodologies to Measure the Evolution of Capital Market Integration in the European Union’, *Centre for Studies in Economic and Finance, Department of Economics and Statistics, University of Salerno*, January 28.

‘Akční program Komunistické strany Československa’, *Rudé právo*, Prague, April 10, 1968, 1-6

Adjaouté, K. and J.P. Danthine (2001), ‘Portfolio Diversification: Alive and Well in Euroland!’, *Centre for Economic Policy Research*, Discussion Paper, no. 3086.

Adjaouté, K., L. Bottazzi, J.-P. Danthine, A. Fischer, R. Hamoui, R. Portes, and M. Wickens (2000), ‘EMU and portfolio adjustment’, *CEPR Policy Paper*, No. 5.

- Allam, M. S. and A. Goerres (2008), 'Adopting the Euro in Post-Communist Countries: An Analysis of the Attitudes toward the Single Currency', *Max-Planck Institute for the Study of Societies (MPIFG)*, Discussion paper 08/1.
- Anderson, C. J. (1998), 'When in Doubt, Use Proxies', *Comparative Political Studies* 31 (5): 569-601.
- Andrews, D. (2003), 'The Committee of Central Bank Governors as a Source of Rules', *Journal of European Public Policy* 10 (6): 956-973.
- Angresano, J. (1996), 'Poland After the Shock', *Comparative Economic Studies* 38 (2/3): 87-111.
- Artis, M. J. and W. Zhang (1996), 'Business Cycles, Exchange Rate Regimes and the ERM: Is there a European Business Cycle?', *EUI Working Papers*, RSC No. 96/55.
- Artis, M. J. and W. Zhang (1997a), 'International Business Cycle and the ERM: Is there a European Business Cycle?', *International Journal of Finance and Economics* 2 (1): 1-16.
- Artis, M. J. and W. Zhang (1997b), 'On Identifying the Core of EMU: An Exploration of Some Economic Criteria', *CEPR Working Paper*, No. 1689.
- Ágh, A. (1996), 'Democratic Parliamentarism in Hungary: The First Parliament (1990-94) and the Entry of the Second Parliament', in D. M. Olson and P. Norton (eds.), *The New Parliaments of Central and Eastern Europe*, Portland, Oregon: Frank Cass, 16-39.
- Balassa, B. (1970), 'The Economic Reform in Hungary', *Economica-New Series* 37 (145): 1-22.

- Balcerowicz, L., B. Błaszczyk and M. Dąbrowski (1996), 'The Polish Way to the Market Economy', in W. T. Woo, S. Parker and J. D. Sachs (eds.), *Economies in Transition: Comparing Asia and Eastern Europe*, Cambridge: The MIT Press, 131-160.
- Baldwin, R. E. (1989), 'The Political Economy of Trade Policy', *The Journal of Economic Perspectives* 3 (4): 119-135.
- Bański J. (2002), 'European Union Pre-Accession Aid in the Development of Poland's Rural Areas', *Rozprawy i Monografie Wydziału Ekonomicznego Uniwersytetu Rzeszowskiego*.
- Baring, A. (1972), *Uprising in East Germany*, Ithaca: Cornell University Press.
- Bartlett, D. L. (1997), *The Political Economy of Dual Transformations: Market Reform and Democratization in Hungary*, Ann Arbor-Michigan: The University of Michigan Press.
- Batory, A. (2002), 'The Political Context of EU Accession in Hungary', *The Royal Institute of International Affairs*-briefing paper, UK.
- Baun, M. (2002), 'EU Regional policy and the Candidate States: Poland and the Czech Republic', *Journal of European Integration* 24 (3): 261-280.
- Baun, M.; J. Dürr; D. Marek and P. Šaradin (2006), 'The Europeanization of Czech Politics: The Political Parties and the EU Referendum', *Journal of Common Market Studies* 44 (2): 249-280.
- Bayer, J. (2005), 'The Process of the Change of the Political System in Hungary; Deepening Crisis, Emerging Opposition', *East European Quarterly* 39 (2): 129-147.

- Bayoumi, T. and B. Eichengreen (1993a), 'Is there a Conflict between EC Enlargement and European Monetary Unification?', *Greek Economic Review* 15: 131-154.
- Bayoumi, T. and B. Eichengreen (1993b), 'Shocking Aspects of European Monetary Unification', in F. Torres and F. Giovazzi (eds.), *Growth and Adjustment in the European Monetary Union*, (Center for Economic Policy Research), Cambridge: Cambridge University Press, 193-230.
- Begg, D. (1998), 'Pegging Out: Lessons from the Czech Exchange Rate Crisis', *Journal of Comparative Economics* 26 (4): 669-690.
- Begg, I. (2006), 'Real Convergence and EMU Enlargement: The Time Dimension of Fit with the Euro Area', in K. Dyson (ed.), *Enlarging the Euro Area: External Empowerment and Domestic Transformation in East Central Europe*, Oxford: Oxford University Press, 71-89.
- Belka, M. and S. Krajewski (1995), 'Polish Transformation After 5 Years- Some General Remarks', in M. Belka and H.-G. Petersen (eds.), *Economic Transformation in Poland: Reforms of Institutional Settings and Macroeconomic Performance*, New York: Campus Verlag, 13-24.
- Berend, I. T. (1999), *Central and Eastern Europe, 1944-1993: Detour from the Periphery to the Periphery*, Cambridge: Cambridge University Press.
- Berend, I. T. (2001), 'Post-Stalinist Reforms: Towards a Hungarian Model of State Socialism', in I. T. Berend and T. Csató (eds.), *Evolution of the Hungarian Economy 1848-1998, Volume I-One-and-a-Half Centuries of Semi-Successful Modernization, 1848-1989*, translated by Brian McLean, New York: Columbia University Press.

- Bergman, U. M. (1996), 'Do Monetary Unions Make Sense? Evidence from the Scandinavian Currency Union 1873-1913, *SNS Occasional Paper*, No. 77.
- Bergman, U. M. and M. Hutchison (1998), 'The Costs and Benefits of Joining EMU: Should the Outsiders Stay on the Periphery', *UCSC Dept. of Economics Working Paper No. 392* (January 19, 1998).
- Bergman, U. M., M. Hutchison and Y.-W. Cheung (1997), 'Should the Nordic Countries Join a European Monetary Union? An Empirical Analysis', *EPRU Working Paper Series*, No. 97-21
- Berger, S. (1973), 'The French Political System', in S. H. Beer and A. B. Ulam (eds.), *Patterns of Government*, New York: Random House, third edition, 333-463.
- Békés C. and M. Kalmár (2001), 'The Political Transition in Hungary, 1989-90', *Cold War International History Project Bulletin 12/13—Woodrow Wilson International Center for Scholars*, Washington, D.C.: 73-91.
- Bielasiak, J. (1988), 'Social Confrontation to Contrived Crisis: March 1968 in Poland', *East European Quarterly* 22 (1): 81-105.
- Bloomberg* (December 7, 2010), 'Polish Euro Adoption 'Isn't on Agenda' Amid Debt Crisis, Tusk Adviser Says', online edition.
- Bloomberg* (May 20, 2011), 'East Will See Fewer Benefits From Fast Euro Adoption, Belka Says', online edition.
- Błaszczyc, B. and R. Woodward (1999) (eds.), 'Privatization and Company Restructuring in Poland', *Centre for Social and Economic Research (CASE)*, No. 18, Warsaw.

- Boeri, T. (2005), 'Euro Adoption and the Labor Market', in S. Schadler (ed.), *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, Washington, D. C.: International Monetary Fund (IMF), 91-104.
- Boote, A. R. and J. Somogyi (1991), *Economic Reform in Hungary since 1968*, Washington, D. C.: International Monetary Fund (IMF).
- Borghijis, A. and L. Kuijs (2004), 'Exchange rates in central Europe: A blessing or a curse?', *International Monetary Fund (IMF) Working Papers*, No. 04/2.
- Borkowski, J. (2001), 'Polish Integration Policy in the Context of the European Union's Accession Strategy', *Year Book of Polish European Studies* 5: 29-50.
- Bottazzi, L. and F. Giavazzi (2005), 'The Euro and the European Financial Industry', in S. Schadler (ed.), *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, Washington, D. C.: International Monetary Fund (IMF), 109-124.
- Boycko, M., A. Shleifer and R. W. Vishny (1994), 'Voucher Privatization', *Journal of Financial Economics* 35: 249-266.
- Bönker, F. (2006), *The Political Economy of Fiscal Reform in Central-Eastern Europe: Hungary, Poland and the Czech Republic from 1989 to EU Accession*, Brookfield/Northampton, UK: Elgar.
- Börzel, T. (1999), "Towards Convergence in Europe? Institutional Adaptation to Europeanization in German and Spain", *Journal of Common Market Studies* 37 (4): 573-596.

- Bratkowski, A. (1993), 'The Shock of Transformation or the Transformation of the Shock? The Big Bang in Poland and Official Statistics', *Communist Economics and Economic Transformation* 5 (1): 5-28.
- Bromke, A. (1981), *Poland: The Last Decade*, Ontario-Canada: Mosaic Press.
- Brown, J. F. (1991), *Surge to Freedom: The End of Communist Rule in Eastern Europe*, Durham and London: Duke University Press.
- Brown, J. D., J. S. Earle and A. Telegdy (2005), 'The Productivity Effects of Privatization: Longitudinal Estimates from Hungary, Romania, Russia, and Ukraine', *Upjohn Institute Staff Working Paper* 05-121.
- Bruszt, L. (1990), '1989: The Negotiated Revolution in Hungary', *Social Research* 57 (2): 365-387.
- Bryant, C. G. A. (1994), 'Economic Utopianism and Sociological Realism: Strategies for Transformation in East-Central Europe', in C. Bryant and E. Mokrzycki (eds.), *The New Great Transformation? Change and Continuity in East-Central Europe*, New York: Routledge, 58-77.
- Buch, R. and K. M. Hansen (2002), 'The Danes and Europe: From EC 1972 to Euro 2000—Elections, Referendums and Attitudes', *Scandinavian Political Studies* 25 (1): 1-26.
- Bulmer, S. (1983), 'Domestic Politics and European Community Policy-Making', *Journal of Common Market Studies* 21 (4): 349-363.
- Bulmer, S. J. (1998), 'New institutionalism and the governance of the Single European Market', *Journal of European Public Policy* 5 (3): 365-386.

- Buiter, W. H. (2000a), 'Optimal currency areas: why does the exchange rate regime matter?—With an application to UK membership in EMU', *Centre for Economic Performance—CEPDP 462*, London School of Economics and Political Science, London, UK.
- Buiter, W. H. (2000b), 'Optimal Currency Areas: Scottish Economic Society/Royal Bank of Scotland Annual lecture, 1999', *Scottish Journal of Political Economy*, 47 (3): 213-250.
- Buiter, W. and A. Sibert (2006), 'Beauties and the beast. When will the new EU members from central and eastern Europe join the euro zone?', mimeo.
- Buras, P. (2005), 'Polish social democracy, policy transfer and programmatic change', *Journal of Communist Studies and Transition Politics* 21 (1): 84-104.
- Buss, T. F. (2000), 'Economic Development in Hungary: The Transition Years—1989 to 1998', *International Journal of Economic Development* 2 (1): 12-34.
- Buti, M. (2003), 'Interactions and Coordination between Monetary and Fiscal Policies in EMU: What are the Issues?', in M. Buti (ed.), *Monetary and Fiscal Policies in EMU: Interactions and Coordination*, Cambridge: Cambridge University Press, 1-25.
- Campbell, J. C. (1984), 'Soviet Policy in Eastern Europe: An Overview', in S. M. Terry (ed.), *Soviet Policy in Eastern Europe*, New Haven: Yale University Press, 1-32.
- Canning, A. and P. Hare (1996), 'Political Economy of Privatization in Hungary: A Progress Report', *Centre for Economic Reform and Transformation (CERT)*, Edinburgh, UK.

