Policymaking in times of crisis. An inquiry into the relationship between crisistime policymaking in the Eurozone and the world of academic economics.

Abstract:

The Eurozone has been the object of much controversy recently. Both on the member-state and on the EU level, policies are being made to cope with the many problems of the Eurozone. In this paper we state that academic economics is often unable to give the right advice for policymakers in the case of the Eurozone crisis, because this is a new situation where academics are disagreeing fundamentally about the best remedy for the problem. We come to this conclusion by first showing how one of the most prominent theories about monetary unions (the Optimum Currency Area theory) is unable to give any good advice to policymakers. After that we make a country-comparitive study between the ten new EU members in Central and Eastern Europe that joined in 2004 and 2007, which shows us that these countries respond fundamentally different on the Eurocrisis and that these reactions are more based on political and public support and national economic performance than on formal academic economics.

Paul Krugman: "But what's almost certain is that economists will have to learn to live with messiness."

Introduction

The developments in the Eurozone are currently one of the most treated topics in world media and economic analysis. The euro, which once started as a crown on the prestigious European integration project and a serious competitor to the dollar, seems to be in dangerous waters now. Politicians and policymakers devote a lot of their time and energy to the problem, and the EU seems to receive more attention now than it ever did. Several policies and reforms are being designed to make the recovery of the Eurozone possible.

At the time of writing, there are many conflicting opinions about the future of the Eurozone, both in academic literature, political rethoric and the press. After rigorous bailout packages, multiple European and international agreements and a deep economic crisis, it is still uncertain where the Euro will be in a few years. Questions on how to make policy in this environment are therefore very relevant, both on the member-state level and on the EU level. We can ask ourselves on what information policy makers could base their policies on in such a dynamic environment.

We can ask ourselves to what degree formal academic economics is useful in a situation like the Eurozone crisis, where the situation changes continuously, the economic situation is different for every member-state and economists fundamentally disagree about how to deal with the crisis. This paper is devoted to giving some inside in how the complex world of policymaking is connected to formal economics in the case of the Eurozone.

In the first part, we will analyze the Optimum Currency Area (OCA). This grand theory has been present for a long time, and did not wholeheartedly recommend building the Eurozone even before its creation. Policymakers however ignored this theory and created the Eurozone nonetheless. How is it possible that policymakers do not take the implications of such a prominent theory into full account when creating a monetary union. We will look into this question in the first section of our paper. We have picked the OCA framework because it is the biggest and most prominent grand-theory about monetary union, covered in almost all important textbooks about the Eurozone and monetary unions in general

In the second part, we will analyze how the new Member-States in the Central and East European region changed their perspectives towards the value of the Eurozone as a result of the current crisis. If a grand theory like the OCA was not taken into account, how do actual member-states form their policies and perspectives, and what are these policies based on? By answering this question we will find out how policy within the EU is actually being made and what foundations politicians use, provided that they cannot use the implications of grand theories like the OCA framework. We have picked the ten new Member-States of Central and Eastern Europe that joined in 2004 and 2007, because most of them have or had to deal with the question of Eurozone accession very recently. Therefore not only policymaking with regards to the Eurozone is very visible in these countries, also they still are more independent in their choices, compared to countries which are already old-time Eurozone members.

We will connect these two analyses by in the end answering the question: To what extent is formal economics useful and relevant for the policymaking process when it comes to the current Euro-crisis? Both academically and practically, probably a lot has changed due to the crisis, and with the two topics we cover, it is likely that we can illustrate nicely how this happened concretely. This paper will try to contribute to Eurozone understanding and policymaking by analyzing on what grounds policies are actually being made, and how this can be improved.

The importance of researching a topic like this can hardly be overstated as not only a very fierce discussion is going on about the strength and vividness of the Eurozone, but also there are great practical consequences attached to different scenarios of failure and success related to the Eurozone. The strength of the world economy depends for a not inconsiderable part on the success of the Eurozone and therefore it is of paramount importance to understand this project very well. Also it is interesting to see if in the end political opinions are more important than strict economic research. Since a project like the Eurozone has never tried before on a similar scale, a lot of academic work is to be done to improve our understanding of the Eurozone.

Methodologically, we will need to use both academic and non-academic sources to get a full picture of the matters we discuss. This is because we are on the one hand analyzing academic developments that are being followed by complex methodological-philosophical discussions but on the other hand also practical policy making developments that are covered more by political reports and statements and the media. Only by combining both kinds of sources can we create a full overview of what matters the Eurozone deals with.

With this thesis, we want to contribute to a broader understanding of the practical and theoretical meaning of the Eurozone by trying to evaluate 3 theses:

1. The Optimum Currency Area (OCA) theory is unfit to give us policy directions in the wake of the Eurozone crisis
2. Member-state and EU policies aimed at solving the Eurozone crisis are for a very large part dependent on ad hoc politics influenced by public opinion
3. Economic theory is only a minor factor in the policy considerations of policymakers dealing with the Eurozone crisis.

After finishing this thesis, the main goal is to gather more information about the changing position of the Eurozone in the public and academic perception. Hopefully some insight will be gathered with regards to the direction the Eurozone is likely to be going to, and the position it will likely have in the post-crisis world. Politicians often claim that policies are based on economic principles as a justification, but what are these policies really based on? This thesis hopes to provide more understanding of these matters.

Part I – The OCA theory and the Eurozone

Introduction

The first part of this thesis will look into recent academic developments regarding the OCA theory. We will analyze how the field of politics and the field of academics are interrelated when it comes to solving modern-day Eurozone issues. More specifically, we will look into the matter how the OCA theory, in academic literature probably the most prominent theory dealing with monetary unions, seemed to be not very represented in policies seeking solutions for the current Eurozone crisis.

In this section we will ask ourselves the question where the reasons can be found for the minor importance a major theory like the OCA framework had in relation to the creation of the Eurozone, and the subsequent dealing with its inherent errors. First we will shortly describe the background and history of the OCA framework, and we will continue after that by describing the specific combination of problems that have made this theory rather weak for actual policy making.

By giving such an analysis, we hope to not only get an insight in how and if the OCA framework could be improved, we also hope to get a further insight into the apparent distance between policymaking and academic research within the Eurozone. By doing this, we might contribute to closing the gap between the two fields, which can in turn help to avoid crises like the current one for the future.

Paragraph 1 – What is the OCA theory?

As mentioned already, the OCA theoretical framework in its broadest sense is a complex and constantly developing set of criteria with which the likelihood of success of any monetary union can be measured. Because we do not want to go into too much detail with regard to the complexity of this theory, because of the limited relevance for this on our research question and also for lack of space, we will stick to six main criteria that are commonly identified in academic literature surrounding this subject:[1]

[1] These basic criteria were taken from the textbook: Baldwin, C., C. Wyplosz, *The economics of European integration* (New York 2009) but can also be found in many other basic textbooks about European economics.

