The Slow Trip to the East: The Domestic Politics of Euro Adoption in the Czech Republic, Hungary and Poland

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Abstract:

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 to date? Has it been lack of political will on the part of the government, a strong voice in the opposition or a euroskeptic president, insufficient administrative capacity, or lack of policy learning? Though there is no consensus among economists regarding whether adopting the euro in the short run is a good idea or not, however, we believe that an economic cost-benefit analysis would suggest that in the long run euro adoption is positive for NMS. Yet macroeconomic analyses do not explain the change in government policies that may lead to euro adoption. Constructivist analyses, that focus 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, are also unable to explain the speed of euro adoption in NMS. This paper adopts a domestic politics approach to analyze the euro adoption process in the Czech Republic, Hungary and Poland. Based on an examination of government documents, reports in the media, academic literature and face-to-face interviews we seek to offer new insights into the role of domestic politics in explaining the process of euro adoption in NMS. Government policies, elections, electoral cycles as well as constitutional rules, turn out to be crucial in explaining the lagging euro adoption process in these countries.

1 INTRODUCTION

Following their accession to the European Union (EU) on May 1st, 2004, ten New Member States (NMS), and two more that joined in 2007, are expected to fulfill the Maastricht convergence criteria and enter the last stage of Economic and Monetary Union (EMU) thereby adopting the euro. However, the Treaty on European Union (TEU) does not specify a time frame. Slovenia joined the euro area in 2007, Cyprus and Malta in 2008, and Slovakia in 2009. Other NMS have not yet adopted the euro. Some have made serious attempts at being ready to join; others are still far removed. So, why have some NMS not been able to join the euro area even if they made serious attempts at the outset?

An economic cost-benefit analysis suggests that in the long run euro adoption is positive for NMS. Economists typically look at macroeconomic conditions to determine whether or not a country is ready (Buiter, 2000; De Grauwe and Schnable 2005; Lipschutz, Lane and Mourmouras, 2005; Schadler 2005). However, they are unable to explain the political processes that change those macroeconomic conditions. By contrast, political scientists studying the euro adoption process in NMS (e.g. Dyson, 2006, 2008; Greskovits, 2006, 2008 and Johnson, 2006) have mostly offered constructivist analyses of euro adoption strategies in NMS. They have typically 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.

We find neither economic nor political science analyses fully satisfactory in their explanation of euro adoption strategy of NMS. We argue that for a complete understanding of the euro adoption strategy in NMS one needs to look at the domestic political situation. This paper adopts a domestic politics approach to analyze the euro adoption process and applies it to three case studies: the Czech Republic, Hungary and Poland. None of these countries have adopted the euro yet and over the past decade each of them have had differing political stances towards it. Based on an examination of government documents, reports in the media, academic literature and face-to-face interviews with nineteen key informants in these three countries we seek to offer new insights into the role of domestic politics in explaining the process of euro adoption in NMS. A cost benefit-analysis indicating positive economic effects of euro adoption and the existence of shared economic values and beliefs among central bankers are insufficient to bring about speedy euro adoption. Government policies, elections, electoral cycles as well as constitutional rules, to name just a few, turn out to be crucial in explaining the lagging euro adoption process in these countries.

The paper is structured as follows. The next section reviews the literature on euro adoption (both economics and political science literature). Section three provides details of the domestic politics approach and reports on the methodology. Sections four through seven offer the empirical analysis of the domestic approach with respect to the three cases. The final section highlights the most important findings of the comparative study and offers some general conclusions.

2 LITERATURE REVIEW

2.1 Economics Literature

The economics literature relevant to the question at hand boils down to understanding the benefits and costs of fixing exchange rates and thereby when it is economically beneficial to join a monetary union. The Optimal Currency Area (OCA) literature (Mundell, 1961; McKinnon, 1963; Kenen, 1969 and Ingram, 1973) 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. In recent years the OCA literature has been adjusted in light of the experience in Europe. The choice to join EMU is no longer one in which prospective partners can renegotiate the terms; they will be joining 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. Thus according to this revised 'endogenous 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). The endogenous OCA theory also discusses what other adjustment mechanisms need to be in place once the exchange rate instrument and monetary policy are no longer available to the national government (see De Grauwe, 2006).

A recent volume (Schadler, 2005) looks explicitly at the concrete question of euro adoption and finds that, in the long run, all NMS will benefit from joining the euro. The question then becomes, under what conditions will they join the euro sooner rather than later? Frankel (2005) argues that if countries still suffer from asymmetric shocks, they should not yet join EMU. But he then goes on to examine asymmetric shocks and finds that they are not likely to happen as frequently in the contemporary European context. Thus he 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.