- Carey, S. (2002), 'Undivided Loyalties: Is National identity an Obstacle to European Integration?', *European Union Politics* 3 (4): 387-413.
- Cass, F. (2007), 'Attracting FDI to transition countries: the use of incentives and promotion agencies', *Transnational Corporations* 16 (2): 77-122.
- Chase-Dunn, C. (1992), 'The National State as Agent of Modernity', *Problems of Communism* 41: 29-37.
- Cērps, U. (2005), 'Comments on "The Euro and the European Financial Industry"', in S. Schadler (ed.), *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, Washington, D. C.: International Monetary Fund (IMF), 125-127.
- Connor, W. D. (1997), 'Social Policy under Communism', in E. B. Kapstein and M. Mandelbaum (eds.), *Sustaining the Transition: The Social Safety Net in Postcommunist Europe*, New York: Council on Foreign Relations-Brookings Institution Press, 10-45.
- Constitution of the Czech Republic of December 16, 1992. Checked online on February 27, 2011. Available at: <http://www.hrad.cz/en/czech-republic/constitution-of-the-cr.shtml>
- Corbin, J. and Strauss, A. (1990), 'Grounded Theory Research: Procedures, Canons and Evaluative Criteria', *Zeitschrift für Soziologie* 19 (6): 418-427.
- Corsetti, G. (2008), 'A Modern Reconsideration of the Theory of Optimal Currency Areas', *EUI Working Papers European University Institute: Department of Economics*, ECO 2008/12.
- Csaba, L. (1990), *Eastern Europe in the World Economy*, Cambridge: Cambridge University Press.

- Csaba, L. (1992), 'Macroeconomic Policy in Hungary: Poetry versus Reality', *Soviet Studies* 44 (6): 947-964.
- Csergo, Z. (2008), 'Ethnicity, Nationalism, and the Expansion of Democracy', in S. L. Wolchik and J. L. Curry (eds.), *Central and East European Politics: From Communism to Democracy*, Plymouth, UK: Rowman and Littlefield Publishers, 87-111.
- Cukierman, A. (1992), *Central Bank Strategy, Credibility and Autonomy*, Cambridge: MIT Press.
- Curie, D. (1997), 'The Pros and Cons of EMU', *HM Treasury*, UK. (This paper is an updated summary of a report published by *the Economist Intelligence Unit* in February 1997). Accessed online on June 30, 2008. Available at: <http://www.hm-treasury.gov.uk/media/2/9/emupc.pdf>
- Curry, J. L. (2008), 'Poland: The Politics of "God's Playground"', in S. L. Wolchik and J. L. Curry (eds.), *Central and East European Politics: From Communism to Democracy*, Plymouth, UK: Rowman and Littlefield Publishers, 165-189.
- Czech Ministry of Finance (2011), 'Economic Policy'. Checked online on March 7, 2011. Available at: http://www.mfcr.cz/cps/rde/xbcr/mfcr/KoPrEN_201001_1_pdf.pdf
- Czech Ministry of Finance and Czech National Bank (2010), *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*, A joint document of the Ministry of Finance of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on 22nd of December 2010.

Czech National Bank (November 28, 2006), *President Appoints New Bank Board*

Members Today. Checked online on March 3, 2009, Available at:

http://www.cnb.cz/en/public/media_service/press_releases_cnb/2006/061128_jmenovani_clenu_br.html

Czech National Bank (March 8, 2007), 'The CNB's new inflation target and changes in monetary policy communication'. Checked online on February 2, 2011. Available at:

http://www.cnb.cz/miranda2/export/sites/www.cnb.cz/en/monetary_policy/strategic_documents/download/inflacni_cil_cnb_en_2010.pdf

Czech National Bank (2008), 'Assessment of the Fulfilment of the Maastricht

Convergence Criteria and the Degree of Economic Alignment of the Czech

Republic with the Euro Area: A joint document of the Ministry of Finance of the

Czech Republic and the Czech National Bank approved by the Government of the

Czech Republic on 16 December 2008'. Checked online on March 20, 2009.

Available at:

http://www.cnb.cz/m2export/sites/www.cnb.cz/en/monetary_policy/strategic_documents/download/maastricht_assessment_2008.pdf

Czech National Bank (2009), *Central Bank Independence*. Checked on March 2, 2009.

Available at: http://www.cnb.cz/en/faq/faq_mp/cb_independence.html

Czech Republic: Ministry of Finance (2009), Medium-term fiscal outlook. Checked

online on October 2, 2009. Available at:

http://mfcr.cz/cps/rde/xbcr/mfcr/FiskalniVyhledEN_2009Q1_3_pdf.pdf

Czech Statistical Office (ČSÚ), 2009, 2010, 2011.

- Dadak, K. and A. Bryk (1985), 'The Self-Governing Republic: A Critical Review of the Major Reforms Proposed by Solidarity', *Review of Socialist Law* 11: 345-367.
- Dahl, R. A. (1971), *Polyarchy: Participation and Opposition*, New Haven, CT: Yale University Press.
- Darvas, Z. (October 29, 2008), 'The Rise and Fall of Hungary', *The Guardian*.
- Darvas, Z. and G. Szapáry (2008), 'Euro Area Enlargement and Euro Adoption Strategies', *European Economy – Economic Papers*, 304, Economic and Financial Affairs DG, European Commission.
- Davies, N. (1984), *Heart of Europe: A Short History of Poland*, New York: Oxford University Press.
- Davies, N. (2005), *God's Playground: A History of Poland*, Vol. II, Oxford: Oxford University Press.
- Dean, J. W. (2004), 'Adopting the euro: Dilemmas and tradeoffs facing EU accession countries', *Journal of Policy Modeling*, 26 (7): 759-767.
- De Grauwe, P. (1997), *The Economics of Monetary Integration*, Oxford: Oxford University Press, third revised edition.
- De Grauwe, P. (2006a), 'What Have We Learnt About Monetary Integration Since the Maastricht Treaty?', *Journal of Common Market Studies* 44 (4):711–730.
- De Grauwe, P. (2006b), *Economics of Monetary Union*, Oxford: Oxford University Press, sixth edition.
- De Grauwe, P. and G. Schnabl, (2004), 'Exchange Rate Regime and Macroeconomic Stability in Central and Eastern Europe', *CESifo Working Paper*, 1182.

De Grauwe, P. and F. Mongelli (2005), 'Endogeneities of optimum currency areas: What brings countries sharing a single currency closer together?', *ECB Working Papers*, No. 468.

Della Porta, D. (2008), 'Comparative analysis: case-oriented versus variable-oriented research', in D. Della Porta and M. Keating (eds.), *Approaches and Methodologies in the Social Sciences: A Pluralist Perspective*, Cambridge: Cambridge University Press, 198-222.

Deutsche Welle (January 13, 2007), 'The Euro is Coming to Poland—But When?'

Checked online on June 11, 2009. Available at: <http://www.dw-world.de/dw/article/0,2144,2308170,00.html>

Dexter, L. A. (1964), 'The Good Will of Important People: More on the Jeopardy of the Interview', *Public Opinion Quarterly* 28 (4): 556-563.

Dexter, L. A. (1970), *Elite and Specialized Interviewing*, Evanston, Illinois: Northwestern University Press.

Die Zeit (2003), 'Der EU-Beitritt ist nicht unser Traum'-Europa als Bedrohung der Demokratie: Ein ZEIT-Gespräch mit dem tschechischen Präsidenten Václav Klaus', 17. Checked online on January 30, 2011. Available at:

http://www.zeit.de/2003/17/V_Klaus?page=all

DiMaggio, P. J. and W. W. Powell (1991), 'Introduction', in W. W. Powell and P. J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*, Chicago: University of Chicago Press, 1-38.

- Dlouhý, V. (2001), 'The Czech Republic: Ten Years of Transition', in M. I. Blejer and M. Škreb (eds.), *Transition: The First Decade*, Cambridge-Massachusetts: MIT Press, 175-191.
- 'Document II: The Action Program of the Communist Party of Czechoslovakia' in P. Ello (ed.), *Czechoslovakia's Blueprint for "Freedom": Dubček's Statements-The Original and Official Documents Leading to the Conflict of August, 1968*, Washington, D. C.: Acropolis, 89-178.
- Domarańczyk, Z. (1990), *100 dni Mazowieckiego*, Warsaw: Wydawnictwo Andrzej Bonarski.
- Dyba, K. and J. Svejnar (1991), 'Czechoslovakia: Recent Economic Developments and Prospects', *The American Economic Review* 81 (2): 185-190.
- Dyson, K. (ed.) (2006), *Enlarging the Euro Area: External Empowerment and Domestic Transformation in East Central Europe*, Oxford: Oxford University Press.
- Dyson, K. (ed.) (2008), *The Euro at 10: Europeanization, Power and Convergence*, Oxford: Oxford University Press.
- Dyson, K. and K. Featherstone (1999), *The Road to Maastricht: Negotiating Economic and Monetary Union*, Oxford: Oxford University Press.
- Dyson, K. and M. Marcussen (eds.) (2009), *Central Banks in the Age of the Euro: Europeanization, Convergence, and Power*, Oxford: Oxford University Press.
- Dyson, K.; K. Featherstone and G. Michalopoulos (1995), 'Strapped to the Mast: EC Central Bankers between Global Financial Markets and Regional Integration', *Journal of European Public Policy* 2 (3): 465-487.

- Dziewanowski, M. K. (1977), *Poland in the Twentieth Century*, New York: Columbia University Press.
- Economic Intelligence Unit (EIU) (1997), *Hungary: Country Profile, 1997-1998*, London.
- Economic Intelligence Unit (EIU) (2005), *Czech Republic Economy: Tuma Reappointed as Central Bank Governor*. London.
- Economic Intelligence Unit (EIU) (2008), *Hungary: Country Profile*, London.
- Economic Intelligence Unit (EIU) (2011), *Country Report: Czech Republic*, London, February.
- Eichengreen, B. (1992), *Should the Maastricht Treaty be Saved?*, Princeton Studies in International Finance No. 74: Department of Economics, Princeton University (December).
- Eichengreen, B. (1997), *European Monetary Unification: Theory, Practice, and Analysis*, Cambridge, Massachusetts: The MIT Press.
- Eichengreen, B. (2003), 'The accession economies' rocky road to the euro', *Political Economy of International Finance, Institute of European Studies, UC Berkeley, Working Paper PEIF-13*, November 2003.
- Eichengreen, B. (2012), 'European Monetary Integration with Benefit of Hindsight', *Journal of Common Market Studies* 50 (S1): 123-136.
- Eichengreen, B. and F. Ghironi (2001), 'EMU and Enlargement', *Boston College Working Papers in Economics*. Paper prepared for a conference on Economic and Monetary Union organized by DG EcFin of the European Commission, Brussels, March 21-22, 2001. Accessed online on June 30, 2008. Available at:

http://escholarship.bc.edu/cgi/viewcontent.cgi?article=1143&context=econ_paper

s

Eichengreen, B. and K. Steiner (2008), 'Is Poland at Risk of a Boom-and-Bust Cycle in the Run-up to Euro Adoption?', *National Bureau of Economic Research (NBER) Working Paper Series* 14438, Cambridge, MA, October.

Eijffinger, S.C.W, and de Haan, J. (1996), "The Political Economy of Central-Bank Independence", *Princeton Studies in International Economics* 19, International Economics Section, Department of Economics Princeton University.

Ekiert, G. (1996), *The State against Society: Political Crises and their Aftermath in East Central Europe*, Princeton-New Jersey: Princeton University Press.

Ekiert, G. (1997), 'Rebellious Poles: Political Crises and Popular Protest Under State Socialism, 1945-89', *East European Politics and Societies* 11 (2): 299-338.

Ekiert, G. (2003), 'Patterns of Postcommunist Transformation in Central and Eastern Europe', in G. Ekiert and S. E. Hanson (eds.), *Capitalism and Democracy in Central and Eastern Europe: Assessing the Legacy of Communist Rule*, Cambridge: Cambridge University Press, 89-119.

Elster, J., C. Offe and U. K. Preuß (1998), *Institutional Design in Post-Communist Societies: Rebuilding the Ship at Sea*, Cambridge: Cambridge University press.

Endre, S. (2004), 'The Political and Economic Transition in Hungary', in R. Blocksome, N. Szabolcs and P. Šajda (eds.), *Medi(t)ations, (Re)conciliations: Conflict Resolution and European Integration*, Ecumenial Anthology III, BGÖI and WSCF-CESR, Bratislava, 85-90.