1. The criterion of Labor mobility developed by Mundell. This criterion defines that the more flexible the labor force is within a Monetary Union, the closer this union is to an optimum currency area. This is because in the case of asymmetric shocks, the labor force can move from the area that experiences a negative shock to the area that experiences a positive shock. This mechanism provides an automatic adjustment against asymmetric shocks.

2. The criterion of production diversification brought forward by Kenen. This criterion states that the more diversified production and exports are, the closer a region comes to an optimum currency area. This is because shocks usually affect a specific industry, meaning that in the case of diversification, shocks never hit one country very strongly. Furthermore if countries have the same production structure shocks are less likely to differ between countries.

3. The criterion of openness, defined by McKinnon. This criterion states that countries that are very open and trade intensively with each other form an optimum currency area. This is because these countries adjust automatically to shocks and do not need an exchange rate to do this.

4. The criterion of fiscal transfers. If countries agree to have a system of fiscal transfers in shape to compensate for shocks within the monetary union. They become closer to an optimum currency area, because this system dampens asymmetric shocks.

5. The criterion of homogenous preferences. This criterion states that the more the different countries in a monetary union have homogenous preferences towards the Philips curve tradeoff between inflation and unemployment, and the way to use monetary policy to achieve this balance, the more suitable they are to form a monetary union. This is because it makes the operating of a shared central bank easier.

6. The existence of solidarity within the monetary union. This is a very important, mostly political, closing criterion, ensuring that if asymmetric shocks appear, the member states of the monetary union can find a common solution to the problem.

The success or failure of any monetary union is measured in the OCA theory by the degree to which this union complies with these criteria. It is never made really clear when a monetary union passes the test of these criteria, and when this is not the case. When a monetary union does not pass or fail all of the criteria it remains objectively undecided whether this monetary union is an optimum currency area or not.

The Eurozone is exactly in this position; it passes some of the above mentioned criteria but fails on others. (Baldwin, Wyplosz 314-350) That is why in most economic textbooks about the Eurozone and the OCA theory, it is left blank whether the Eurozone is an optimum currency area or not, based on these criteria. Some theorists claim the when the Eurozone comes into existence, the criteria where it fails will become less grave due to increasing integration as a result of the Eurozone. Other theorists argue exactly the opposite, namely that the weaknesses that the Eurozone has as a monetary union according to this theory, will only become a bigger and bigger liability when the Eurozone is created.

Considering that the OCA theory is so closely related to the Eurozone, it is interesting that it cannot provide a clear answer whether the Eurozone is an optimum currency or not. The criteria that are given are all argued in an understandable way and make sense, but together they cannot give a proper answer towards the measure of which the Eurozone is an optimum currency area. It is interesting in this context how the OCA theory has developed alongside the Eurozone, something we will analyze in the next part.

Paragraph 2 – The Eurozone and the OCA theory, brothers or archrivals?

The OCA theory has always been closely linked to the actual development of the Eurozone. We might even claim that although the OCA theory claims to be universal in its conclusions, it bases itself for a major part on the developments in the Eurozone. The theory has come into existence at approximately the same time when also the first designs for monetary union had been created in the EU area in the 1970's.(Wyplosz 207-213) Since then, both the theory and the actual plans for monetary union have been slightly developing.

In the early 1990's the new political tide in Europe created an unprecedented window of opportunity for all the EU member-states to agree on actually forming a monetary union. (Palmer, Colton, Cramer) Despite of past failures to bring the countries closer together in a monetary sense, new plans were drawn to form a monetary union no later than the start of the 21st century. (Bomberg, Stubb) Considering the high risk and the past failures, one would expect that the member-states would be highly careful before starting this project and only going one step at a time.

The OCA theory has always been doubtful about the possible success of the Eurozone. (Baldwin, Wyplosz 314-350) The main argument against monetary union in the EU was that the different participating states would be economically too heterogeneous and that this had to be taken away first before any monetary union would be possible. (Wyplosz 207-213) The member-states however did not wait for this and created the Eurozone at high speed, with the argument that once the monetary union would be in place, economic differences between the different participating states would go away because of the economic convergence brought about by one big market and one big monetary union. (Praet)

Instead of taking into account the many criteria of the OCA theory, the EU policymakers created their own set of criteria that would form the foundation of the Eurozone. These were the five Maastricht criteria that were all concerned with the fiscal solidity of the Member-States. (European Commission) Also, the European Central Bank (ECB) got price stability as its main criteria. (Treaty on the functioning of the European Union) These criteria were not a middle way to bring the fiscally loose southern member-states and the fiscally tight northern member-states closer together, but rather an imposing of the German model of fiscal and monetary policy on the rest of the Eurozone. (Baldwin, Wyplosz 314-350) It was thought that this model would in the end also discipline the southern member-states, bringing them lower inflation more economic credibility and with that the same solid economic foundation of the northern member-states. (Wyplosz 207-213) This convergence would bring fiscal and monetary homogeneity to the Eurozone and the OCA problem of hetrogenity within the monetary union would be solved.

In the early years of the Eurozone, this plan seemed to work, as interest rates on government loans lowered considerably in the southern member-states and economic growth was strong. The Euro was seen as the main cause for impressive economic growth and a strong trading position vis-à-vis the rest of the world. (Wyplosz 207-213) This success story however came to an abrupt halt with the economic crisis that started in 2008 and is still ongoing at the time of writing. Major asymmetric shocks and an ever-decreasing trust of financial markets in the Eurozone have brought about so much damage and loss of prestige for the Eurozone and the EU that some economists even predict the Eurozone to fail, with major economic decline for its members as a result. (Feldstein)

As a result of all the damage done to the Eurozone, a deep remedy was needed to turn around the occurring problems. Because a crisis of this magnitude had not occurred before however, the Eurozone members did not have a readymade answer for a crisis of this magnitude. The support funds, trying to keep weaker countries like Greece in the Eurozone were simply not enough to turn around the whole crisis in the long-term and were not enough to find a durable solution for all the occurring problems.(Kanter) Therefore, other more structural solutions had to be found as well, and of course a starting point for these solutions are the world of academic research.

If we look at actual post-crisis policymaking, the stress of the solutions against the Eurozone crisis lies in combining making the existing fiscal rules members of the monetary union have to obey to, with new structural economic rules. (Kanter) It is the argument of policymakers that the crisis came into existence not because the Eurozone was an imperfect monetary union, but because the weaker member-states cannot obey the rather strict fiscal rules of the monetary union without also making structural adjustments to their economies. Therefore, governments are forced to cut their spending and size considerably to help them meet the fiscal criteria of the Eurozone.