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 integrated economies, and small open economies, having an exchange rate separate from the larger area may actually be a source of shock. In these cases the loss of exchange rate might be a benefit. As for Buiter (2000), he has been a skeptic of the argument that benefits outweigh the costs and that exchange rates take the right track and tend to ease the costs of shocks and going hand in hand with a stable monetary policy. Some scholars examine the cost of the transition as a country might incur major costs if it is not done well (Lipschutz, Lane and Mourmouras, 2005). However, even if there are some short-term costs when the conditions are not exactly right, there are factors that can offset these problems (such as policies to improve research and development or develop the financial sector and make it more resilient).

Eonomists view the euro adoption process in NMS as beneficial in the long-run, when some policies in NMS are in place to address possible imbalances and when their economies are sufficiently convergent. They also find that euro adoption will assist this process. However, these analyses do not concentrate on the question of how we can understand the process of euro adoption (the government policies that may affect the macroeconomic conditions), nor do they offer insights into what other factors within the country that may lead to a fast or slow euro adoption strategy.

2.2 Political Science Literature

Turning to the political science literature, the question of euro adoption may be situated in the broader literature. Literature on economic policy decisions in CEECs, since the end of the Cold War, has focused on the launch of political and economic transition in these countries and with it the observation that a fast trend of institutional development has taken place not only as a result of European integration and international incentives but also due to an ongoing social learning process. The EU played a very important role in post-communist countries' political domestic change by giving a lot of incentives regarding the accession to the EU. One of the main beliefs that were transferred to Central and East European Countries (CEECs) and other transition economies was the importance of central bank independence and protecting price stability. The creation of independent central banks was the result of the continuous effort of the EU, various leading national central banks and international institutions (Johnson, 2006). The transfer of ideas, technical assistance, and socialization process led to privatization and economic and institutional development that aimed at transforming those countries into a capital-market economic system. The move from independent central banks to being part of the European System of Central Banks (ESCB) is, in this view, a logical step (Dyson and Marcussen, 2009). The problem is, however, that preparing for euro adoption through the path of getting the central banks ready for EMU is not sufficient for actually adopting the euro.

EMU has also been viewed through the lens of "Europeanization" i.e., "domestic adaptation to the pressures emanating directly or indirectly from EU membership" (Featherstone, 2003: 7). In a pioneering book on euro adoption in CEECs edited by

Kenneth 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). Although explicitly dealing with EMU and the CEECs, the study does not offer a thorough understanding of how the domestic political environment influences the decisions taken regarding euro adoption.

Our point is that although these studies provide a useful analysis of the general conditions under which euro adoption might flourish, we find the factors looked at unable to explain the specific government policies, the success of those policies, and thus the resulting *timing* of euro adoption. 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 until they joined the EU. However, since EU accession, we find the Europeanization literature not satisfying in providing a useful framework for analysis to understand euro adoption policies—especially in the Czech and Polish cases as we will see later.

3 THEORETICAL FRAMEWORK AND METHODOLOGY

3.1 Domestic Politics Approach

We are not the first to point to the importance of the domestic setting and domestic actors in explaining EMU (cf. Sandholtz, 1993; Dyson and Featherstone, 1996; Hallerberg, 2004). Yet, these earlier authors have not explicitly addressed the question of how one is to understand the divergence in outcome in euro adoption process among NMS. Seen that many factors could be captured by this approach we have narrowed the scope of our study and are restricting ourselves to four broad categories that cover the day-to-day politics: (1) macroeconomic characteristics and conditions; (2) government and opposition, the electoral cycle and any legal or constitutional constraints; (3) the central bank; (4) public opinion, the media and economic interest groups. In the macroeconomic conditions we review country performance on the convergence criteria. The second category contain factors which we review in order to assess the degree of power that various actors have: the government, opposition, who appoints the monetary council and the governor of the central bank, the change in power due to elections and how does change affect the relation between the new government and the central bank. The category 'the central bank' contains information about central bank independence as well as some of the idiosyncrasies of the central bank in each country. The factors in the fourth category are of importance as they influence the whole political process. Public opinion is a proxy of the voice of the electorate – those who can bring certain parties to power and force others into opposition. The media plays a crucial role in informing the public about the euro and in lobbying for or against it. These four main indicators are used to analyze and explain the euro adoption strategies in the Czech Republic, Hungary and Poland.