- Epstein, R. (2005), 'Diverging Effects of Social Learning and External Incentives in Polish Central Banking and Agriculture', in F. Schimmelfennig and U. Sedelmeier (eds.), *The Europeanization of Central and Eastern Europe*, Ithaca, NY: Cornell University Press, 178-198.
- Epstein, R. A. (2006), 'Cultivating Consensus and Creating Conflict: International Institutions and the (De)Politicization of Economic Policy in Post Communist Europe', *Comparative Political Studies* 39: 1019-1042.
- Epstein, R. and J. Johnson (2009), 'Czech Republic and Poland: The Limits of Europeanization', in K. Dyson and M. Marcussen (eds.), *Central Banks in the Age of the Euro: Europeanization, Convergence, and Power*, Oxford: Oxford University Press, 221-240.
- Epstein, R. and J. Johnson (2010), 'Uneven Integration: Economic and Monetary Union in Central and Eastern Europe', *Journal of Common Market Studies* 48 (5): 1237-1260.
- Epstein, R. A. and U. Sedelmeier (2008), 'Beyond Conditionality: International Institutions in Postcommunist Europe after Enlargement', *Journal of European Public Policy* 15 (6): 795-805.
- ERSTE (2008), *Euro Adoption in CEE: Special Report*. May 2008. Checked online on March 2, 2009. Available at:
http://www.slsp.sk/downloads/EN_Specialny_komentar/2008/20080508_special_report_euro_svk.pdf
- Eudey, G. (1998), 'Why Is Europe Forming A Monetary Union', *Federal Reserve Bank of Philadelphia Business Review* (November/December): 13-21.

EUbusiness (September 13, 2010), ‘Hungary ‘had to introduce bank tax’’.

EUobserver (October 13, 2008), ‘Crisis will delay Czech Euro Adoption, Says Bank Chief’.

EUobserver (October 29, 2008), ‘Record rescue package for battered Hungarian economy’.

EUobserver (March 24, 2009), ‘Czech Government Falls, Putting EU Presidency at Risk’.

EUobserver (September 18, 2009), ‘Sarkozy Warns Czech President on EU Treaty’.

EUobserver (September 15, 2011), ‘Latvia Aiming to Join Eurozone in 2014’.

Euractiv (April 21, 2005), ‘The race for the euro: Hungary running out of steam?’.

Euractiv (February 22, 2007), ‘Hungary plans euro adoption road map’.

European Central Bank (ECB) (2004), ‘Convergence Report’, Frankfurt, May.

European Central Bank (ECB) (2006), ‘Convergence Report’, Frankfurt, May.

European Central Bank (ECB) (2008), ‘Convergence Report’, Frankfurt, May.

European Central Bank (ECB) (2009), *Long-term interest rate statistics for EU Member States*, Frankfurt.

European Central Bank (ECB) (May 2010), ‘Convergence Report’, Frankfurt.

European Commission (2002), Report from the Commission of 22 May 2002: Convergence report 2002 Sweden, COM (2002) 243.

European Commission (2004), Convergence Report, Brussels.

European Commission (2005), ‘Introduction of the Euro in the New Member States-Wave 2’, Brussels.

- European Commission (2006), 'September 2006 Adjusted Update of the Convergence Programme of Hungary (2005-2009)—An Assessment', ECFIN/55812/06-EN, Brussels.
- European Commission (2008a), 'Introduction of the Euro in the New Member States: Analytical Report', *Eurobarometer*, Brussels.
- European Commission (2008b), *Convergence Report*, Brussels.
- European Commission (2008c), 'EMU@10: Successes and Challenges After 10 Years of Economic and Monetary Union', *European Economy* 2, Directorate-General for Economic and Financial Affairs.
- European Commission (2009a), *EU interim forecasts for 2009-2010: sharp downturn in growth*, Brussels.
- European Commission (2009b), 'Introduction of the Euro in the New Member States: Analytical Report', *Eurobarometer*, Brussels.
- European Commission (2010a), 'Convergence Report', Brussels.
- European Commission (2010b), 'Introduction of the Euro in the New Member States: Analytical Report', *Eurobarometer*, Brussels.
- European Council (1993), *Presidency Conclusions, Copenhagen European Council*, June 21-22, 1993.
- European Council (1995), *Conclusions of the Madrid European Council*, December 15-16, 1995.
- Eurostat Data-set. Available at:
<http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/>

- Eurostat Press Release (2010), Provision of deficit and debt data for 2009 - Second notification Euro area and EU27 government deficit at 6.3% and 6.8% of GDP respectively-Government debt at 79.2% and 74.0%, No. 170/2010, November 15.
- Faruqee, H. (2004), 'Measuring the Trade Effects of the Euro', *International Monetary Fund (IMF) Occasional Papers*, No. 04/154, Washington, D. C.
- Fazekas, K. (2004), 'Low Participation and Regional Inequalities – Interrelated Features of the Hungarian Labor Market, Case Study', paper presented at the conference *Demographic Changes and Labor Markets in Transition Economies*, organized by the Institute of Economic Research (IER), Hitotsubashi University, Tokyo, 20–21 February.
- Featherstone, K. (2003), "Introduction: In the Name of 'Europe'", in K. Featherstone and C. Radaelli (eds.), *The Politics of Europeanization*, Oxford: Oxford University Press, 3-26.
- Feldstein, M. (2010), 'Let Greece take a eurozone 'holiday'', *Financial Times*, February 16.
- Feldmann, M. (2008), 'Baltic States: When Stability Culture is not Enough', in K. Dyson (ed.), *The Euro at 10: Europeanization, Power and Convergence*, Oxford: Oxford University Press, 243-257.
- Feldstein, M. (March 2011), 'Vaclav Klaus and the Euro', Cambridge, Massachusetts. Checked online on December 6, 2011. Available at:
<http://www.nber.org/feldstein/essaysinhonorofVaclavKlaus.pdf>
- Financial Times* (September 10, 2008), 'Poland's first step to reform'.
- Financial Times* (September 11, 2008), 'Poland aims to join euro by 2011'.

Financial Times (September 29, 2008), ‘Tusk gambles on euro to boost premiership’,
online edition.

Financial Times (October 28, 2008a), ‘Hungary gets \$25.1bn rescue package’.

Financial Times (October 28, 2008b), ‘Warsaw to speed euro adoption’, online edition.

Financial Times (October 29, 2008), ‘Hungary rescue a bid to contain crisis’, online
edition.

Financial Times (March 25, 2009), ‘Czech MPs Oust Government over Economic
Crisis’.

Financial Times (April 23, 2010), ‘Greek deficit sparks further euro losses’.

Forder, J. (1998), “Central Bank Independence – Conceptual Clarifications and Interim
Assessment”, *Oxford Economic Papers* 50 (3): 307-334.

Fowler, B. (2004) ‘Hungary: Unpicking the Permissive Consensus’, *West European
Politics* 27 (4): 624-651.

Frankel, J. (2005), ‘Real Convergence and Euro Adoption in Central and Eastern Europe:
Trade and Business Cycle Correlations as Endogenous Criteria for Joining the
EMU’, in S. Schadler (ed.), *Euro Adoption in Central and Eastern Europe:
Opportunities and Challenges*, Washington, D. C.: International Monetary Fund
(IMF), 9-21.

Frankel, J. and Rose, A. (1998) ‘The Endogeneity of the Optimum Currency Area
Criteria’, *Economic Journal*, Vol. 108, 1009–1025.

Frankel, J. and A. Rose (2002), ‘An Estimate of The Effect Of Common Currencies On
Trade And Income’, *The Quarterly Journal of Economics* (MIT Press) 117 (2):
437-466.

- Friedman, M. (1953), *Essays in Positive Economics*, Chicago, IL: University of Chicago Press.
- Galgóczi, B. (2001), 'Twelve Years of Privatization in Hungary-Drawing up a Balance Sheet', *South-East Europe Review (Special Issue)*, 45-54.
- Gallup Europe (2007), 'Heading to the Euro-Zone, Hopes and Fears about the Euro in the New Member States'. http://ec.europa.eu/public_opinion/flash/fl183-en.pdf
- Garton Ash, T. (1983), *The Polish Revolution: Solidarity 1980-82*, London: The Trinity Press.
- Gati, C. (2006), *Failed Illusions: Moscow, Washington, Budapest, and the 1956 Hungarian Revolt*, Stanford: Stanford University Press.
- Gazeta Wyborcza* (August 29, 2011), 'Rostowski: Albo solidarność, albo rozpad Europy'—(Solidarity or the breakup of Europe), (online edition) Warszawa, Polska.
- Gács, J. (2000), 'Macroeconomic Developments in Hungary and the Accession Process', *International Institute for Applied Systems Analysis (IIASA)*, Interim Report IR-00-013, Laxenburg: Austria.
- Geddes, B. (1990), 'How the Cases You Choose Affect the Answers You Get: Selection Bias in Comparative Politics.' *Political Analysis* 2:131-150.
- Geršl, A. (2006), 'Political pressure on Central Banks: The Case of the Czech National Bank', *Finance a úvěr—Czech Journal of Economics and Finance* 56 (1-2): 18-39.
- Giario, T. (2006), 'Modernisierung durch Transfer-Schwund osteuropäischer Rechtstraditionen', in T. Giario (ed.), *Modernisierung durch Transfer im 19 und*

frühen 20 Jahrhundert, Rechtskulturen des modernen Osteuropa, Traditionen und Transfers, vol. 1, Frankfurt, 275-332.

Goertz, G. (1995), *Contexts of International Politics*, Cambridge: Cambridge University Press.

Goldman, M. F. (1997), *Revolution and Change in Central and Eastern Europe: Political, Economic and Social Challenges*, New York: M. E. Sharpe.

Gomulka, S. (1995), 'The IMF-Supported Programs of Poland and Russia, 1990-1994: Principles, Errors, and Results', *Journal of Comparative Economics* 20 (3): 316-346.

Government of the Republic of Hungary (2011), 'Convergence Programme of Hungary 2011-2015—Based on the Széll Kálmán Plan', Budapest, Hungary, April 2011.

Górzyński, M., K. Stanchev, G. Stoev, J. Pańków, M. Walewski and A. Yonkova (2000), *Fiscal Effects from Privatization: Case of Bulgaria and Poland*, (Edited by J. Pańków), Centre for Social and Economic Research (CASE), No. 37, Warsaw-Sofia.

Granick, D. (1973), 'The Hungarian Economic Reform', *World Politics* 25 (3): 414-429.

Greenberger, R. (February 11, 1992), 'U.S., Allies may be Asked to Back Ruble', *The Wall Street Journal*, A2.

Greskovits, B. (2006), 'The First shall be the Last? Hungary's Road to EMU', in K. Dyson (ed.), *Enlarging the Euro Area: External Empowerment and Domestic Transformation in East Central Europe*, Oxford: Oxford University Press, 178-196.

- Greskovits, B. (2008), 'Hungary and Slovakia: Compliance and its Discontent', in K. Dyson (ed.), *The Euro at 10: Europeanization, Power and Convergence*, Oxford: Oxford University Press, 274-291.
- Greskovits, B. (2009), 'Estonia, Hungary, and Slovenia: Banking on Identity', in K. Dyson and M. Marcussen (eds.), *Central Banks in the Age of the Euro: Europeanization, Convergence, and Power*, Oxford: Oxford University Press, 203-220.
- Gros, D. and A. Hobza (2003), 'Exchange rate variability as an OCA criterion: Are the candidates ripe for the euro?', *ICEG Working Papers*, No. 23.
- Gros, D. and N. Thygesen (1998), *European Monetary Integration. From the European Monetary System to European Monetary Union* (2nd Edition), London: Longman.
- Grosfeld, I. and P. G. Hare (1991), 'Privatization in Hungary, Poland and Czechoslovakia', *Centre for Economic Policy Research (ECPR)*, Discussion Paper Series No. 544, London: UK.
- Grzymała-Busse, A. M. (2002), *Redeeming the Communist Past: The Regeneration of Communist Parties in East Central Europe*, Cambridge: Cambridge University Press.
- Hall, P. A. (1993), 'Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain', *Comparative Politics* 25 (3): 275-296.
- Hall, P. A. and R. C. R. Taylor (1996), 'Political Science and the Three New Institutionalisms', *Political Studies* 44 (5): 936-957.
- Hallerberg, M. (2004a) *Domestic Budgets in a United Europe*, Ithaca: Cornell University Press.