As was the case during the creation of the Eurozone, the OCA theory was again largely ignored during the solving of the crisis if we look at the difference between the actual measures taken, and the measures that the OCA would recommend. Therefore the question that remains is why a theory that is so prominent in the textbooks about monetary union has been ignored so deeply by European policymakers. Do these policymakers ignore its implications because the monetary union is a political goal that they want to achieve despite of the grim predictions of the OCA theory or is the OCA theory simply not practically relevant enough for EU policymakers to take it into account for understanding the Eurozone? In the second section of this chapter we shall analyze why the OCA was not used in finding the cure for the Eurozone.

Paragraph 3 – The OCA theory and its link to policymaking

The OCA theory is a set of broadly defined criteria that are supposed to be a measuring instrument for the level of success any monetary union is likely to have. Despite of its rather straightforward and simple character, the theory has not been widely used in Eurozone policymaking, both before and after the crisis. It remains an important question why this big theory was not more present, especially during the current Eurozone crisis.

In this paragraph we will try to analyze what the main reasons are for this lack of usage of the OCA theory, both while the Eurozone was being designed and while dealing with the Eurozone crisis. This way we hope to find out where the major weaknesses of the OCA theory can be found that can explain why this theory is so less present in policymaking compared to its big present in academic literature.

<u>Problem 1: Te lack of measurability and operability of the OCA theory</u>

A first problem of the OCA framework is that the OCA theory is very rich and broad, but not very specific and measurable, and this makes it hard to use the theory for tracing weaknesses in a monetary union and drawing conclusions that will help to solve them. In fact, it is almost impossible to measure the OCA criteria towards any specific standards. Even if measuring these criteria would be possible in principle, means to measure them in one unified way are not provided and therefore, most textbooks simply use their own self-made criteria to measure these things.

This problem of lack of measurability is strongly related to the second problem, which is that very often, no final conclusions can be drawn with regards to the strength of a currency area from the OCA theoretical framework. The theory therefore also lacks a certain operability.

Before we consider this a problem, we have to realize, that the OCA as a framework is in principle not meant for ex post policy use. The framework is made to tell us something about the viability of a monetary union, in the case a group of countries are considering creating one, but the theory is not designed for giving policy advice afterwards. Therefore, the theory cannot be fully blamed for not being operable after the Eurozone crisis hit, because it did warn policymakers before creating the Eurozone that it would not be a perfect optimum currency area. This fact does however not excuse the OCA theory from telling us to what extent a monetary union is and will be an optimum currency area, something the OCA theory has more or less failed to do.

The OCA theory claims to be able to judge monetary unions for their economic viability by giving a set of criteria which a monetary union does or does not fulfill, the OCA tries to indicate when creating a monetary union is a promising idea and when it is not. In practice it seems though, that it has been hard for the OCA theory to give a meaningful answer towards the question whether the Eurozone is a viable monetary union. (Baldwin, Wyplosz 314-350) The core the issue is, that according to the theory, the Eurozone is not fully an OCA, but also not fully not.(Wyplosz 207-213) The only criterion that seems to have been fully met is the criteria of full labor mobility. (Baldwin, Wyplosz 314-350) Most other criteria are in different degrees met or not met. This is compared by Wyplosz to a glass half full and half empty.(Wyplosz 207-213) Of course this is a considerable problem if we try to use the OCA to give us any policy advice.

This lack of measurability is firstly the result of that fact that the OCA theory as a whole does not have conclusive measuring tools to analyze whether a monetary union is, or is not an OCA. (Wyplosz 207-213) The theory can only work in terms of lesser and more, but not in yes or no, when it comes to assessing whether an entity is a viable monetary union or not. What makes conclusive measuring even harder, is that the different OCA criteria all need to be combined in the final judgment of any monetary union and this is very hard if every individual criterion remains vague about its conclusions.

A second major problem is that even the individual OCA criteria are sometimes hard to measure. We can see that when evidence is abundant, like the evidence that proves that the Eurozone has helped to increased interbloc trade considerably, it is relatively easy to prove that the specific criteria has been met. (Baldwin, Wyplosz 314-350) When there is however not such abundance of evidence that a criteria is met or not met, or if the proof leaves this question without a clear answer, it is very hard to draw a conclusion. (Baldwin, Wyplosz 314-350) These vaguenesses make it hard to conclude the viability of a monetary union even in the case of individual criteria.

On top of this, some OCA criteria, like that of interbloc solidarity, cannot be measured in a quantitative way at all, and is vulnerable to subjectivism in a qualitative way. The result of this weakness of measurability is that these criteria only blur the sharpness of an overall OCA analysis as they make the space for discussion and interpretation bigger, and not smaller. Of course in social science we have to accept that there is always space for discussion and interpretation, but with criteria as broad as those of the OCA theory, it could help the usefulness of the theory if they were more specific.

For all these reasons the OCA theory is hard to use in a measurable way. Because of this, any conclusions that come out of the theory are very broad, and extremely open for interpretation. This makes the theory easy to use for politicians if they need an academic foundation for their arguments, but much harder to use for policymakers that need a solid ground to build their policies on. This reduces the usefulness the theory can have for policymakers.

Of course one could argue that some policy use can be found if we analyze criteria qualitative instead of quantitative, and afterwards try to design policies to improve a monetary union with regards to a given criterion. If we would do this however, it will often be very vague how much an OCA needs to be fixed with regards to a specific criterion and what is the best solution to achieve this fixing. An additional problem with regards to this is that criteria and ways to improve them might be conflicting to each other, but we will deal with this in more detail later.

All in all we can conclude that the practical use of the OCA theory for policy analysis, at least in the cases where there is no abundance of either positive or negative proof, is not very big if we want measurable quantitative results. Because of this, Eurozone policymakers were not only unable to get a lot of clear answers from the OCA theory, but were even able to interpret the OCA conclusions as they wanted to interpret them. From a scientific point of view, this is of course exactly the kind of thing that science is supposed to prevent and therefore the lack of measurability weakness is a sizable problem from an OCA perspective.

Problem 2: The conflicting nature of specific OCA criteria

Another issue that makes the OCA theory problematic is that its set of criteria is being presented as being definite, complete and fully coherent. In reality however, the different OCA criteria were not created as a coherent and complete set, but where rather created overtime, with different criteria being added when needed. (Baldwin, Wyplosz 314-350)   In principle this could be a normal course of scientific development (most theories are being edited and made more complete overtime), but this is not necessarily the case with the OCA theory, if we look at how the criteria work in practice.