3.2 Case Selection and Methodology

In our overall project, we examine all ten NMS that joined the EU on May 1st, 2004. In this paper we choose to analyze only a few cases: the Czech Republic, Hungary and Poland. These three countries differ in their relative enthusiasm (or reservation) towards euro adoption, since the early 2000s. Some of them first were enthusiastic and set optimistic goals but then had to postpone these target euro adoption dates. Moreover, they are the largest and most influential countries among the CEECs. They also have an interesting historical background regarding nationalism, sovereignty and fighting communism. Their perceptions regarding the euro adoption changed from pacesetters to laggards. As for other countries such as the Baltics, Cyprus, Malta and Slovenia, they are unique in their experience and are too small to tell us really why countries decide to adopt the euro fast or delay it. Slovakia joined in a very critical moment in the mid of the financial crisis. Add to this the fact that all these countries (except for Czech Republic, Hungary and Poland) have been almost consistent in their enthusiasm regarding the EU and euro adoption.

The empirical case studies presented below are based on official documents, reports in the media, academic literature, a few presentations by key informants at public events, and personal interviews. From April-June 2009, based on a semi-structured list of questions, we conducted nineteen face-to-face interviews with officials from ministries of finance, the central banks, research institutes, and other financial and monetary elites in each of the three countries.

4 MACROECONOMIC INDICATORS

4.1 Czech Republic

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 early the Czech government had the plan for speedy euro adoption.

As can be seen from Table 1, 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.

[Table 1 about here]

Until 2008 it ran an excessive deficit, but then managed to bring it to 1.5 percent (below the threshold). In 2008 inflation was still too high, but the Czech Republic performed well regarding other criteria: long-term interest rate and public debt. However, because of the financial crisis, the country is running an excessive deficit (6.6 percent), the debt increased slightly (from 30 percent in 2008 to 34.4 percent in 2009), and the unemployment is also increasing (7.9 percent in February 2010) (Eurostat, 2010; European Commission, 2009a; see Table 1). In other words, before the financial crisis the Czech Republic had not quite met the convergence criteria even if it was not overly far removed from meeting them.

In terms of its exchange rate economy, Czech Republic has chosen to have a flexible exchange rate and has had it for a decade. Nevertheless, the Czech koruna has typically been more or less stable against the euro and other currencies in the region (from 1999-mid 2009 the koruna gradually appreciated about 30 percent against the euro). With the global financial meltdown of fall 2008 the currency depreciated considerably (15 percent) over a period of three months (October 1st, 2008– mid February 2009) but then picked up again (6 percent) in the same period thereafter. Moreover, the positive GDP in 2008 (2.5 percent) contracted by 4.8 percent in 2009.

4.2 Hungary

At the outset, Hungary was among the most enthusiastic of all NMS to join the euro as early as possible. In the early 2000s, euro entry was projected for the year 2006. Ironically, in 2004, the year Hungary joined the EU, the country failed to meet most of the criteria for adopting the euro, except for the public debt that was slightly below the 60 percent reference value (57.6 percent).

[Table 2 about here]

All others were problematic: for instance, as can be seen in Table 2 its inflation rate was 6.8 percent and the budgetary deficit stood at 6.2 percent and the interest rate was 8.1 percent – far above the threshold (European Commission, 2005: 73). Since this time the situation has not improved (see Table 2). Although the numbers have changed, two things are still stable: the existence of an excessive deficit since 2006 and that Hungary still fails to meet most of the Maastricht criteria.

In terms of its exchange rate, Hungary adopted a policy of 'ERM-II shadow' or a crawling peg to the euro with a ± fifteen percent band and inflation targeting of three to five percent by 2005 (Dean, 2004: 763; and Loli, 2003). It fluctuated a bit over the period January 1,1999 through mid May 2008 though the fluctuations evened out. However, the second half of 2008 and the first half of 2009 saw a gradual decline of the Hungarian currency by about twenty percent (ECB, 2009). Moreover, the GDP contracted by 6.3 percent in 2009 after having still showed growth of 0.6 percent in 2008. As for unemployment, it is projected to continue increasing to 11.2 percent 2010 respectively (in February 2010, the unemployment stood at 11 percent) (European Commission, Spring 2009a; see Table 2).

4.3 Poland

Poland is the largest NMS of those who joined the EU in 2004. As can be seen in Table 3, in that year Poland did not fulfill the convergence criteria; in fact it was further removed from meeting them than others.

[Table 3 about here]

Since 2000, Poland has had a freely floating exchange rate regime. Polish officials intend to join ERM2 for the shortest time needed, and their aim was to join some time before July 1, 2009. In May 2009, that date was delayed due the financial crisis and the resulting economic and currency turmoil. The Polish zloty has fluctuated over the period January 1, 1999 through the end of July 2008 but showed a trend of upward appreciation over this period of close to thirty percent. However, with the onset of the major difficulties in financial markets of summer and fall 2008 the zloty came down. From mid September 2008 to early June 2009 it tumbled more than 25 percent (ECB, 2009). In 2009, Poland missed most of the convergence criteria (except for the public debt which is high but still within the limit 50.6 percent). As for the GDP, although it declined in 2009, it stayed positive (1.7 percent).