- Hallerberg, M. (2004b), 'Don't Touch It', *Finance and Development* 41 (2): 28.
- Hallerberg, M. and von Hagen, J. (2006), 'Budget Process in Poland: Promoting Fiscal and Economic Stability', Report prepared for the Ernst & Young Better Government Program in Poland, Warsaw.
- Handelsblatt* (2010), Interview by Stefan Menzel with the CNB Governor Miroslav Singer (in German) on September 15, 2010, 'Es gibt derzeit keine Aussichten auf die Euro-Mitgliedschaft', p. 53. Checked online on October 5, 2010. Available at the CNB Website at: http://www.cnb.cz/en/public/media_service/interviews/
- Hanley, S. (2002), 'Party Institutionalisation and Centre-Right Euroscepticism in East Central Europe: the Case of the Civic Democratic Party in the Czech Republic', *Paper prepared for presentation at the 29th ECPR Joint Sessions of Workshops*, Turin, 22-27 March 2002.
- Hanley, S. (2003), 'Referendum Briefing No 6: The Czech EU Accession Referendum 13-14 June 2003', *Opposing Europe Research Network (OERN)*, Sussex European Institute-UK.
- Hanley, S. (2004), 'A Nation of Sceptics? The Czech EU Accession Referendum of 13-14 June 2003', *West European Politics* 27 (4): 691-715.
- Harper, G. D. (1999), 'Restitution of Property in Cuba: Lessons Learned from East Europe', *ASCE* 19: 409-424.
- Hausner, J. (1995), 'Dilemmas of the Economic Strategy', unpublished manuscript prepared for the Polish Deputy Prime Minister for Economic Affairs.
- Heipertz, M. and A. Verdun (2010), *Ruling Europe: Politics and Theory of the Stability and Growth Pact*, Cambridge: Cambridge University Press.

- Henerson, M. E., L. L. Morris and C. T. Fitz-Gibbon (1987), *How to Measure Attitudes*, California, London and New Delhi: Sage Publications.
- Higley, J. and G. Lengyel (2000), *Elites after state socialism: Theories and Analysis*, Lanham.
- Hooghe, L. and G. Marks (2005), 'Calculations, Community and Cues: Public Opinion on European Integration', *European Union Politics* 6 (44): 419-443.
- Horvath, J. (2009), 'Global Financial Crisis: Implications for the Hungarian and the Slovak Economy', in A. Dandashly, A. Surdej and H. T. Własczuzuk (eds.), *Global Financial Crisis and Euro Zone Enlargement*, Krakow, Poland: Adam Marszalek Publishing House, 47-59.
- Hosli, M. O. (2005), *The Euro: A Concise Introduction to European Monetary Integration*, Boulder and London: Lynne Rienner.
- Howard, M. M. (2003), *The Weakness of Civil Society in Post-Communist Europe*, Cambridge: Cambridge University Press.
- Huelshoff, M. G. (1994), 'Domestic Politics and Dynamic Issue Linkages—A Reformulation of Integration Theory', *International Studies Quarterly* 38 (2): 255-279.
- Hunter, R. J. and L. V. Ryan (2009), 'Poland, the European Union, and the Euro: Poland's Long Journey to Full European Integration', *Global Economy Journal* 9 (2): 1-18.
- Illner, M. (1999), 'Territorial Decentralization: An Obstacle to Democratic Reform in Central and Eastern Europe?', in J. Kimball (ed.), *The Transfers of Power:*

- Decentralization in Central and Eastern Europe*, Budapest: The Local Government and Public Service Reform Initiative, 7-42.
- Immergut, E. M. and K. M. Anderson (2008), 'Historical Institutionalism and West European Politics', *West European Politics* 31 (1-2): 345-369.
- Inglot, T. (1996), 'Historical Legacies, Institutions, and the Politics of Social Policy in Hungary and Poland, 1989-1999', in G. Ekiert (ed.), *The State against Society: Political Crises and their Aftermath in East Central Europe*, Princeton-New Jersey: Princeton University Press, 210-247.
- Ingram, J. (1973), *The Case for European Monetary Integration*, Princeton Essays in International Finance 98, Princeton: Princeton University-International Finance Section.
- Irish Times* (October 29, 2008), 'Poland Unveils Plan to adopt Euro as its Currency by 2012'.
- Jacoby, W. and P. Cernoch (2002), 'The Pivotal EU Role in the Creation of Czech Regional Policy', in R. H. Linden (ed.), *Norms and Nannies: The Impact of International Organizations on the Central and East European States*, Lanham-Maryland: Rowman and Littlefield, 317-340.
- Janáček, K. and S. Janáčková (2004), 'European Monetary Union and Risks for Real Convergence', *Politická ekonomie* 52 (4): 435-449.
- Jankovics, L. (2003), 'Roadmap for the Adoption of the Euro in Hungary: Dangers and Opportunities', paper presented at the Conference on *Institutional and Policy Diversity—Its Role in Economic Development*, Debrecen-Hungary, November 3-5, 2003.

- Jankovics, L. (February 22, 2008), 'Public finance reform in Hungary: light at the end of the tunnel?', *Economic analysis from the European Commission's Directorate-General for Economic and Financial Affairs—Ecfm Country Focus* 5 (4): 1-6.
- Jeffries, I. (2002), *Eastern Europe at the Turn of the Twenty-first Century: A guide to the Economies in Transition*, London and New York: Routledge.
- Johnson, J. (2002), 'Financial Globalization and National Sovereignty: Neoliberal Transformations in Post-Communist Central Banks', paper presented at the American Political Science Association annual Meeting, Boston.
- Johnson, J. (2003), 'Agents of Transformation: The Role of the West in Post-Communist Central Bank Development', *The National Council for Eurasian and East European Research (NCEEER)*, Title VIII Program, Chicago: Loyola University, 1-33.
- Johnson, J. (2006), 'Two-Track Diffusion and Central Bank Embeddedness: The Politics of Euro Adoption in Hungary and the Czech Republic', *Review of International Political Economy* 13 (3): 361-386.
- Johnson, J. (2008), 'The Remains of Conditionality: The Faltering Enlargement of the Euro Zone', *Journal of European Public Policy* 15 (6): 826-842.
- Jones, E. (2002), *The Politics of Economic and Monetary Union: Integration and Idiosyncrasy*, Rowman and Littlefield publishers.
- Jones, E. (2003), 'Liberalized Capital Markets, State Autonomy, and European Monetary Union', *European Journal of Political Research* 42 (2): 197-222.
- Jones, E.; J. Frieden and F. Torres (eds.) (1998), *Joining Europe's Monetary Club: The Challenges for Smaller Member States*, New York: St. Martin's Press.

- Kaelberer, M. (2003) 'Knowledge, power and monetary bargaining: central bankers and the creation of monetary union in Europe', *Journal of European Public Policy* 10 (3): 365-379.
- Kaminska, J. (2007), 'New EU members and the CFSP: Europeanization of the Polish Foreign policy', *Political Perspectives EPRU* 2 (2): 1-24.
- Kaplan, K. (1987), *The Short march: The Communist Takeover in Czechoslovakia 1945-1948*, London: C. Hurst and Company.
- Kaplan, K. (1989), 'Czechoslovakia's February 1948', in N. Stone and E. Strouhal (eds.), *Czechoslovakia: Crossroads and Crises, 1918-88*, New York: St. Martin's Press, 147-168.
- Karpinski, J. (1982), *Count-Down*, New York: Karz-Cohl.
- Katzenstein, P. (1977), 'Domestic and International Forces and Strategies of Foreign Economic Policy', *International Organization* 31 (4): 587-606.
- Kenen, P. B. (1969), 'The Theory of Optimum Currency Areas: an Eclectic View', in R. Mundell and A. Swoboda (eds.), *Monetary Problems of the International Economy*. Chicago: University of Chicago Press, 41-60.
- Kenney, P. (2002), *A Carnival of Revolution: Central Europe 1989*, Princeton: Princeton University Press.
- King, G., R. O. Keohane, S. and Verba (1994), *Designing Social Inquiry: Scientific Inference in Qualitative Research*, Princeton, NJ: Princeton University Press.
- Kingdon, J. W. (1995), *Agendas, Alternatives, and Public Policy* (2nd edition), New York: HarperCollins College Publishers.

- Kis, J. (János) (1991), 'Postcommunist Politics in Hungary', *Journal of Democracy* 2 (3): 3-15.
- Kiss, J. (Judit) (1994), 'Debt Management in Eastern Europe', *Eastern European Economics* 32 (3): 52-75.
- Klaus, V. (2003), *The Future of Euro: A View of A Concerned Outsider*, Prague. Checked online on February 13, 2011. Available at: <http://www.klaus.cz/clanky/439>
- Klaus, V. (2006), 'The Economic Transformation of the Czech Republic: Challenges Faced and Lessons Learned', *Economic Development Bulletin* 6. Checked online on February 21, 2011. Available at: <http://www.cato.org/pubs/edb/edb6.pdf>
- Kochanowicz, J., P. Kozarzewski and R. Woodward (2005), 'Understanding Reform: The Case of Poland', *Center for Social and Economic Research-CASE Reports*, Warsaw-Poland.
- Kolodko, G. W. (2000), *Post-Communist Transition: The Thorny Road*, Rochester-NY: University of Rochester Press.
- Komárek, V. (1990), 'Prognóza a Program', *Academia*, Praha.
- Kondratowicz, A. and M. Okolski (1993), 'The Polish Economy on the Eve of the Solidarity Take-over', in H. Kierzkowski, M. Okolski and S. Wellisz (eds.), *Stabilization and Structural Adjustment in Poland*, New York: Routledge, 7-28.
- Král, D. (2010), 'The Czech 2010 Elections: Beginning of a New Political Era?', *European Policies Initiative*, Policy Brief 22, June.
- Krugman, P. (September 11, 2011), 'An Impeccable Disaster', *The New York Times* (online edition).

- Laca, P. (2010), 'Janacek Made Newest Euroskeptic Czech Central Banker', *Bloomberg Businessweek* (June 29, 2010).
- Ladrech, R. (1994) 'Europeanization of Domestic Politics and Institutions: the Case of France', *Journal of Common Market Studies* 32 (1): 69–88.
- Landman, T. (2003), *Issues and Methods in Comparative Politics-An Introduction*, (2nd Edition) London and New York: Routledge.
- LaPlant, J. T.; M. Baun; J. Lach and D. Marek (2004), 'Decentralization in the Czech Republic: The European Union, Political Parties, and the Creation of Regional Assemblies', *Publius: The Journal of Federalism* 34 (1): 35-51.
- Lepak, K. J. (1988), *Prelude to Solidarity: Poland and the Politics of the Gierek Regime*, New York: Columbia University Press.
- Lijphart, A. (1971), 'Comparative Politics and the Comparative Method', *American Political Science Review*, 65 (3): 682-693.
- Linghal, R. and D. Naurin (2005), 'Sweden: The Twin Faces of a Euro-Outsider', *European Integration* 27 (1): 65-87.
- Lipschitz, L., T. Lane and A. Mourmouras (2002), 'Capital Flows to Transition Economies: Master or Servant?', *IMF Working Paper* No. 02/1.
- Lipschitz, L., T. Lane and A. Mourmouras (2005), 'Real Convergence, Capital Flows, and Monetary Policy: Notes on the European Transition Countries', in S. Schadler (ed.), *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, Washington, D. C.: International Monetary Fund (IMF), 61-69.
- Lipton, D. and J. Sachs (1991), 'Privatization in Eastern Europe: The Case of Poland', in V. Corbo, F. Coricelli and J. Bossak (eds.), *Reforming Central and Eastern*

- European Economies: Initial Results and Challenges*, Washington, D. C.: The World Bank (A World Bank Symposium), 231-251.
- Lohmann, S. (1993), 'Electoral Cycles and International Policy Cooperation', *European Economic Review* 37 (7): 1373-1391.
- Loli, C.-M., (2003), 'EMU and the Accession Countries: Who Should Walk and Who Should Run', Florence, Italy, October 1-3, 2003.
- Lomax, B. (1976), *Hungary, 1956*, New York: Saint Martin's Press.
- Lomax, B. (1985), 'The Hungarian Revolution of 1956 and the Origins of the Kadar Regime', *Studies in Comparative Communism* 18 (2-3): 87-113.
- Löchel, H. (1998), 'The EMU and the Theory of Optimum Currency Areas', *Hochschule für Bankwirtschaft (HfB)*, working paper 10.
- Luedtke, A. (2005), 'European Integration, public Opinion and Immigration Policy: Testing the Impact of National Identity', *European Union Politics* 6 (1): 83-112.
- Luthardt, W. (1993), 'European Integration and Referendums: Analytical Considerations and Empirical Evidence', in A. Cafruny and G. G. Rosenthal (eds.), *The State of the European Community: The Maastricht Debates and Beyond*, Boulder, Colorado: Lynne Rienner, 53-71.
- Machonin, P. (1994), 'Social and Political Transformation in the Czech Republic', *Czech Sociological Review* 2 (1): 71-87.
- Maes, I. and A. Verdun (2005), 'Small States and the Creation of EMU: Belgium and the Netherlands, Pace-setters and Gate-keepers', *Journal of Common Market Studies* 43 (2): 327-348.