A first important conflicting element can be found between the criterion of fiscal preference coherence and the criterion of solidarity. During the recent crisis it became extra clear that if there is a high degree of solidarity and willingness to support each other in a monetary union, this can be an incentive to behave irresponsibly when it comes to fiscal policy as this state can always count on the solidarity of other states. (Boone, Johnson 1-2) This has de facto contributed to the slowing down of the intended increase of coherence between fiscal preferences of several member-states. This slowing down can also be caused by the risk sharing mechanisms that another OCA criteria considers beneficial for the functioning of a monetary union.

Related to this, also the existence of fiscal transfers and solidarity could potentially be a danger towards guaranteeing full labor mobility. This point has not been thoroughly researched, and therefore we have to be careful by making statements, but it would not be illogical that, because of the solidarity transfers made in the past, certain European Member-States were able to keep high unemployment and generous social welfare systems intact, despite of the inability of states to pay for this by themselves. (Garcia-Rubiales 27-29).This has blocked the motivation of the citizens of these poorer states to move to other states to get a job.

This example can be clearly explained if we compare Poland and Greece. The Polish government was forced to meet the Copenhagen criteria and has always followed policies of fiscal stabilization and lowering the role of the welfare state. (Buzek 187-190) Greece on the other hand did not have to reform their state finances as intensively and has a much bigger welfare state. (Pessoa 21-22) The result has been that Poland has seen relatively big labor mobility and low unemployment, while Greece has seen high unemployment and low labor mobility. (Buzek 187-190) In the past Greece could finance it with occasional devaluations vis-à-vis other EU member-states and later cheap borrowing made possible due to the credibility received by belonging to the Eurozone, but now with the Eurocrisis it becomes painfully clear that fiscal reforms are needed to turn the tide. (Pessoa 21-22)

The biggest problem with this lack of coherence and direction between the OCA criteria, is that it gets very vague what good policy steps are in an OCA framework. It is hard to make policies to strengthen a country with regards to one OCA criterion, if these policies potentially harm how the country performs with regards to another criterion. Therefore this lack of coherence poses another serious problem with regards to the serious use of the OCA framework.

<u>Problem 3 – The lack of political interest in the OCA conclusions</u>

An additional problem with the OCA has nothing to do with the academic quality of the theory. This problem is purely related towards Eurozone politics. The message that the OCA brings is not always convenient for Eurozone politicians. The reason for this is firstly due to the fact that the political will of EU politicians to create a Eurozone was sometimes stronger than the academic opinions about this Eurozone. Secondly, considering the circumstances, the creation of closer monetary union also seemed unavoidable in the environment of ever closer European integration. We will explain these two factors in more details below.

With regards to the political will of Eurozone politicians, we have to consider that during the time of the Eurozone creation, as we already described, a unique window of opportunity was open in the early 1990's when the Eurozone was created. (Jonung, Drea) For this reason, politicians were strongly pressed to form the Eurozone as quickly as possible, even though theories like the OCA theory were not overly supportive of this idea. The Eurozone was seen as an important political and economic means of bonding inside the Eurozone and the focus of the creators was of the benefits, mainly the lowering of transaction costs and the increase of interbloc trade that it would mean.

With regards to the unavoidability of the Eurzone creation, by the early 1990's, economic circumstances had developed to a point that a very good argument could be made that there was no other solution for the Eurozone than a full-scale monetary union. Since the Bretton-Woods system collapsed in the early 1970's, the EU had been looking for an answer to how to deal with the obvious trouble flexible exchange rates brought to the ever more deeply integrating common market. (Baldwin, Wyplosz)All attempts to create more stable exchange rates however, had resulted in failure so far. In the end, it seemed that there was only a choice between flexible exchange rates on the one hand, and a fully fledged monetary union on the other hand. All attempts to create something in between had proven to be unstable and prone to fail. (Baldwin, Wyplosz) Since the politicians of the EU Member-States had great things in mind or the EU, a monetary union seemed like the more desirable option over the idea of fully flexible exchange rates. The plans were backed by the scientific idea of monetarism, which stated that convergence would follow after the creation of a monetary union. (de Grauwe)

It is not to state that politicians willfully ignored the OCA theory; the good reasons they had to ignore it are just part of the problem here. The other part is that, as we discussed earlier, the OCA was too vague and inoperable to give any strong arguments or answers against the politicians ignoring the theory. The best that could be done from the OCA point of view was arguing that the Eurozone was not a perfect monetary union, but how imperfect it was no one could really tell. This made it easier for decision makers to overlook this theory altogether.

On top of this, as we already showed, the OCA theory leaves a lot of space for interpretation because it is unable to provide clear and unambiguous conclusions. As a result, politicians have been able to use the OCA theory in whatever way they saw fit. Critics could claim that the OCA theory has always been claiming that the Eurozone was not a perfect monetary union; Europhiles could claim that although the Eurozone is not a monetary union in OCA terms, there are enough arguments in favor of it. Because the theory leaves space for these interpretations, it loses credibility.

We can conclude that both on purpose and because of the academic weaknesses of the OCA theory, policymakers did not, or were not able to take the conclusions of the OCA into account. The important thing we need to realize here however is that the main reason for the ignoring of OCA conclusions by politicians, was probably not out of political objectives, but because of the lack of hard conclusions coming from the OCA theory. This partially frees these politicians from the guilt of being biased.

Problem 3: the lack of relevance of the OCA theory with regards to the current crisis

We have already assessed that the OCA theory has its weaknesses with regards to solving the current crisis because of the lack of operability, measurability and conflicting individual criteria. An additional problem that decreases the usefulness of the OCA theory is probably the fact that the biggest issues causing the current crisis in the Eurozone seem to be only thinly related to the topics that the OCA framework deals with. Because of this, it is hard for policymakers to use the Eurozone in a relevant way. In this chapter we will analyze how much the policies that have been designed recently to cope with the crisis can be linked to the OCA theory.

If we look at the current trends of analysis inside the Eurozone, one of the biggest problems seem to be the structural differences with regards to economic, fiscal and structural culture within the Eurozone. (O'Leary 1-5) This leaves the member states with a very clear choice, either they will have to adapt to the one size fits all Eurozone, or they have to abandon the Eurozone. Slowly Eurozone members are getting closer towards more convergence to make all members adapt to the Eurozone, but there is still a long way to go.