5 GOVERNMENT, OPPOSITION AND THE ELECTIONS

5.1 Czech Republic

The June 13-14, 2003 referendum on EU accession represented a victory not only of the 77.3 percent (55.2 percent turnout) who voted for joining the EU (Hanley, 2004), but also to the efforts of the political elites, 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, Dürr, Marek and Šaradín, 2006: 250-251).

In the Czech Republic, the major parties are divided about their overall stance to the EU and, by extension, the euro. The four parties that have had seats in parliament since 2002, two of them are major parties: Civic Democratic Party (CDP or ODS) which is a euroskeptic party created by President Václav Klaus and the Czech Social Democratic Party (CSDP or ČSSD) – a party of the centre-left. The two others are much smaller – a communist party and a smaller Christian Democratic Party. In 2002 the CSDP was the largest party with 70 of the 200 seats, while the CDP 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 Prime Minister Topolanek. But the balance of power was very delicate. Indeed, after four attempts, the parliament succeeded on March 23, 2009 to bring down the Topolanek government (*FT*, March 25, 2009).[1]

From the outset the Czech government had planned to adopt the euro in 2010. However, by 2006 this date was becoming increasingly unlikely. In February 2007 the Finance Minister 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, an assessment was made by ERSTE Bank suggesting that euro adoption would not take place before 2015. In January 2009, the Topolanek government announced that a date to adopt the euro would be decided by November 1, 2009 (Prague Daily Monitor, January 2, 2009). This announcement was welcomed by opposition parties, though it was never fulfilled due to the unstable political situation. In addition, the term of the new government of technocrats, which was appointed following the fall of Topolanek government, lacks the

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

mandate to make major decisions during its short time in power before the parliamentary elections take place in May 2010.[2]

In the Czech case, the role of the euroskeptic President Klaus is of particular importance. The President first took office in 2003 and was re-elected in 2008. He was a devoted euroskeptic and influential figure in the Czech political scene. Besides having founded the Civic Democratic Party in 1991, 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.[3]

5.2 Hungary

The April 12, 2003 referendum 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 percent of eligible voters who turned out to vote in the referendum (one of the lowest turnouts in NMS referendums on EU accession), 83.76 percent voted in favor of EU accession while 16.24 were against (Fowler 2005). The major political parties were in favor of EU accession and there was no division among them neither regarding the EU nor the euro.

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[2] Following the fall of the Topolanek government in the spring of 2009, an early parliamentary election was scheduled to be held on 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 allows for early elections to be held on November 6-7, 2009. However, the amendment did not pass due to the lack of support where the Social Democrats, Communists and Greens blocked it. Therefore, the parliamentary elections will not take place until the four year term of the current chamber is over which will be in May 2010.

[3] Klaus euroskepticism is clear through out his speeches and acts. He even compared the EU to the former Soviet Union and even 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, 2009).

The Hungarian political system is characterized as a multiparty system as there are two major parties, but neither can form a majority without a coalition partner. The two major parties are the Hungarian Civic Union (FIDESZ), the main conservative party, and the Hungarian Socialist Party (MSZP), the main social democratic party and currently the minority government. MSZP has had a minor coalition partner: the Alliance of Free Democrats (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 by not only 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 factor that contributed importantly to the domestic political landscape was the fact that welfare spending and the euro adoption strategy "became heavily politicized" (Greskovits, 2008: 283). The opposition not only criticized 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. With the exception of some insignificant extreme right and left parties, the major political parties are pro euro and support euro adoption (interviews with the authors; Greskovits 2006). Thus, when political tensions were high, political parties quarreled over healthcare and privatization rather than the euro (see EIU, 2008).

Hungary's 2002 elections witnessed hefty competition among the various political parties to attract voters. In the heat of the campaign each of the political parties pledged more and more funding to various societal groups. 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 (Greskovits, 2006: 186; Horvath, 2009; EIU, 2008: 31). All these efforts were directed to increase the popularity of the political parties and attract more votes. Part of the government target was to provide funds to inactive citizens because a large part of the economy was inactive (Fazekas, 2004; OECD, 2005; Horvath, 2009). The introduction of the huge welfare measures by Socialist government of Prime Minister Péter Medgyessy led to the sharp increase in the budget deficit (9 percent of GDP) (Euractiv, 2005). These measures that increased spending did not take into consideration the euro adoption target, with as result a poorer performance on the convergence criteria.