- Magyar Nemzeti Bank (MNB) (2003), *Annual Report-Business Report and Financial Statements of the Magyar Nemzeti Bank*, Budapest-Hungary.
- Magyar Nemzeti Bank MNB (2004), *Public information 'ECB: No need for amendment of the MNB Act'*,
http://english.mnb.hu/Engine.aspx?page=mnben_sajtokozlemenyek&ContentID=6235
- Major, I. (1994), 'The Constraints on privatization in Hungary: Insufficient Demand or Inelastic Supply?', *MOCT-MOST* 4: 107-145.
- Major, I. (2003), 'Privatization in Hungary and its Aftermath', in D. Parker and D. Saal (eds.), *International Handbook on Privatization*, Massachusetts, U.S. and Cheltenham, UK: Edward Elgar Publishing, 427-453.
- Maliszewska, M. (2006), 'EMU Enlargement and Trade Creation', in M. Dabrowski and J. Rostowski (eds.), *The Eastern Enlargement of the Euro Zone*, US: Springer, 63-74.
- Marcinkin, A. and S. van Wijnbergen (1997), 'The impact of Czech privatization methods on enterprise performance incorporating initial selection-bias correction', *Economics of Transition* 5 (2): 289-304.
- Marcussen, M. (2000), *Ideas and Elites: The Social Construction of Economic and Monetary Union*, Aalborg: Aalborg University Press.
- Marer, P. (1984), 'The political Economy of Soviet Relations with Eastern Europe', in S. M. Terry (ed.), *Soviet Policy in Eastern Europe*, New Haven: Yale University Press, 155-188.

- McKinnon, R.I. (1963), 'Optimum Currency Areas', *American Economic Review* 53: 717-725.
- McNamara, K. (2004), 'Making Money: Political Development, the Greenback, and the Euro', *Institute of European Studies Political Economy of International Finance*, University of California, Berkeley.
- Meade, J. E. (1957), 'The Balance of Payments Problems of a Free Trade Area', *Economic Journal* 67 (267): 379-396.
- Meiklejohn Terry, S. (1989), 'The Future of Poland: Perestroika or Perpetual Crisis?', in W. E. Griffith (ed.), *Central and Eastern Europe: The Opening Curtain?*, Boulder: Westview Press, 178-217.
- Mendelski, M. (2008), 'Institutional reforms in South-Eastern Europe: A comparative analysis during different periods of transition', (Unpublished paper), Harvard University.
- Micco, A.; E. Stein and G. Ordoñez (2003), 'The Currency Union Effect on Trade: Early Evidence from EMU Economic Policy', *Economic Policy* 18 (37): 315–356.
- Mikulka, V. (1999), 'The Dissolution of Czechoslovakia and Succession in Respect of Treaties', in M. Mrak (ed.), *Succession of States*, The Hague, Netherlands: Kluwer law International, 109-126.
- Mill, J. S. (1872), *A System of Logic: Ratiocinative and Inductive*, London: Longmans.
- Millard, F. (2007), 'The Czech Republic, Hungary and Poland', in S. White, J. Batt and P. G. Lewis (eds.), *Developments in Central and East European Politics 4*, Durham: Duke University Press, 37-55.

Ministry for National Economy Hungary (2010), *New Széchenyi Plan: Preliminary, Abridged version for public Review-The Development Strategy of Recovery and progress*, Budapest-Hungary.

Ministry of Foreign Affairs of Poland (May 15, 2010), *The Committee for European Integration (1996-2009)*. Checked online on May 14, 2011. Available at: [http://polskawue.gov.pl/The,Committee,for,European,Integration,\(1996-2009\),889.html](http://polskawue.gov.pl/The,Committee,for,European,Integration,(1996-2009),889.html)

Mlynář, Z. (1980), *Nightfrost in Prague: the End of Humane Socialism*, translated by Paul Wilson, New York: Karz Publishers.

Mohácsi Nagy, P. (2006), 'Financial Market Governance: Evolution and Convergence', in K. Dyson (ed.), *Enlarging the Euro Area: External Empowerment and Domestic Transformation in East Central Europe*, Oxford: Oxford University Press, 237-260.

Monetary Policy and Euro (Visegrad info) (April 17, 2010), *Euro versus National Currencies in Visegrad Countries*. Checked online on May 8, 2011. Available at: <http://www.visegrad.info/monetary-policy--euro/factsheet/euro-versus-national-currencies-in-visegrad-countries.html>

Mongelli, F. P. (2002), "'New' Views on the Optimum Currency Area Theory: What is EMU telling us?", *European Central Bank (ECB): Working Paper Series*, No. 138.

Mongelli, F. P. (2005), 'What is European Economic and Monetary Union Telling us About the Properties of Optimum Currency Areas?', *Journal of Common Market Studies* 43 (3): 607-663.

- Mongelli, F. P. (2008), 'European Economic and Monetary Integration, and the Optimum Currency Area Theory', *European Economy – Economic Papers*, 302, Economic and Financial Affairs DG, European Commission.
- Montalto, P. A. (2011), 'Enlargement and Emerging Europe', in J. Llewellyn and P. Westaway (eds.), *Europe will work—But it needs to strengthen its governance, fix its banks, and reform its structural policies*, Nomura Global Economics-March 2011, 93-104.
- Moravcsik, A. (1994), 'Why the European Community Strengthens the State: Domestic Politics and International Cooperation', Harvard University, Center for European Studies, Working Paper Series, no. 52. Presented at the Annual Meeting of the American Political Science Association, New York, September.
- Mundell, R. A. (1961), 'A Theory of Optimum Currency Areas', *American Economic Review*, 51 (4): 509-517.
- Mundell, R. A. (1969), 'Problems of the International Monetary System', in R. A. Mundell and A. K. Swoboda (eds.), *Monetary Problems of the International Economy*, Chicago: Chicago University Press, 21-38.
- Mundell, R.A. (1973), 'A Plan for a European Currency', in H. Johnson and A. K. Swoboda (eds.), *The Economics of Common Currencies*, London: George Allen & Unwin Ltd, 143-172.
- Myant, M. (1982), *Poland: A Crisis for Socialism*, London: Lawrence and Wishart.
- Myant, M. (1989), *The Czechoslovak Economy, 1948-1988*, Cambridge: Cambridge University Press.

- Myant, M., F. Fleischer, K. Hornschild, R. Vintrová, K. Zeman and Z. Souček (1996), *Successful Transformations? The Creation of Market Economies in Eastern Germany and the Czech Republic*, Cheltenham-UK and Brookfield-Virginia: Edward Elgar.
- National Bank of Poland (NBP) Website: <http://www.nbp.pl>
- National Election Office (2003), *Referendum on the Accession to the European Union 12 April 2003*, Budapest-Hungary. Checked online on July 10, 2011. Available at: http://www.valasztas.hu/en/onkval2010/199/199_0.html
- National Phare Programme—Czech Republic (1998).
- Navrátil, J. (ed.) (1998), *The Prague Spring 1968*, translated by M. Kramer, J. Moss and R. Tosek, Budapest: Central European University.
- Nečas, P. (January 14, 2011), *Prime Minister Petr Nečas' Address to the "Active European Policy" Conference*. Checked online on March 7, 2011. Available at: <http://www.petr-necas.cz/en/article/prime-minister-petr-necas-address-to-the-quot-active-european-policy-quot-conference>
- Nelson, R. M., P. Belkin and D. E. Mix (2010), 'Greece's Debt Crisis: Overview, Policy Responses, and Implications', *Congressional Research Services-CRS Report for Congress*.
- NEWEUROPE* (February 23, 2009), 'Czech President Klaus compares EU to Soviet Union: He came, he saw, he spoke, he didn't conquer', No. 822. Checked online on January 7, 2010. Available at: <http://www.neurope.eu/articles/92962.php>
- NEWEUROPE* (May 15, 2011), 'Slim majority of Poles against joining euro', No. 935.
- Nowak, J. R. (1988), *Wegry: Burzliwe lata, 1953-1956*, Warszawa: Almapress.

- Oblath, G. (1992), 'Hungary's Foreign Debt: Controversies and macroeconomic Problems', in I. P. Székely and D. G. Newbery (eds.), *Hungary: An Economy in Transition*, Cambridge: Cambridge University Press, 193-223.
- Oblath, G. and A. Valentinyi (1993), 'Macroeconomic Policy, Liberalization and Transition: Hungary's Case', *Center for Social and Economic Research*, Warsaw-Poland.
- OECD (1992), *Reforming the Economies of Central and Eastern Europe*, Paris: France.
- OECD (1997), *OECD Economic Surveys: Poland*, Paris: OECD.
- OECD (2000), *Economic Survey: Czech Republic*, Paris: OECD.
- OECD (2005), *Economic Survey: Czech Republic*, Paris: OECD.
- OECD (2009), *OECD Economic Outlook-Czech Republic*, Paris, OECD.
- OECD (2010), *Launch of the Czech Republic Economic Survey*, presentation by Angel Gurría, OECD Secretary-General, Prague, April 6, 2010.
- Official Journal of the European Union C 321 (2007), *Consolidated Version of the Treaty on the European Union and of the Treaty Establishing the European Community*.
- Official Journal of the European Union C 83 (2010), *Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union*
- O'Neil, P. H. (1996), 'Revolution from within: Institutional Analysis, Transitions from Authoritarianism, and the Case of Hungary', *World Politics* 48 (4): 579-603.
- Ostrander, S. A. (1993), 'Surely You're Not in this just to be Helpful. Access, Rapport, and Interviews in Three Studies of Elites', *Journal of Contemporary Ethnography* 22 (1): 7-27.

- Párttörténeti Intézet Archívuma (Archives of the Institute of Party History, hereafter PTIA), 288.f. 23/1957. Minutes of the Economic Committee meeting on December 10, 1956.
- ‘Peking on Coexistence’ (1959/1960), *Foreign Affairs* 38 (4): 676-681
- Peabody, R. L., S. W. Hammond, J. Torcom, L. P. Brown, C. Thompson, C. and R. Kolodny (1990), ‘Interviewing Political Elites’, *PS: Political Science and Politics* 23 (3): 451-455.
- Pierson, P. (2004), *Politics in Time: History, Institutions, and Social Analysis*, Princeton, NJ: Princeton University Press.
- Pittaway, M. (2007), ‘From Communist to Post-Communist Politics’, in S. White, J. Batt and P. G. Lewis (eds), *Developments in Central and East European Politics 4*, Durham: Duke University Press, 20-36.
- Pogany, I. (1993), ‘Constitutional Reform in Central and Eastern Europe: Hungary’s Transition to Democracy’, *International and Comparative Law Quarterly* 42 (2): 332-355.
- Polański, Z. (2004a), ‘Poland and the Euro Zone Enlargement: Monetary Policy, ERM II, and Other Issues’, *Atlantic Economic Journal* 32 (4): 280-292.
- Polański, Z. (2004b), ‘Poland and the European Union: The Monetary Policy Dimension. Monetary Policy before Poland’s Accession to the European Union’, *Polityka Pieniężna-Bank I Kredyt* (May).
- Polish Ministry of Finance (October, 2008), *The Roadmap for Poland’s Euro Adoption: Policy Outline*, Warsaw-Poland.