The only element of the theory that touches this specific problem is the OCA criterion that countries in a successful monetary union need to have similar fiscal preferences.(Baldwin & Wyplosz This is one of the few parts of the OCA theory that has been actively embraced by Eurozone policy makers and has been taken into account a lot while forging the Eurozone. Every member state had to commit itself to strict anti-inflationary fiscal and monetary policies that were supposed to make the Euro a strong and healthy currency.

Already before the crisis however, the rules that were supposed to make this possible were ignored by almost all Eurozone members and the EU did little against this, not for a large part because it was just not possible for some member-states to forge their policies in a way to both obey these rules and make the national electorate happy. (Baldwin & Wyplosz) With the current crisis we can see that the mere existence of these rules on the surface are simply not enough to save the Eurozone as it becomes more and more visible that the underlying structure of the individual state is essential for making Eurozone friendly fiscal and monetary policies on the surface.

This more fundamental problem however, is not picked up at all by the OCA theory, because it only chooses to focus on the policies of fiscal preferences, which are mainly the surface. The whole underlying reality about the structure of national economies and societies, which together form the main reason why specific countries have specific fiscal and monetary preferences and mentalities, is mostly overlooked. (Baldwin & Wyplosz) The problem is that these underlying realities are now exactly the things that policymakers consider important to fix, for getting over the Euro crisis. Just stating that fiscal preferences have to be brought closer to each other is meaningless if not also the structures of the different member-states is forced to become closer.

As a result, actual policies made to cure the Eurozone (more strictly enforced fiscal rules, forced macroeconomic reforms in return for bailout packages and the proposal of European bonds and a banking union) have little connection to the OCA theory. (O'Leary 1-5) European policymakers realize that they have to go deeper than just paying attention to simple difference in fiscal preferences to reform the Eurozone. Also they seem to focus on the point of structural and fiscal differences inside the Eurozone, leaving most other OCA criteria completely out of the picture in their policy proposals.

For these reasons we can state that for saying anything meaningful about the current financial and economic crisis, the OCA theory is far too shallow. Not only is the statement that fiscal preferences have to be close between the member-states far too vague, as we cannot find out how close these have to be, nor how adjustment can be achieved. Also the underlying reasons why fiscal preferences are not closer than they are between the member-states is not treated at all. It is exactly this structural divergence between member-states economies and societies which form the main differences in fiscal preferences and on this subject matter the OCA remains mostly silent.

Conclusion

As we could when considering the four problems dealt with in this section, several reasons can be found why the OCA theory, though prominent in academic literature, was not more relevant for policymakers dealing with the current Eurozone. We can summarize these objections to problems of an academic nature, problems of a practical nature and problems of a political nature.

With regards to the problems with an academic nature, we have mainly seen that the OCA theory is firstly too vague and inoperable to give us the strong answers needed from the academic world when a problem in the practical world arises. The OCA theory has not been able to give these answers, especially in the face of the current crisis, and this has reduced its credibility to policymakers. Not only was the OCA unable to provide strong conclusions, in the case of the Eurozone, the theory was also unable to provide any definite conclusion with regards the Eurozone being an OCA or not, because the answer was left in the middle.

From a practical perspective, we can conlude that the OCA is unable to give a strong basis for policymaking. This is related to the academic lack of strong conclusions given by this theory, but also because the theory does not fully cover the problems that are currently plaguing the Eurozone. Especially with regards to the current crisis, the OCA fully overlooks the structural economic and social differences between the different Eurozone Member-States that form the basis for differing fiscal and monetary preferences. In the past, Eurozone policymakers thought that it would be enough to bring these policies closer on the surface, but now it has become clear that also the structural basis for these policies will have to be adjusted, and this is something the OCA tends to fully overlook.

With regard to the problems related to politics, the OCA is just not a strong enough theory to give the kind of answers that can truly change policies. Because the OCA is particularly vague in describing the Eurozone, politicians have been able to use the theory for their own particular aims, because too much space was left for interpretation in the OCA theory. Therefore the theory has not only lost credibility in politics, but also loses value at the moment when actual important policy decisions have to be made.

Before we draw our final conclusion it is important though to make one final note with regards to the OCA theory. In this chapter, we have found several arguments to point out that the OCA theory had several flaws in the context of the Eurozone, with a specific stress on the current Eurozone crisis. We however in no way try to state that the OCA theory is useless altogether. On the contrary, the OCA theory can give us some very important insights into the basic conditions a monetary union needs to function. We should however consider the OCA theory more as a wide-ranging philosophical theory than a practical economic theory that can give us some answers about how to make policy.

Part II – Changing perspectives on the Eurozone in the new member-states of Central and Eastern Europe as a result of the current crisis

Introduction

After analyzing the relevance of the OCA framework in the first part of this paper, we have seen that this theory is far removed from actual policy in the Eurozone. At the same time however, life goes on and policy has to be made. Is the policy being made in the Eurozone strongly based on academic findings, or is it more the result of day to day politics? We will analyze this deeper in the second part of this paper. In Central and Eastern Europe, many countries are currently facing the question of when and how to join the Eurozone. The current crisis the Eurozone is in has not made this decision easier. In both the academic and the political sphere, the current problems of the Eurozone have undoubtly changed the perspectives towards joining the Eurozone.

We have chosen to analyze the ten new Member-States of Central and Eastern Europe and their changing perspective towards Eurozone accession as a result of the Eurozone crisis because these countries are mostly new Eurozone members or on their way to membership, they have relatively more flexibility with regards to making decisions regarding the Eurozone than their brothers in the West. Also, since most of them are not yet Eurozone members, they can have a more independent view on the Eurozone than countries already inside the group, and even if they did already join the Eurozone, they did so mostly while the crisis was already unfolding.

For every country we will separate our analysis between political and economic arguments. First we will analyze how the political perspectives towards the Eurozone changed as a result of the crisis. After that we will do the same for economic perspectives. We make this separation because with regard to the Eurozone the economic, more analytical view is often different from the more practical political view. Therefore we will need to analyze both if we want to get a full picture over the country. In the end we will try to get an overview over how policy is really being made, and to what extent this is based on academic findings and on what extent on day-to-day politics.

We will analyze the countries by region, as usually perspectives towards the Eurozone differ depending on the region. We will start with an analysis of the four Central European countries Poland, Hungary, the Czech Republic, Slovakia and the only ex-Yugoslavian country Slovenia. After that we will analyze the three Baltic states and finally we will look at the two 2007 members Romania and Bulgaria. These groups are not only most of the time located in the same region, but also economically they are often similar. Therefore it makes sense to analyze the countries as one group.