Between 2002 and 2006, the fiscal conditions worsened and the credibility of the Hungarian government was shaken due to the continuous missing of the targets set in the various convergence reports. In the 2006 election campaign, "social welfare and the appropriate policy strategy for euro adoption" were used as tools to gain more electoral support (Greskovits, 2008: 283). The budgetary problems, especially the size of the deficit, did not disappear. By 2006, the 2010 euro entry date was dropped due to problems with the budget indicators (Euractiv, 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).

In Hungary, several reasons led to deteriorating fiscal situation, which rendered impossible the government's initial fast-track euro adoption strategy. These reasons included competition between political parties, the fiscal profligacy of governments in power, lack of political will, and the inexperience of governments with public finance. 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 to be ready to adopt the euro. 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.

5.3 Poland

In September 1993 elections, the 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 reform plan and the speed of such reforms. This political instability and division continued even after joining the EU and is reflected in the disagreement among the Polish elites and parties regarding euro adoption until now. The division in the Polish society created two kinds of conflicts: the first between the National Bank of Poland (NBP) and the government (in particular when Leszek Balcerowicz was the NBP governor from 2000-2006) and the second between the government and the opposition to which we now turn.

There are currently two major political parties in Poland: Civic Platform (Platforma Obywatelska or 'PO') and the Law and Justice Party (Prawo i Sprawiedliwość or 'PiS'). Both parties are centre-right but the PO falls in 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 Alliance of the Democratic Left (SLD) and a party called 'Labor Union' (UP) led by Prime Minister 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, the 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 percent and PO won 42 percent of the vote. A new government was formed under the leadership of Prime Minister Donald Tusk.

As far as the euro adoption strategy is concerned, the left-leaning government of the early 2000s (SLD-UP-PSL) formed a very motivated plan for euro accession in which the euro adoption date was set for 2007 (Zubek, 2008: 299). 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, 300). The PiS government was much less favorable to euro adoption. Prime Minister 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, 2007).

Following the 2007 elections PM Donald Tusk was once again more favorable to euro adoption and aimed 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 parliament, a decision to amend the constitution needs the votes not only of the ruling party, but also the opposition (especially PiS). The opposition, in addition to some left-leaning politicians, do not favor adopting the euro with the beginning of 2012.

On September 10, 2008 Donald Tusk made his announcement to aim at joining the euro by 2012 – a day after European Union finance ministers ordered Poland to do something regarding the deficit which was forecasted to exceed the ceiling of 3 percent of GDP in 2008 (Polish Ministry of Finance, October 2008; *The Economist*, 2008). However, with the fall-out of the financial crisis, the decline in the deficit will be hard to obtain. There are larger domestic obstacles that may frustrate the government’s ambitious plan. PiS made it clear that the only possible way to accept the constitutional amendment is if the current government calls for a referendum and has the decision be approved in a popular referendum. 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 percent, which is unlikely to happen. Furthermore, it is unclear what question would have to be posed to the electorate in such a referendum.[4]

The euroskeptic President Lech Kaczynksi[5] at first supported the new fast-track plan but then changed his mind (EUObserver 2008). 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 these issues affect the capability of the government to take a major policy such as a euro adoption policy. In fact, on November 14, 2008, a day after having met with ECB President Jean-Claude Trichet, Tusk declared that there might need to be a delay to the 2012 date – quoting the need to avoid a referendum demanded by PiS (*FT* November 14, 2008). This likely delay was further signaled in spring 2009 (*FT* April 2, 2009).

With presidential and parliamentary elections to be held before 2012, a fragile coalition government formed between PO and PSL that might not continue after the parliamentary elections in 2011, euro adoption does not seem to be happening any time soon.

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[4] When Poland joined the EU, it committed to joining EMU, so effectively Poland has already committed itself to adopting the euro at some point.

[5] President Lech Kaczynksi 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. Under Poland's constitution, Mr Bronislaw Komorowski, speaker of the parliament, takes over the presidential duties until new elections are held. Presidential elections have to be held within 6o days.

6 CENTRAL BANK

6.1 Czech Republic

The Czech National Bank (CNB) was established in 1993 as an independent central bank. Since 1997, and at least until 2005, the CNB whose officials overall favored an early euro adoption faced considerable political pressure from those in government against speedy euro adoption. This 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 European Central Bank (ECB) and the International Monetary Fund (IMF)—criticized these changes. In 2001, the Czech Constitutional Court ruled the amendment unconstitutional and annulled it.

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, 2015 is more likely). 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 period and are appointed for a six-year term. The new board members we interviewed hold views similar to those of the president (EIU, 2005).