Polish Ministry of Finance (April, 2009), *Government Plenipotentiary for the Introduction of the Euro in Poland: Prerequisites for Implementation of the Next Stages of the Road Map for Euro Adoption in Poland—Executive Summary*, Warsaw-Poland.

Polish National Election Commission (Państwowej Komisji Wyborcza) (2011). Available online at: <http://pkw.gov.pl/>

Portes, R. (1994), 'Transformation Traps', *The Economic Journal* 104 (426): 1178-1189.

Poznanski, K. Z. (1996), *Poland's Protracted Transition: Institutional Change and Economic Growth 1970-1994*, Cambridge: Cambridge University Press.

Prague Daily Monitor (January 2, 2009), 'Czech Euro Adoption Date to be Set in Nov'.

Prague Daily Monitor (September 7, 2009), 'Analysts: Czech economy hit bottom one year after start of crisis'.

Prague Daily Monitor (March 4, 2011), 'Poll: Only 15% of Czechs are for euro adoption'.

Prague Stock Exchange (2011). Checked online on November 10, 2011. Available at: <http://www.pse.cz>

Pravda, A. (1982), 'Poland 1980: From 'Premature Consumerism' to Labour Solidarity', *Soviet Studies* 34 (2): 167-199.

Program NSZZ "Solidarność" uchwalony przez I Krajowy Zjazd Delegatów— "Samorządna Rzeczpospolita". Checked online on October 20, 2010. Available at: <http://www.internacjonalista.pl/menu-kraj/historia-solidarnosci/1484-program-nszz-solidarno-uchwalony-przez-l-krajowy-zjazd-delegatow.html>

Protocol on the Statute of the European System of Central Banks and of the European Central Bank. Checked on August 17, 2011. Available online at:

http://www.ecb.int/ecb/legal/pdf/en_statute_2.pdf

Protokoły porozumień Gdańsk, Szczecin, Jastrzębie. Statut NSZZ, 'Solidarność', KAW, Warszawa, 1980.

Pryor, F. L. (1963), *The Communist Foreign Trade System*, Cambridge: MIT Press.

Przeworski, A. (1993), 'Economic Reforms, public opinion, and political institutions: Poland in the Eastern European perspective', in L. C. Bresser Pereira, J. M. Maravall and A. Przeworski (eds.), *Economic Reforms in New Democracies*, Cambridge: Cambridge University Press, 132-198.

Przeworski, A. and H. Teune (1970), *The Logic of Comparative Social Inquiry*. New York: Wiley.

Putnam, R. D. (1988), 'Diplomacy and Domestic Politics: The Logic of Two-Level Games', *International Organization* 42 (3): 427-460.

Putnam, R. D. (1993), *Making Democracy Work: Civic Traditions in Modern Italy*, Princeton: Princeton University Press.

Radaelli, C. M. (2000), 'Whither Europeanization? Concept Stretching and Substantive Change', *European Integration online Papers (EIoP)* 4 (8).

Ragin, C. (1987), *The Comparative Method*, Berkeley: University of California Press.

Rajski, J. (1994), 'Privatization of State-Owned Enterprises in Poland', *Hastings International and Comparative Law Review* 17: 767-780.

- Ramet, P. (1989), 'Christianity and National Heritage among the Czechs and Slovaks', in P. Ramet (ed.), *Religion and Nationalism in Soviet and East European Politics*, Durham: Duke University Press, pp. 264-285.
- Renner, H. (1989), *A History of Czechoslovakia since 1945*, London: Routledge.
- Reuters (July 19, 2010), *UPDATE 1-Hungary rules out austerity to IMF/EU, markets fall*.
- Risse, T.; S. C. Ropp and K. Sikkink (eds.) (1999), *The Power of Human Rights: International Norms and Domestic Change*, Cambridge: Cambridge University Press.
- Rollo, J. (2006), 'EMU and the New Member States: Strategic Choices in the Context of Global Norms', in K. Dyson (ed.), *Enlarging the Euro Area: External Empowerment and Domestic Transformation in East Central Europe*, Oxford: Oxford University Press, 47-70.
- Rondinelli D. A. and J. Yurkiewicz (1996), 'Privatization And Economic Restructuring in Poland: An Assessment of Transition Policies', *American Journal of Economics and Sociology* 55 (2): 145-160.
- Rose, A. (2000), 'One money, One market: Estimating the Effect of Common Currencies on Trade', *Economic Policy* 15 (30): 7-45.
- Rose, R. (1995), 'Making Progress and Catching Up: Comparative Analysis for Social Policymaking', *International Social Science Journal* 47 (143): 113-126.
- Rose, R. (2009), *Understanding Post-Communist Transformation: A Bottom up Approach*, London: Routledge.

- Rostowski, J. (2007), 'Institutional Transplants in the Transformation of Poland's Economy and Polity', *Center for Social and Economic Research-CASE 339*, Warsaw, Poland.
- Rothschild, J. (1989), *Return to Diversity*, New York: Oxford University Press.
- Rothschild, J. and N. M. Wingfield (2000), *Return to Diversity: A Political History of East Central Europe Since World War II*, third edition, New York: Oxford University Press.
- Rothstein, B. (1998), *Just Institutions Matter: The Moral and Political Logic of the Universal Welfare State*, Cambridge: Cambridge University Press.
- Sachs, J. (1991), 'Poland's Big Bang after One Year', *Skandinaviska Enskilda Banken Quarterly Review* 1-2: 3-7.
- Sachs, J. (1992), 'The Economic Transformation of Eastern Europe: The Case of Poland', *Economics of Planning* 25 (1): 5-19.
- Sadeh, T. (2006), *Sustaining European Monetary Union: Confronting the Cost of Diversity*, Colorado: Lynne Rienner Publishers.
- Sadeh, T and A. Verdun (2009), 'Explaining Europe's Monetary Union: A Survey of the Literature', *International Studies Review* 11 (2): 277-301.
- Sakwa, R. (2004), *Putin: Russia's Choice*, London; New York: Routledge Press.
- Sandholtz, W. (1993a), 'Choosing Union: Monetary Politics and Maastricht', *International Organization* 46 (1): 1-39.
- Sandholtz, W. (1993b), 'Monetary Bargains: the Treaty on EMU', in A. W. Cafruny and G. G. Rosenthal (eds.), *State of the European Community: The Maastricht Debates and Beyond*, Harlow, Essex: Longman and Lynne Rienner, 125-39.

- Schadler, S. (ed.) (2005), *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, Washington, D. C.: IMF.
- Schadler, S., P. Drummond, L. Kuijs, Z. Murgasova and R. van Elkan (2005), *Adopting the Euro in Central Europe: Challenges of the Next Step in European Integration*, Washington, D. C.: IMF.
- Schimmelfennig, F. and U. Sedelmeier (2004), 'Governance by Conditionality: EU Rule Transfer to the Candidate Countries of Central and Eastern Europe', *Journal of European Public Policy* 11 (4): 661-679.
- Schimmelfennig, F. and U. Sedelmeier (2005), 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', in F. Schimmelfennig and U. Sedelmeier (eds.), *The Europeanization of Central and Eastern Europe*. Ithaca, NY: Cornell University Press, 1-28.
- Schöpflin, G. (1993), *Politics in Eastern Europe, 1945-1992*, Oxford: Blackwell.
- Schütte, C. (2000), *Privatization and Corporate Control in the Czech Republic*, Studies in Comparative Economic Systems, Cheltenham and Northampton, MA: Edward Elgar.
- Schwartz, A. H. (2006), *The Politics of Greed: How Privatization Structured Politics in Central and Eastern Europe*, Lanham, Maryland: Rowman and Littlefield.
- Sedmíhradský, M. and S. Klazar (2002), 'Stanislav, Tax Competition for FDI in Central-European Countries', *CEifo Working Paper Series No. 647*.
- Selucký, R. (1973), 'The Relationship Between Political and Economic Reform in Eastern Europe, and in Czechoslovakia in Particular', in V. V. Kusin (ed.), *The Czechoslovak Reform Movement 1968*, Santa Barbara: ABC-Clio Press.

- Selucký, R. (1991), 'From Capitalism to Socialism', in H. G. Skilling (ed.), *Czechoslovakia 1918-88*, London: Macmillan, 154-173.
- Siune, K. and P. Svensson (1993), 'The Danes and The Maastricht Treaty: The Danish EC Referendum of June 1992', *Electoral Studies* 12 (2): 99-111.
- Skilling, H. G. (1951), 'Czechoslovakia—The Soviet Impact', *International Journal* 6 (2): 109-117.
- Skilling, H. G. (1989), 'Czechoslovakia Between East and West', in W. E. Griffith (ed.), *Central and Eastern Europe: The Opening Curtain?*, Boulder: Westview Press, 241-262.
- Skocpol, T. (1979), *States and Social Revolutions: A Comparative Analysis of France, Russia, and China*. New York: Cambridge University Press
- Skocpol, T. (1985), 'Bringing the State Back In: Strategies of Analysis in Current Research', in P. B. Evans, D. Reuschemeyer and T. Skocpol (eds.), *Bringing the State Back In*, Cambridge: Cambridge University Press, 3-37.
- Skocpol, T. (1992), *Protecting Soldiers and Mothers: The Political Origins of Social Policy in the United States*, Cambridge, Massachusetts: Harvard University Press.
- Slay, B. (1993), 'The Dilemmas of Economic Liberalism in Poland', *Europe-Asia Studies* 45 (2): 237-257.
- Slay, B. (2000), 'The Polish Economic Transition: Outcome and Lessons', *Communist and Post-Communist Studies* 33 (1): 49-70.
- Smelser, N. J. (1976), *Comparative Methods in the Social Sciences*, Prentice-Hall.
- Soós, G. (2002), 'Local government Reforms and the Capacity for Local Governance in Hungary', Paper presented at the Joint International Conference *Reforming local*

- government: closing the gap between democracy and efficiency*, organised by the IPSA Research Committee 05 and the DVPW Workgroup “Local government studies”, Stuttgart, September 26th to 27th 2002.
- Stevens, J. N. (1985), *Czechoslovakia at the Crossroads: The Economic Dilemmas of Communism in Postwar Czechoslovakia*, New York: Columbia University Press.
- Stokes, G. (ed.) (1996), *From Stalinism to Pluralism: A Documentary History of Eastern Europe since 1945*, 2nd Edition, Oxford: Oxford University Press.
- Stone, J. and S. Menell (eds.) (1980), *Alexis de Tocqueville—On Democracy, Revolution, and Society*, Chicago and London: The University of Chicago Press.
- Streeck, W. and K. Thelen (eds.) (2005), *Beyond Continuity: Institutional Change in Advanced Political Economies*, Oxford: Oxford University Press.
- Syrop, K. (1957), *Spring in October: The Polish Revolution of 1956*, London: Weidenfeld and Nicolson.
- Szapáry, G. and J. von Hagen (eds.) (2004), *Monetary Strategies for Joining the Euro*, Cheltenham-UK: Edward Elgar.
- Szegvári, P. (2002), ‘Methods and Techniques of Managing Decentralization Reforms in Hungary’, in *Decentralization and Public Administration Reform. Mastering Decentralization and Public Administration Reforms in Central and Eastern Europe*, OSI/LGI, Budapest, 137-162.
- Šmídková, K.; J. Běhounek; T. Hlédik; J. Jílek; M. Koštel; I. Matalíková; D. Rottová and J. Staňková (1997), ‘Koruna Exchange Rate Turbulence in May 1997’, *Czech National Bank*, Working Paper No. 2., Prague.

Tamás, S. and P. Turóczy (2007), 'Insolvency: Bankruptcy Law. Overview of Changes to Hungarian Bankruptcy Act', *Journal of International Banking Law and Regulation* 22 (1).

The Act on the National Bank of Poland of August 29, 1997 as published in *Dziennik Ustaw (the Journal of Laws)*, 1997, 140, 938.

The Baltic Course (February 24, 2010), 'János Rékasi: The euro-goal will be one of the most important priorities of the next Hungary government'.

The Constitution of the Republic of Poland as adopted by the National Assembly on the 2nd of April 1997. As published in *Dziennik Ustaw* No. 78, item 483.