Group I: Slovenia, Slovakia, the Czech Republic, Poland and Hungary

Introduction

The first five countries of analysis are characterized by being geographically closer to the heart of the European Union and being the five that are relatively more prosperous then the other five countries that belong to our second group of analysis. All but Slovenia also belong to the so-called Vysehrad group, where development and EU affairs are discussed in a common framework. These countries were forerunners in the process of seeking EU accession.

At the same time however, the countries have very different economic and political backgrounds if we compare them with each other. Some countries experienced continuing strong economic growth after the recent crisis took place; others saw a considerable economic downturn. Some countries are, from a macroeconomic perspective, totally ready to join the Eurozone, others have strong macroeconomic problems that still need to be solved. Not in the least part also, some countries are already part of the Eurozone, others are not.

It will be interesting in this chapter to find out whether a comparison between these countries will give us any recognizable commonalities when it comes to perspectives towards the Eurozone and views with regards to solidarity with the Eurozone bloc.

Slovenia

Introduction

Although we put Slovenia in the group with other Central European countries, the country is in many ways different from its neighbors. It has a different historical background, because it was part of Yugoslavia and not of the Russian satellite states. Also the culture of Slovenia is more Alpine, while the other countries in the group are more Slavonic. Also economically Slovenia has a considerably higher GDP per capita compared to the other countries, and its economic structure is less neoliberal than the other countries in the group. (World Bank)

At the same time however, Slovenia is closer in relative welfare to the other countries in the group, then to other EU countries.(World Bank) Also, like Poland and the Czech Republic, the country was one of the spearhead countries when it came to joining the EU.(Mrak, Rojec, Silva-Jauregui 367-381) When we look back further, Slovenia shares the heritage of the Austro-Hungarian Empire with the Czech Republic, Hungary, Slovakia and southern Poland.

Politics

Slovenia was the first of the new member states that decided to join the Eurozone in 2007, and was able to do so. This decision was made before the economic and financial crisis hit the Eurozone, and therefore the original decision to join was not influenced by the idea of unreliability of the Eurozone, on the contrary, the decisions were made during the glory years of the Eurozone. Only after joining, Slovenian politics had to form its perspective towards the evolving crisis.

Since Slovenia was already a member of the Eurozone, the decision was not whether or not to join, but rather how far to go when it came to saving the Eurozone. What is very important to realize is that Slovenia, like the other new member-states that joined the Eurozone, had to fulfill the very strict accession criteria, while the South-European member-states that joined the Eurozone from the beginning did not have to do this.(Cain) This difference has made the new member-states not very pitiful towards the Southern members that are in problems because they did not obey the

Eurozone rules from the beginning. (Cain) Many Slovenians are opposed to harsh austerity measures in their own country while other countries are being bailed out. (Cain)

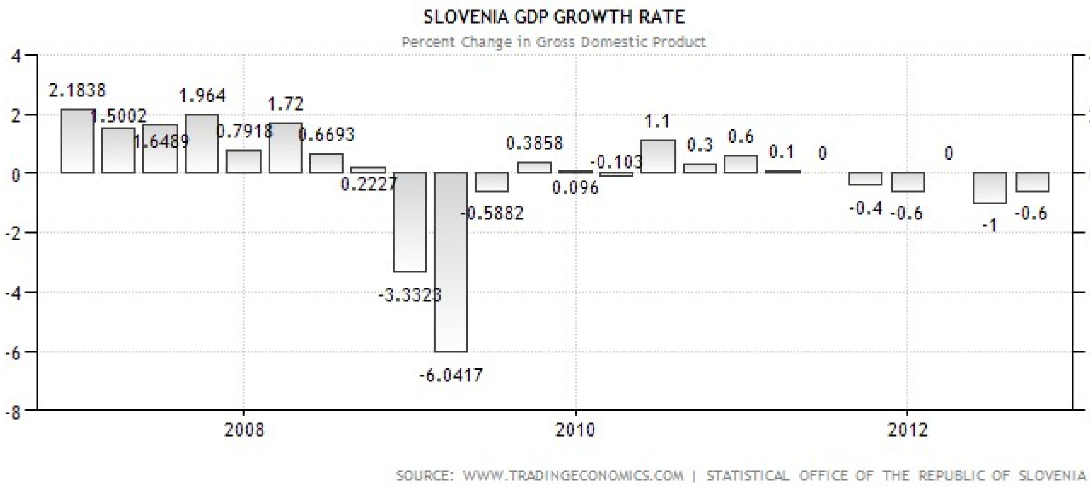
At the same time however, the majority of Slovenian politics realizes that the country is small and highly dependent on European trade. Therefore, most politicians are willing to stay in the Eurozone and take part in the bailout packages for the Southern Member-States. (Cain) There are little voices in Slovenian politics that truly state that the country should leave the Eurozone. With Slovenia bound to receive a bailout package itself in the near future, the country has increased its support for these measures even more. (Ernst & Young 3)

Slovenian politics is not one of radical opinions or high volatility in election results. If we look at the election results of the 2011 parliamentary elections we can see that three centre parties (positive Slovenia, the Slovenian democrat party and the social democrats) have a solid majority in Slovenian politics, one which they have had for a long time. (Cain) This guarantees a stable support for Eurozone membership and a pro-Europe stance from the politics. If we look at public support for the Eurozone in Slovenia, we can see that the majority of Slovenes back their politicians in supporting the Eurozone even though people are getting more and more gloomy about the general economic outlook for Slovenia. (Appendix I). This support is even despite of the very low confidence by Slovenians in their own economy as a whole.

We can conclude that Slovenian politics has a stable pro-Euro majority in politics which leads to an exceptional moderateness and Eurofriendliness considering the region Slovenia is in. Slovenian politics is therefore relatively supportive of Eurozone membership and is willing to make considerable effort for saving the Eurozone. This is partially the result of the fact that Slovenia feels that it has little choice with regard to its economic development than to be part of a healty Eurozone, partially it is also the result of its very moderate political scene. The perspective towards Eurozone membership therefore has changed very little as a result of the recent financial and economic crisis in Slovenia. Of course, being the first member of the Eurozone has become a lot less honorable and prestigious due to the recent problems, but this has not made any deep changes into the Slovenian political attitudes towards it.

Economy

Just as Slovenian politics is very centre-oriented and moderate, so is the Slovenian economic perspective towards the Eurozone. In contrast to the other countries of the group we are analyzing, Slovenia has a very social economic structure with a considerable role for the state. (Mrak, Rojec, Silva-Jauregui 367-381) This fact has also created more tolerance for EU economic intervention than the more neoliberal-oriented countries of Central Europe. (Emsden)



As a result of the crisis Slovenian economists of course could not escape from becoming more critical of Eurozone membership. (Eurobarometer 16-17) This does however not mean that they have started criticizing the basic economic rationales of the Eurzone. Economists realize very well that Slovenia's future lies in the European Union and that the Euro is a big step towards more economic integration into this union and more welfare. (Emsden)

At the same time however, the Eurozone has forced Slovenia to think about its economic future and development in the Eurozone. Before the crisis, joining the Eurozone was simply a big target for the country that was carried by a big consensus. (Mrak, Rojec, Silva-Jauregui) Joining the Eurozone was just another step towards a bright economic future for the country, and little economic arguments seemed to exist that would not favor Eurozone accession.