The CNB incurred reputational costs because it had pushed and failed to secure an early euro adoption. Moreover, the appointment of persons who held views similar to those of the President caused the CNB's independence indirectly to be undermined. It seems to us 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 it stance. When it refrained from pushing hard for an early adoption, it allowed for more cooperation between the Ministry of Finance and the CNB. The two subsequently published joint documents similar to the one approved by the Government of the Czech Republic on December 16, 2008 (CNB, 2008). The report set out the intension of the Czech Government to join the euro area once the economic conditions are right. This renewed positive relationship between the government and the CNB in first instance contributed to the Czech Republic in 2006-8 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 percent will not be achieved—rather the annual growth of real GDP stood at -4.8 per cent in 2009. CNB governor Tuma announced on October 12, 2008 that the Czech Republic needs a break until the markets settle down and the financial crisis is sort of resolved (EUobserver, 2008).

6.2 Hungary

According to Article 1(2) of the Act LVIII of 2001 on the Magyar Nemzeti Bank (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 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 Járai (2002-2007), threatened the independence of the MNB. In an act that was considered a "political provocation" against Medgyessy (and the MSZP government)[6], 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. Jarai's views were strongly influenced by the 2006 target date to adopt the euro and he was critical of the government's promises to increase wages regardless of its effect on increasing the inflation. The forint had a ± fifteen percent fluctuation band against the euro and the MNB adopted an inflation targeting policy "and the exchange rate was used as a tool of disinflation" (Greskovits, 2008: 282). MNB policies were criticized of being too tight. Governor Járai, who was supported by FIDESZ-MPSZ (Hungarian Civic Alliance), 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

[6] Although Péter 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 Gyurcsány from MSZP.

and MPSZ who considered it to be a violation of the central bank's independence (Greskovits, 2006: 186).

The MNB policies were not only criticized by the government, but also by the exporters. Dissatisfaction with the MNB policies and governor Járai 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. This 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. However, 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, the MSZP won the majority and continued its coalition with the SZDSZ to govern. The disagreement and conflict between the government and the MNB was alleviated with the end of Járai term. The political reason for the conflict between the MNB and the government disappeared in March 2007 with the appointment of Andras Simor as governor of the MNB. Cooperation between the government and MNB strengthened and Simor succeeded in convincing the government to abandon the ± 15 percent fluctuation band target of the forint with respect to the euro. This supported the MNB efforts to reduce inflation (EIU, 2008: 33). The development in the relations between the MNB and the government eases the way for working harder to meet the criteria for adopting the euro.

6.3 Poland

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 zloty, 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 has 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 or not the euro should be adopted fast or slow. The euro enthusiast 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—represented mainly by the NBP governor Slawomir Skrzypek[7] (2007-2010)[8], PiS and the SLD—it prefer the slow track. Following the Tusk government announcement in fall 2008 to target 2012 for euro adoption, the euroskeptic governor has had reservations about its wisdom. Over the course of the spring and summer of 2009 others in the central bank also became

[7] He was appointed while PiS was in power in 2007.
[8] Slawomir 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 World War II. Around 20,000 Polish officers and soldiers were executed. Slawomir Skrzypek is replaced by the bank's deputy, Piotr Wiesiolek until a new governor is appointed.

convinced that the government's fast-track simply was not sustainable (central bank officials, April 2009 interviews with the authors).

The Polish road to EMU was delayed due to conflicts within the NBP over euro adoption, since the NBP was blamed for causing an economic slowdown due to its monetary policy. The SLD-Labor Union (UP)-Polish people's party (PSL) entered into conflict with the NBP accusing it of adopting bad policies leading to slow growth (Zubek, 2008: 298). The Miller government put all the blame on the NBP and mainly 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 euro entry was postponed to 2009. Although the plan helped the government absorb the EU pressures, the domestic implementation of the plan was not that successful. The main reasons behind that were the problems within the SLD ruling party resulting from Prime Minister Miller's support for 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 the NBP increased following the 2005 parliamentary elections. The new 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 Banking Supervision Commission

(KNB). This act by the new government was clearly considered an attack on the NBP governor at that time—Leszek Balcerowicz (Warsaw Voice, 2006; Zubek, 2006; 2008).

7 PUBLIC OPINION AND THE MEDIA

7.1 Czech Republic

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 (European Commission, 2008a: 38; Geršl, 2006: 38). Eurobarometer data for 2009 show that 54 percent of the population is dissatisfied with the fact that the euro will replace their currency while only 37 percent is content with that prospect (see Table 4). Moreover, according to the same poll 47 percent of the population wants euro accession to be as late as possible compared to only 14 percent that prefers fast euro adoption.