The Economist (May 29, 1997), 'Bohemia's fading rhapsody: The Czech's status as post-communit Europe's economic frontrunners is under threat. They have only themselves to blame', (online edition).

The Economist (May 28, 2009), 'Poland's Legacy of 1989—Still in the Soup: Political Squabbles 20 Years after the Collapse of Communism'.

The Economist, (October 26, 2011), 'The euro-zone crisis: The long shadow of Greece'.
Checked online on October 30, 2011. Available at:

<http://www.economist.com/blogs/freeexchange/2011/10/euro-zone-crisis-3>

The New York Times (March 19, 1989), 'Poland Tying Political Reform to Aid From West'.

The New York Times (October 7, 1989), 'Poland Details Economic Change', online edition.

The New York Times (December 26, 1989), "'Shock Therapy' for Poland: Jolt Might Be Too Damaging', (online edition).

The New York Times (February 12, 1990), ‘Poland Applies Shock Treatment to Revive Its Economy’.

The New York Times (January 2, 2000), ‘What Putin’s Rule Protends to Russia’, (online edition).

The New York Times (October 26, 2011), ‘Europe Agrees to Basics of Plan to Resolve Euro Crisis’.

The Republic of Hungary Constitution.

The Times (August 17, 1978), ‘Czech and Polish dissidents forge links’, 11.

The Wall Street Journal (January 31, 2011), ‘Polish Conservatives Oppose Euro Entry for ‘at Least 20 Years’’.

The Wall Street Journal (May 5, 2010), ‘Polish Support for Euro Adoption Falls Below 50%’.

The World Bank (1999), *Czech Republic: Toward EU Accession*, A World Bank Country Study, Washington, D. C.: The World Bank.

The World Bank (2008), *Regulatory Transformation in Hungary, 1989-98: Case Studies on Reform Implementation Experience*, Washington, D. C.

Thelen, K. and S. Steinmo (1992), ‘Historical institutionalism in comparative politics’ in S. Steinmo, K. Thelen and F. Longstreth (eds.), *Structuring Politics: Historical Institutionalism in Comparative Politics*, Cambridge: Cambridge University Press, 1-33.

Thimann, C. (2005), ‘Real Convergence, Economic Dynamics, and Adoption of the Euro in the New European Union Members States’, in S. Schadler (ed.), *Euro Adoption*

- in Central and Eastern Europe: Opportunities and Challenges*, Washington, D. C.: IMF, 24-32.
- Tökés, R. (1996), 'Political Transition and Social Transformation in Hungary', *Fundació CIDOB-Afers Internacionals* 34-35: 79-101.
- Treaty of Accession to the European Union (2003).
- Tsoukalis, L. (1977), *The Politics and Economics of European Monetary Integration*, London: Allen and Unwin.
- Ulc, O. (1965), 'Pilsen: The unknown Revolt', *Problems of Communism* 14 (3): 46-49.
- Ulc, O. (1992), 'The Bumpy Road of Czechoslovakia's Velvet Revolution', *Problems of Communism* 41 (3): 19-21.
- USAID (1999), 'Ten Years of Collaboration: A retrospective Look at USAID's Role in Hungary's Transition', *USAID-Hungary*, Budapest-Hungary, August 20.
- Vachudova, M. A. (2008), 'The European Union: The Causal Behemoth of Transnational Influence on Postcommunist Politics', in M. A. Orenstein; S. Bloom and N. Lindstrom (eds.), *Transnational Actors in Central and East European Transitions*, Pittsburgh, PA: University of Pittsburgh Press, 19-37.
- Valenta, J. (19884), 'Soviet Policy toward Hungary and Czechoslovakia', in S. M. Terry (ed.), *Soviet Policy in Eastern Europe*, New Haven: Yale University Press, 93-124.
- Vanagunas, S. (1999), 'Civil Service Reform in the Baltics', in T. Verheijen and A. Kotchegura (eds.), *Comparative Civil Service Systems: Central and Eastern Europe*, Cheltenham, UK: Edward Elgar, 213-234.

- Verdun, A. (1999), 'The Role the Delors Committee in the Creation of EMU: An Epistemic Community?', *Journal of European Public Policy* 6 (2): 308-328.
- Verdun, A. (2000), *European Responses to Globalization and Financial Market Integration: Perceptions of Economic and Monetary Union in Britain, France and Germany*, New York: Palgrave Macmillan.
- Verheijen, A. J. G. (=T.) (2003), 'Public Administration in Post-Communist States', in B. G. Peters and J. Pierre (eds.), *Handbook of Public Administration*, London: Sage Publications, 489-497.
- Viñals, J. (2005), 'Comments on "Real Convergence, Capital Flows, and Monetary policy: Notes on the European Transition Countries"', in S. Schadler (ed.), *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, Washington, D. C.: IMF, 70-74.
- Vliegthart, A. and L. Horn (2007), 'The role of the EU in the (trans)formation of corporate governance regulation in Central Eastern Europe – The case of the Czech Republic', *Competition and Change* 11 (2): 137-154.
- Von Hagen, J. and M. Fratianni (1994), 'The Transition to European Monetary Union and the European Monetary Institute', in B. Eichengreen and J. Frieden (eds.), *The Political Economy of European Monetary Unification*, Boulder, Colorado: Westview Press, 129-148.
- Voszka, E. (1996), 'Privatization in Central East Europe: Can it be Designed?', in A. Lijphart and C. H. Waisman (eds.), *Institutional Design in New Democracies: Eastern Europe and Latin America*, Boulder-Colorado: Westview Press, 177-194.

- Voszka, E. (1999), 'Privatization in Hungary: Results and Open Issues', *Economic Reform Today* 2: 12-17.
- Wagstyl, S. (June 9, 2010), 'Has Hungary's PM done enough?', *Financial Times*.
- Wallace, H., W. Wallace and C. Webb (eds.) (1977), *Policy-Making in the European Communities*, London: John Wiley.
- Warsaw Voice* (March 22, 2006), 'Balcerowicz under Fire', online edition.
- Warsaw Voice* (November 5, 2008), 'Poland's Road to NATO', online edition.
- Warsaw Voice* (December 16, 2009), 'Balcerowicz Plan: 20 Years On', online edition.
- Weber, M. (1957), 'From Max Weber: Essays in Sociology', edited with an introduction by H. H. Gerth and C. W. Mills, London: Routledge.
- Weigle, M. A. and J. Butterfield (1992), 'Civil society in reforming Communist regimes: The logic of emergence', *Comparative Politics* 25 (1): 1-23.
- Wheaton, B. and Z. Kavan, *The Velvet Revolution: Czechoslovakia, 1988-1991*, Boulder: Westview Press, 1992.
- Williams, K. (1997), *The Prague Spring and its Aftermath: Czechoslovak Politics 1968-1970*, Cambridge: Cambridge University Press.
- Wolchik, S. L. (2000), *Czechoslovakia in Transition: Politics, Economics and Society*, Leicester: Leicester University Press.
- Wolchik, S. L. and J. L. Curry (2008), 'Democracy, the Market, and the return to Europe: From Communism to the European Union and NATO', in S. L. Wolchik and J. L. Curry (eds.), *Central and East European Politics: From Communism to Democracy*, Plymouth, UK: Rowman and Littlefield Publishers, 3-29

- Wojnicka, E. (2001), 'Foreign Direct Investment in Privatisation of the Polish Economy', *INTERECONOMICS*, November/December, 305-314.
- Wróbel, P. (2005), 'Poland', in R. Frucht (ed.), *Eastern Europe: An Introduction to the People, Lands and Culture*, ABC-CLIO, 1-60.
- Zecchini, S. (1995), 'The Role of International Financial Institutions in the Transition Process', *Journal of Comparative Economics* 20 (1): 116-138
- Zieleneic, J. (1990), *Československo na rozcestí, svazek edice Archy 1*, Praha: Lidové noviny.
- Zinner, P. E. (ed.) (1956), *National Communism and Popular Revolt in Eastern Europe: A Selection of Documents on Events in Poland and Hungary, February-November, 1956*, New York: Columbia University Press.
- Zubek, R. (2006), 'Poland: Unbalanced Domestic Leadership in Negotiating Fit', in K. Dyson (ed.), *Enlarging the Euro Area: External Empowerment and Domestic Transformation in East Central Europe*, Oxford: Oxford University Press, 197-214.
- Zubek, R. (2008), 'Poland: From Pacesetter to Semi-Permanent Outsider', in K. Dyson (ed.), *The Euro at 10: Europeanization, Power and Convergence*, Oxford: Oxford University Press, 292-306.
- Zulu, J. B., I. S. McCarthy, S. Almuiña and G. Sensenbrenner (eds.) (1994), *Central Banking Technical Assistance to Countries in Transition—Papers and Proceedings of Meeting of Donor and Recipient Central Banks and International Institutions*, Washington, D. C.: Monetary and Exchange Affairs Department—IMF.

APPENDIX—METHODOLOGY

1. Choosing the Right Persons for the Interviews

The interviews were conducted in person. The list of questions that guided the interview has approximately nine main questions and was sent ahead of time to the interviewee.

This allowed the interviewee to prepare his/her answers, which made the interview more helpful and fruitful. On average each interview took about ninety minutes. The interviewees were government officials from the ministry of finance, ministry of foreign affairs, officials from the national central banks, in addition to representatives of the main unions and epistemic communities. In some cases the interview was with few officials from the same organization at the same time. In other cases, interviews were conducted at the same organization successively. But how did I find the right respondents?

After doing the research on euro adoption strategies in the three countries, the search was directed to find out those key informants who were involved in the liberalization of the economy and adopting pro/anti euro policies. In addition, based on the questions I asked, I was interested in hearing the view of those experts who were involved in euro adoption policies and not in politicians's views. Politicians usually change their position due to elections or other issues and try to convey certain messages that might influence the results of the research. The circle of those experts is not large and most key infomants were either at the central bank or the ministry of finance or economics. Few informants were outside this circle and I managed to interview some of them. Based to what I highlighted and due to the limited resources, I managed to

interview twenty key informants in the three countries. As for interviews with media informants, I did not think it was needed since based on my pre-interviews research, I found that the media's role is insignificant and as explained in the thesis, this is partly because of lack of political debate on the issue. In case I discovered a need to conduct interviews with other groups based on the interviews I conducted with the twenty key informants, I would have done so. Moreover, during my stay in the three countries, I managed to have discussions with academics and experts on the euro that contributed to a better understanding of the euro issue in the Czech Republic, Hungary and Poland.

Once I identified the key informants, I compiled a list of the possible interviewees with their affiliation and contact information. An official letter was prepared explaining who I was and the kind of research I was conducting and the outcome of the research. Along to this letter, a consent form and a copy of the questionnaire were sent. A request for interview to be conducted at a certain date was sent. This information was sent via email. The importance of sending all this information to the respondent was to allow him/her has a look at the questionnaire and to know about the research. This helped in making sure that the respondent is familiar with the topic and is the right person to interview.

In case of refusal, a follow up email was sent thanking the individual and asking if he/she recommends someone else. This was very helpful since when sending a request for an interview based on the recommendation of Mr./Mrs. X²¹⁶ to discuss euro adoption strategies, this resulted in a positive response. The interviews were organized in a way not to have conflicting times. I also made sure I knew the places where the interview was held and always arrived fifteen minutes earlier. By arriving earlier, I had time for the

²¹⁶ In that case, the recommender was copied to the email sent.

formalities and security checks (especially when going to ministries or central banks) so that I was not late for the interview and to benefit from every minute I had with the interviewee who might have other appointments.

The interview lasted for about ninety minutes. The respondent in most cases was prepared for the interview since he/she looked at the questions.²¹⁷ In some cases, the respondent had prepared documents, files and some publications that were given to me.

²¹⁷ This does not mean he/she prepared the interview answers, but only minor preparation to familiarize himself/herself with the kind of questions asked.