Now, the country that was once the richest and top performing country of the new member-states of Central and Eastern Europe is facing severe economic difficulties. While other countries in our group of analysis could keep economic decline within reasonable bounds, and even showed economic growth in the face of the crisis, Slovenia has been facing a deep recession. (OECD 1) Because the structure of the state and the economy is much more founded on a big state than the other countries of the group, Slovenia has found it hard to show the required flexibility and dynamism in the wake of the crisis, and was lacking the investment needed to help the economy recover. (OECD 11-12) In its recent macroeconomic imbalances report, the European Commission especially exposes the vulnerability of Slovenian banks and the threat of loss of competitiveness. (Ecofin Slovenia)

With regards to Eurozone membership Slovenia is now facing public interest rate rises that make it almost necessary for the country to apply for a bailout in the near future. (Emsden) Of course such a loss of national prestige has made economists reconsider many things about the structure of the Slovenian economy and state in relation to the Eurozone. In contrast to countries that faced bailouts earlier though, there seems to be no big resistance from the Slovenian society.

It seems to be the case in this specific country that because of current problems, Slovenia is mostly not blaming the Eurozone for problems in its economy, but is rather blaming its economy for problems with regards to the Eurozone. (Emsden) In the past, major economic reforms have already been made to make it possible for this country to join the Eurozone, and it seems that the country is not scared to plan even further reforms to stay a healthy Eurozone member.

We can therefore conclude that from an economic point of view, Slovenia's perspective towards the Eurozone did not change much with regards to the positive/negative dichotomy. The biggest perspective change was, that Slovenia changed from a country that rather blindly took everything European as a step forward and strove for full Eurozone membership, towards a country that now carefully analyzes the development of the Eurozone and the relation towards its own economy.

In fact, many international economists feel that the recent Eurozone problems are a good motivational factor for Slovenia to make structural reforms in its economy. (OECD 11) As the richest of the new joiners, Slovenia has long been spoiled, being less forced than other newcomers in the EU to think about reforming their state. This lag is now catching up with Slovenia's development and therefore there is finally a strong motivation in the country to reform state finances and the banking system. (OECD 11) The first moves are now being made by Slovenia to ensure these reforms, and this is for a large part because of the weaknesses made obvious by the Eurozone problems.

Economically therefore, Slovenia is in a rather unique position compared to the other countries in our group of analysis and even in the European Union as a whole. In its GDP per capita and state structures, it resembles more a western country than a new member state. The Alpine nature of the country is therefore also reflected in its state organization which is much more social than the other new member states. At the same time however, the country never got as privatized as other Central European countries which puts them in a unique position. Therefore the constructive attitude towards the Eurozone related reforms is also unique.

Conclusion

If we consider the political and economic perspective change in Slovenia as a result of the recent economic and financial crisis, we can conclude that there has been little growth of skepticism towards the Eurozone, both in a political and in an economical sense. Politically Slovenia's biggest political parties have kept supporting the Eurozone, realizing that Slovenia has little future outside of the Eurozone. Economically, Slovenia sees its lacking reforms as the major cause of its current problems and not Eurozone membership itself. Slovenia has remained faithful to the Eurozone and is willing to support the zone until the end.

Slovakia

Introduction

Slovakia is the second new Member-state to join the Eurozone in 2009. After several problems of mainly political nature in the 1990's, the country was one of the fastest growing economies in Europe between joining the EU and the coming of the crisis as we can see in the diagram below.(Table SK1) It surpassed its former 'big brother' the Czech Republic in economic growth figures and Slovaks were paying with the Euro before the Czechs did. The country seemed to be facing a bright future, safely embedded in the European Union and on its way to hit West-European GDP per capita and general welfare figures.

Despite of the crisis and Eurozone membership, Slovakia continues to grow, and therefore there seems to be little reason for change in the countries perspective towards Eurozone membership. In 2011 however the country reached newspaper headlines by the unwillingness of its government to support a further bailout package for Greece.(Stobart) It is therefore interesting to look deeper into the views of this country on the Eurozone.

Politics

Slovakia's decision to join the Eurozone was made before the financial and economic crisis arrived, but the final step was taken when the crisis was already visible. In 2009 and 2010, it briefly seemed like Slovakia would suffer deeply from the crisis and joining the Euro was only making these problems worse as we can see in the table in the introduction. Since then however, Slovakia has continued growing and shows that being a part of the Euro does not have to be a liability. How did the political perspective on the Eurozone change because of the recent crisis?

After severe political problems during the Meciar era in the 1990's, which estranged Slovakia temporarily from the west, Slovakia made a swift comeback in the first decade of the 21st century. This involved major economic and political reforms to make the country a modern democracy and market economy. EU membership was embraced, and so was the joining of the Eurozone in 2009.Slovakia had to make major structural economic reforms to join the Eurozone and therefore a solid political support was needed. Getting this support before the crisis was no problem. Slovakia had set a clear course to embed itself in the institutions and organizations of the West and being part of the EU and the Eurozone was a natural element in this process.(Visehrad) Additionally, Slovakia as a small, export driven economy owed its growth for a large part to being part of the EU and joining the Eurozone was expected to only bolster growth.(European Commission) The reforms that had to be made were sometimes painful, but most parties felt that making these reforms were unavoidable anyway for making the Slovak economy a modern economy.

When the crisis came, political support for being in the Eurozone on itself did not change much.(Appendix I) Slovakia keeps growing and has little other options than staying in the Eurozone. The political perspective however changed greatly with regards to how the Eurozone is organized. Slovakia is no longer a country that is outside of the Eurozone and has to obey the gatekeepers, but is now a full member and in economic terms maybe even an example for other European states.