[Table 4 about here]

The role of the media in the Czech Republic is a little haphazard. 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. Another trigger for a larger public debate was the onset of Slovakia adopting the euro in January 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 percent of the Czechs were in favor of setting a date for euro accession during that coming year while 36 percent 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) are motivated in part because the Czech koruna is quite strong relative to the euro and other currencies (Prague Daily Monitor, January 2, 2009).

Independent of their opinion, overall citizens have not felt the euro adoption issue to be all that important. This lack of salience is one of the main reasons the major parties are not using the euro adoption as a tool to attract voters in the coming elections in May 2010.

7.2 Hungary

In 2007 only 49 percent of Hungarians were excited about the prospect that a strong euro would eventually replace their weak forint (Gallup Europe, 2007). Eurobarometer data of 2009 confirmed that Hungarians are divided on the issue euro adoption (see Table 5). 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. The percentage of those who consider the consequences of euro adoption to be negative is increasing: only 34 percent prefer speedy euro adoption compared to 24 percent who prefer a late adoption. As for the media, it is not that focused on euro adoption issues although 83 percent of Hungarians consider the television to be the main source of information. For Hungarians euro adoption is about costs and benefits in economic terms; the currency is not a source of identity (interview with the authors; see also Greskovits, 2008).

[Table 5 about here]

7.3 Poland

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 a 2009 Eurobarometer report, almost the same percentage of Poles is dissatisfied/satisfied with the overall prospect that the euro will eventually replace their currency (see Table 6). As can bee seen in that Table, although almost all Poles care about the implications of the euro with respect to their salaries, pensions, and bank accounts, 62 percent of Poles feel they lack knowledge about the euro. Almost half of the Poles think the euro eventually will have positive effect rather than negative effect.

Following the crisis, there was some pressure from some Poles, especially those who have loans in foreign currencies, for speedy euro adoption. They were concerned about the depreciation of the zloty. These advocates for early euro adoption, however, only constituted a minority since a small percentage of Poles want the euro to be adopted as soon as possible (18 percent) compared to 39 percent who want it as late.

[Table 6 about here]

As a result of the financial crisis, more Poles (albeit not the majority of the population) have become more enthusiastic regarding the euro, especially since 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.

9 CONCLUSION

Despite the fact that the long-term economic benefits outweigh the costs of euro adoption, the Czech Republic, Hungary and Poland are still outside the euro area. In this paper we offer an alternative explanation to the cost/benefit analysis and the predominantly constructivist approaches in political science to understand why three countries have not joined the euro yet. Although we agree that an economic analysis and a constructivist approach offer useful insights, they fall short in explaining what actually happens in nation states regarding the euro adoption strategy. While macroeconomic analysis points to the point of departure (the extent to which the countries are already close to meeting the convergence criteria, openness of the economy, etc.) it 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. By contrast, Poland, which is not close to meeting the convergence criteria, has a government keen to try to meet the criteria as soon as possible so as to join. Yet in Poland major obstacles are 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).

In this paper we have argued that a closer look at domestic politics helps understand the *process* and in particular the *timing* of euro adoption. All three countries went through the socialization process and transfer of ideas. In all three countries we saw more movement in the direction of cutting the ties with the communist past and moving in a full speed toward market economy and democratization, something emphasized by constructivists as explaining why euro adoption might be forthcoming. Yet, these developments were simply insufficient to secure a fast track to euro adoption.

An important finding is that no clear political consensus existed in the Czech Republic, Hungary or Poland. All three countries have had domestic problems and internal struggles. The Czech Republic experienced a long-time conflict between the CNB (early euro adoption) on one hand and the government and the president (euroskeptic) on the other. Hungary had a macroeconomic situation that would have made it easy to adopt the euro sooner rather than later but the government did not pursue the policies needed to enable early euro adoption (in fact totally opposing policies were pursued that sought to appease the electorate in which government and opposition were each trying to hand out funds to the electorate). As for Poland, the domestic problems leading to euro accession delays are several: struggle between the NBP and the government during the years of central bank Governor Balcerowicz; struggle between the government (euro enthusiast) on the one hand and the current NBP's governor and the president (both are euroskeptic) on the other; a struggle between the current coalition and the opposition (euroskeptic); and some legal issues that need to be resolved before joining the euro (changing the constitution).

In so far as public support is concerned, we were 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. What we found is that the public 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. From our interviews with key informants in these three countries, we 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.