2. The Interviews

All the interviews started in a similar fashion in which I asked for permission to use a tape recorder.²¹⁸ I emphasized the research topic, the purpose and scope of the research. The interviewee was asked about his/her country's policies towards EMU and the process of adopting the euro. Moreover, I discussed with the interviewee whether or not his/her organization had a written statement regarding its position on EMU and euro adoption. I asked the interviewee to indicate when his/her answers reflect his/her personal opinion or his/her institution. Then the respondent was asked if he/she had a look at the consent form (sent to him/her in advance) and to sign it after filling it and choosing if he/she preferred to be quoted directly or remaining anonymous. He/she was asked to choose between four options:

- the report can refer to your name at any time in the final report
- the report will only mention your name when at least half of all participants have indicated that their names be disclosed
- Your name remains anonymous at all times; in the final report there will be only indication of your function (more or less precise) and the organization for whom you work
- No indication of your function, just the organization for which you work.

Before the interview started, the respondent was asked to say something about himself/herself such as his/her function within the organization and how long he/she has

²¹⁸ In one of the cases, one respondent refused to be taped, so detailed notes were taken. The respondents' answers were written in details right after the interview ended and a copy was sent to the interviewee to make sure no misquoting or misunderstanding exists. The respondent responded positively by agreeing to the notes taken regarding the interview.

been working there, and the professional background. During the interview, if the interviewee shifted the attention from the question, a follow up question was asked to make sure the main question is answered thoroughly. In most parts of the interview, the effort was directed to keep the focus on the questionnaire for the sake of consistency with respect to the other interviews conducted.

3. The Questionnaire—The Rationale behind the Questions

The questionnaire had nine open-ended questions that gave the opportunity to the interviewees to thoroughly answer the question. In this section, I highlight the questions asked and the reasoning behind each question and what was expected to be learned.

Question 1

The first question (1a) asked about the perception of the organization regarding adopting the euro.

1a. Membership in EMU and ultimately euro adoption is required as part of all New Member States' (NMS) membership of the European Union (EU). However, not all NMS have joined the euro area since having become a member. What is your organization's opinion towards euro adoption?

This question was asked in order to know how the attitude of the organization changed over the years and if he/she or his predecessors and colleagues support euro adoption or not and why this is so.

The next three questions (1b, 1c, 1d) were posed to know how the respondent's organization perceives the costs and benefits from joining the euro area. The intention was to know what are the short-term costs and long-term benefits from adopting the euro.

1b. Did your organization feel it was be beneficial for your country (and is it still perceived this way)?

1c. If your organization perceived EMU to be beneficial could you elaborate on what benefits you believe it was going to deliver? Have these benefits meanwhile materialized?

1d. Did you perceive that there would be any costs for your country associated with membership in EMU / euro adoption? Have these costs indeed meanwhile occurred?

Since the larger project deals with all the NMS, the questionnaire had some questions regarding the post euro adoption costs and benefits. Therefore, the second part of question 1d and question 1e discuss the situation post joining the euro area.

1d. Did you perceive that there would be any costs for your country associated with membership in EMU / euro adoption? Have these costs indeed meanwhile occurred?

1e. In your opinion before joining, did the benefits of membership outweigh the costs or is the reverse true? Do you still hold the same opinion?

Question 2

After asking about the costs and benefits regarding euro adoption, the questions moved to focus on the central factors influencing euro adoption policies. The first among these is the economic factors.

2a. Have economic factors always been central to your country's policy towards EMU?

2b. If so what specific economic factors?

2c. Have potential economic gains been seen as sufficient to offset any of the economic constraints?

This is an important question since it allows to see how significant are the economic cost/benefit analysis for the euro adoption strategies. It also opens the door to check if

there are other calculations that are significant or even more important than the economic costs and benefits.

Question 3

The third question moves beyond the economic factors and focuses on other political calculations involved in the decision-making. The answer to this question is key to an understanding of the research regarding domestic politics and how important the different factors are.

3. What have been the domestic political considerations that influenced your country's policy towards EMU/euro adoption?

Question 4

Question four emphasizes the other relevant player regarding euro adoption strategy: the public opinion. In case a significant percentage of the population is pro euro then those countries might have worked harder to adopt the euro, and vice versa.

4. What impact, if any, has public opinion had on the euro adoption strategy within your country?

Question 5

Question five is to get the feedback on the logical and rational analysis of the timeline set regarding the euro. Is it possible or not to adopt the euro within the timeline set by the government?

5. Do you feel the euro adoption timeline your country pursued was appropriate?

Question 6

Question 6 reflects on the constructivist literature regarding symbols and identity and helps address this issue and respond to the constructivist literature.

6. It has been said that joining the European Union signals a “return to Europe” for your country. Do you agree with this statement?

Questions 6a, 6b, and 6c highlight the return to Europe issue and if the euro adoption has any thing to strengthen this return. These questions are also to know how significant are the symbolic factors with respect to euro adoption policies.

6a. Do you feel that one of the motivations for early euro adoption strategy in your country was the factor that by adopting the euro your country would become more “a part of Europe”?

6b. Are the euro and EMU a fundamental component of this return?

6c. Is this type of symbolic role for the euro perceived to be an important consequence of euro adoption?

Question 7

Question 7a focuses on the relations between the benefits of euro adoption and the symbols and if the citizens feel more European because of euro adoption.

7a. Do you feel that there are any other potential domestic symbolic benefits to the adoption of the euro that were deemed important prior to joining? For example do you think elites may have thought that citizens of your country would feel more European once your country would have adopted the euro?

Question 7b builds on the previous question to check if the symbolic benefits of EMU (in case they exist) help in facing some of the euro adoption costs.

7b. Before joining, did you think there would have been some potential symbolic benefits of the euro and EMU to help counteract some of the constraints which

result from EMU such as having less control over exchange and interest rates and inflation?

Question 8

Question 8a moves from the domestic to the EU level. The importance of this question is to see the role played by the EU to help the NMS adopt the euro. It also allows to reflect on the policy learning and transfer that was going on post the end of the Cold War.

8a. What role has the EU played in helping to shape your policy towards EMU?

Questions 8a. and 8b. focus on the role of euro adoption in increasing the power and legitimacy of the new euro members not only at the EU level but also internationally.

8b. Do you feel that the adoption of the euro and participation EMU enhances your legitimacy and influence as an actor in the EU?

8c. Do you feel that the adoption of the euro and participation in EMU enhances the position of your country internationally or do you feel that there is no appreciable significance in this regard to your participation in EMU and the eurozone? If yes, is this enhanced position important and why?

Question 9

The aim behind question 9 is to give an opportunity to the respondent to add anything he/she would like to and to reflect on some issues that they wanted to clarify regarding some of their answers. Also to give them an opportunity to reflect on the financial crisis and how did it affect the euro adoption strategies.

9. Is there anything else which would like to add to this conversation?

4. List of Interviewees

| Name | Affiliation | Address and contact |
|---------------------------------------|---|---|
| The Czech Republic (June 2009) | | |
| Zděnek Čech | Counsellor to the Deputy Minister—Czech Ministry of Finance | Letenská 15, 118 10 Prague 1 Tel. +420 257 04 2717 Fax. +420 257 04 2204 Email. Zdenek.cech@mfcz.cz |
| Oldrich Dedek | Chief Coordinator for Euro Adoption in the Czech Republic—Ministry of Finance | Letenská 15, 118 10 Prague 1 Tel. +420 257 042 909 Fax. +420 257 533 533 Email. Oldrich.Dedek@mfcz.cz |
| Jan Frait | Economic Research and Financial Stability Department (Former member of the Monetary Council) —Czech National Bank | Na Příkopě 28 115 03 Praha 1; Czech Republic Tel. + 420 22441 4430 Fax. + 420 22441 4278 Email. jan.frait@cnb.cz |
| Mojmír Hampl | Vice-Governor—Czech National Bank | Na Příkopě 28, 115 03 Praha 1 Tel. +420 22441 2004 Fax. +420 22441 3430 Email. Mojmir.hampl@cnb.cz |
| Tomáš Holub | Executive Director Monetary and Statistics Department—Czech National Bank | Na Příkopě 28, 115 03 Praha 1 Tel. +420 22441 2340 Fax. +420 22441 2329 Email. Tomas.holub@cnb.cz |
| Petr Očko | -Director of Section of EU Funds, Research and Development at the Czech Ministry of Industry and Trade -Member at EuroTeam -Lecturer and post-doctoral researcher at Charles University | Email: petr.ocko@mpo.cz |
| Jiří Palán | Head of Unit EU Department –Structural Policies Unit—Czech Ministry of Finance | Letenská 15, 118 10 Prague 1 Tel. +420 257 04 2498 Fax. +420 257 04 2204 Email. Jiri.palan@mfcz.cz |

| | | |
|----------------------------|---|---|
| Michal Skořepa | Advisor to the Vice-Governor—Czech national Bank | Na Příkopě 28, 115 03 Praha 1 Tel. +420 22441 2318 Fax. +420 22441 3430 Email. Michal.skorepa@cnb.cz |
| Zuzana Šmídová | Head of Unit EU Department-Economic and Financial Policies Unit— Czech Ministry of Finance | Letenská 15, 118 10 Prague 1 Tel. +420 257 04 3230 Fax. +420 257 04 2204 Email. Zuzana.smidova@mfer.cz |
| Hungary (June 2009) | | |
| Ágnes Csermely | Director-Monetary Strategy and Economic Analysis —Magyar Nemzeti Bank | H-1054 Budapest, Szabadság tér 8-9 Tel. +36 (1) 428-2660 Fax. +36 (1) 428-2590 Email. csermelya@mnb.hu |
| Tibor Erhart | Deputy Director general Economic Policy Department—Hungarian Ministry of Finance | H-1051 Budapest, József Nádor Tér 2-4 Tel. +36 (1) 327-2112 Fax. +36 (1) 327-2552 Email. Tabor.erhart@pm.gov.hu |
| Gergely Kiss | Economist at the Economics Department —Magyar Nemzeti Bank | H-1054 Budapest, Szabadság tér 8-9 Tel. +36 (1) 428-2600/1852 Fax. +36 (1) 428-2590 Email. kissge@mnb.hu |
| Gábor Oblath | Fiscal Council (former Member of the Monetary Council)—Magyar Nemzeti Bank | H-1054 Budapest, Szabadság tér 8-9 Tel. +36 (1) 428-2600/1212 Mobile. +36-20-922-9497 Email. oblatgh@mnb.hu |
| Márton Szili | Economist at the Economic Policy Department —Hungarian Ministry of Finance | H-1051 Budapest, József Nádor Tér 2-4 Tel. +36 (1) 327-9230 Fax. +36 (1) 327-2552 Email. Martin.szili@pm.gov.hu |
| László G. Tóth | Deputy Director general Economic Policy Department —Hungarian Ministry of | H-1051 Budapest, József Nádor Tér 2-4 Tel. +36 (1) 327-5993 |

| | | |
|----------------------------|--|---|
| | Finance | Fax. +36 (1) 327-2417 Email. Laszlo.toth@pm.gov.hu |
| Poland (April 2009) | | |
| Jakub Borowski | (Former Economist at the National Bank of Poland) Chief Economist—INVEST BANK SA | Al. Stanów Zjednoczonych 61 A, 04-028 Warsaw TEL.+48 22 516 28 04 Mobile. +48 600 457 021 Email. jakub.borowski@investbank.pl |
| Michał Brzoza-Brzezina | Director-Bureau of Applied Research—National Bank of Poland | Ul. Świętokrzyka 11/21, 00-919 Warszawa, Poland Tel. +48 22 653 15 74 Fax. +48 22 826 99 35 Email. michal.brzoza-brzezina@mail.nbp.pl |
| Dariusz Filar | (Former member of the Monetary Policy Council at the National Bank of Poland) Dr. Hab. Prof of Economics at the Faculty of Economics UNIWERSYTET GDAŃSKI | Armii Krajowej 119/121 81-824 Sopot, Poland Tel.+48 58 523 12 38 (lub wew. 1238) Email. ekodf@ug.edu.pl |
| Paweł Kowalewski | Acting Director Bureau for Integration with Euro Area—National Bank of Poland | Ul. Świętokrzyka 11/21, 00-919 Warszawa, Poland Tel. +48 22 585 43 63 Fax. +48 22 585 43 63 Email. pawel.kowalewski@nbp.pl |
| Marek Rozkurt | Director-Financial Policy, Analyses and Statistics Department-Polish Ministry of Finance | Ul. Świętokrzyka 12; 00-916 Warszawa-Poland Tel. +48 22 694 54 02 Fax. +48 22 694 36 30 Email. marek.rozkurt@mofnet.gov.pl |