Reflecting on these three cases we conclude that in order to understand euro adoption strategy one needs to take a domestic politics approach. Simply examining the pros and cons from a cost benefit analysis perspective is unsatisfactory, as is a general the constructivist approach. The latter is unable to examine the day-to-day politics, and hence the developments on the ground that lead to the policies that eventually determine whether a country is ready to adopt the euro.

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TABLES

Table 1: Performance of the Czech Republic on the Convergence Criteria 2004-2008

Czech Republic						
	2004	**2004 Reference Value**	**2008**	**2008 Reference Value**	2009	**2009 Reference Value**
Inflation rate %	1.8	**2.4**	6.3	**3.2**	0.6[a]	**1.53**
Interest rate %	4.7	**6.4**	4.63	**6.5**	4.84[a]	**5.9**
Public Debt %	37.9	**60**	30.0	**60**	34.4[b]	**60**
Deficit %	5.0	**3.0**	1.5	**3.0**	6.6[b]	**3.0**
GDP Growth[a]	4.5	NA	2.5	NA	-4.8	**NA**

(a) data from Eurostat; (b) data from EIU data set.
Source: European Commission (2004; 2008b); Economist Intelligence Unit (2010) and Eurostat 2010.

Table 2: Performance of Hungary on the Convergence Criteria 2004-2008

Hungary						
	2004	**2004 Reference Value**	**2008**	**2008 Reference Value**	2009	**2009 Reference Value**
Inflation rate %	6.8	**2.4**	6.0	**3.2**	4.0[a]	**1.53**
Interest rate %	8.1	**6.4**	6.9	**6.5**	9.12[a]	**5.9**
Public Debt %	57.6	**60**	73.0	**60**	70.2[b]	**60**
Deficit %	6.2	**3.0**	4.0	**3.0**	4.0[b]	**3.0**
GDP Growth[a]	4.9		0.6		-6.3	

(a) data from Eurostat; (b) data from EIU data set.
Source: European Commission (2004; 2008b); Economist Intelligence Unit (2010) and Eurostat 2010.

Table 3: Performance of Poland on the Convergence Criteria 2004-2008

Poland						
	2004	**2004 Reference Value**	**2008**	**2008 Reference Value**	2009	**2009 Reference Value**
Inflation rate %	3.6	**2.4**	4.2	**3.2**	4.0[a]	**1.53**
Interest rate %	6.9	**6.4**	6.1	**6.5**	6.12[a]	**5.9**
Public Debt %	43.6	**60**	47.2	**60**	50.6[b]	**60**
Deficit %	4.8	**3.0**	3.8	**3.0**	7.2[b]	**3.0**
GDP Growth[a]	5.3		5.0		1.7	

(a) data from Eurostat; (b) data from EIU data set.
Source: European Commission (2004; 2008b); Economist Intelligence Unit (2010) and Eurostat 2010.

Table 4: Czech Republic Public Opinion in 2009

Czech Republic's Public Opinion	
% of population	**2009**
Dissatisfied with the fact that the euro will replace their currency	54
Content with the fact that the euro will replace their currency	37
Want euro accession as late as possible	47
Want euro accession as early as possible	14
Well informed about the euro	52
Not well informed about the euro	45
Think the euro will have positive consequences	41
Think the euro will have negative consequences	46
Form their opinion based on its effect on salaries, pensions an personal accounts	87.2
Television is the main source of information	81
Using the euro makes people feel more European	67

Source: European Commission (2009b).

Table 5: Public Opinion in Hungary in 2009

Hungary's Public Opinion	
% of population	**2009**
Dissatisfied with the fact that the euro will replace their currency	38
Content with the fact that the euro will replace their currency	54
Want euro accession as late as possible	24
Want euro accession as early as possible	34
Well informed about the euro	38
Not well informed about the euro	62
Think the euro will have positive consequences*	49
Think the euro will have negative consequences**	37
Form their opinion based on its effect on salaries, pensions an personal accounts	88
Television is the main source of information	78
Using the euro makes people feel more European	30

* This has been increasing since 2004 when it was 32 per cent.
**This has been decreasing since 2004 when it was 54 per cent.
Source: European Commission (2009b).

Table 6: Public Opinion in Poland in 2009

Poland's Public Opinion	
% of population	**2009**
Dissatisfied with the fact that the euro will replace their currency	44
Content with the fact that the euro will replace their currency	45
Want euro accession as late as possible	39
Want euro accession as early as possible	18
Well informed about the euro	37
Not well informed about the euro	62
Think the euro will have positive consequences	52
Think the euro will have negative consequences	37
Form their opinion based on its effect on salaries, pensions an personal accounts	87
Television is the main source of information	96
Using the euro makes people feel more European	59

Source: European Commission (2009b).