Like Slovenia, Slovakia had to make deep and painful reforms to be able to join the Eurozone, contrary to some already existing Eurozone members. Therefore many people feel like the bailout packages Greece is receiving now can only come with the same kind of deep reforms they had to make to join the Eurozone. This view is part of the explanation of Slovakia's hard stand with regards to bailout packages and the difficulties the country had in supporting the packages for Greece in 2011. (Stobart)

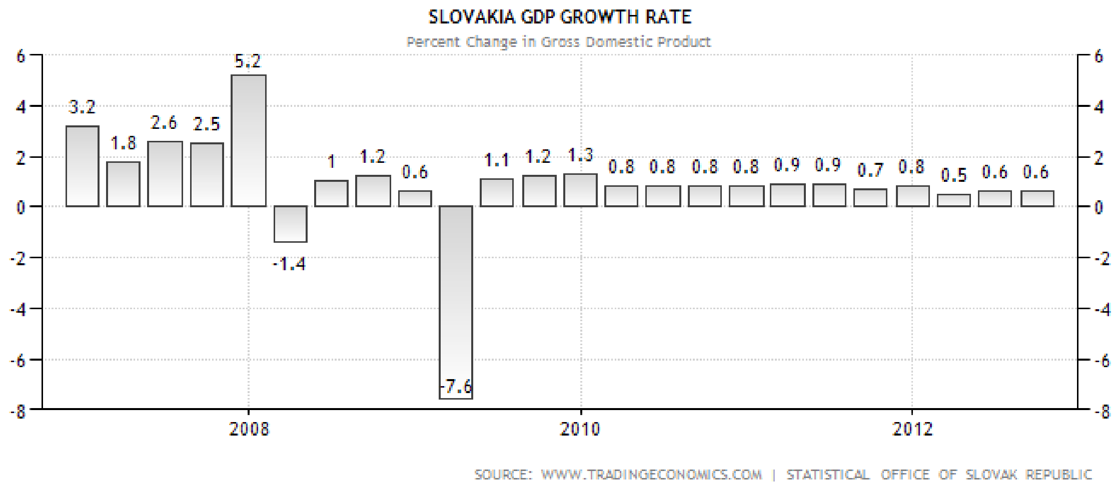
The other important part for Slovakia's strong stand with regard to the bailout packages given to Greece and other countries, is that Slovakian politicians realize that the country has a lot to win or lose with regards to the continuing success of the Eurozone. Therefore there is a strong opinion in Slovakia is that the Eurozone needs to be fixed, and that the economic health of the Eurozone is more important than the political goal to keep the Eurozone together. If changes have to be made to the composition to the Eurozone to make it healthy again, like some countries leaving it, for Slovakia this sometimes seems like a sacrifice that is worth to be made.(Visehrad.info)

We can conclude that the current crisis has not made Slovakian politicians more Eurosceptic in general. Scepticism about the health of the Eurozone and the worthiness of some of its members to be a part of it, has risen a great deal though. Slovakia values its recently gained economic success and knows how deep reforms can help to reform a countries economy. It is therefore not scared to expect these reforms also in a European context.

Economy

Slovakia is one of the champions of the new member-states of the EU when it comes to economic growth. Since 2004 the country has had unprecedented growth figures and despite of a slight downturn in 2009 and 2010, the country is now again experiencing growth, despite of the crisis. This growth is especially impressive if we consider that most of the 1990's, Slovakia was having major political problems that almost isolated the country from the west.

Table SK1



Ever since the country came out of this isolation in the late 1990's though, growth has been very fast. Slovakia made an impressive economic comeback in the early years of the 21st century and it was still able to join the EU with the other Vysehrad countries in 2004. This was an important milestone for Slovakia as economic growth was bolstered even more after this. Slovakia was able to use the common market for its industrial export and a vast inflow of FDI followed.(European Commission) Being part of the EU and the Eurozone is probably the most important reason for the growth Slovakia is experiencing. Slovakia's growth started to increase significantly after joining the common market in 2004. Therefore, before the 2009 crisis, there were no significant economic arguments in Slovakia not to seek Eurozone accession as well, as this would only strengthen the benefits the country was already gaining from EU membership.

When the crisis came, Slovakia freshly joined the Eurozone. The country experienced a severe economic downturn after years of growth in 2009, and some economists would argue that seeking Eurozone accession was not a good idea after all. However from the beginning it was clear that Slovakia as a small, export driven economy had no real future outside of the EU and the Eurozone. Therefore, from an economic point of view, the perspective in Slovakia that Eurozone membership was beneficial did not change much because of the crisis.

On top of this, Slovakia managed to achieve a considerable recovery since 2010 which got the country back on track. This strengthened the arguments of pro-euro economists as the countries development increasingly became an example of how Eurozone membership did not have to be disadvantageous for a country. As long as the country keeps up its performance in the way it is doing now, it is unlikely that economists will consider the euro a bad choice for Slovakia.

To conclude, we can state that, because Slovakia has shown to be doing very well economically, despite of its Eurozone membership, there are little economic arguments against Eurozone membership for Slovakia. The currency has proven to strengthen the inflow of FDI and embeds the export oriented economy even deeper into the common market.

Conclusion

Slovakia has proven that, in the midst of the crisis, Eurozone membership can be beneficial. Slovakian transition to the Eurozone has been smooth and its economy is still growing. Although public support for the Euro is not as high as it could be, for a large part because of inflation perception, the Euro is now solidly founded in the Slovakian economy, and both politics and economics largely support the Eurozone project. This was the case before the crisis came, and is still the case after the crisis hit the Eurzone.

The Czech Republic

Introduction

After 1989, the Czech Republic was seen as the most promising former Soviet satellite state. Its economic transformation went relatively smoothly and also politically the Czech Republic was scoring the highest of all satellites on many criteria. Over the years, the Czech Republic has been able to maintain this position at the top, although recently, economic growth in the Czech Republic has been slower than in some of its neighboring countries.

With regards to the Eurozone accession, the Czech Republic is an interesting case to study. Because the country is economically one of the most advanced and strongest countries of all the new members of 2004 and 2007, one would expect the country to want to join the Eurozone as quickly as possible, especially because the Czech Republic is an export-oriented country that relies heavily on foreign trade, in particular with the EU. This far however, the Czech Republic has been resisting accession. In this section we will analyze what the major arguments are for this.

Politics

The relationship between the EU and the Czech Republic has always been a difficult one. Eurosceptics have a relatively strong support in Czech politics and know how to make themselves very visible, both nationally and internationally because many Czech Euroskeptics are in high government positions (most famous president Václav Klaus himself). (Carney) Therefore, Eurozone accession was never an easy consensual point on the Czech political agenda.

Originally, the accession date for the Euro in the Czech Republic was set at 2010, but was then postponed time after time, and currently it is uncertain when and if the Czech Republic will join the Eurozone. Prime minister Necas even officially declared that the setting of the accession date to the Eurozone would not be set during his time in government.(Bauerova) This negativity towards joining the Eurozone is supported by a vast majority of the Czech Public.(Appendix II)

Even before the 2009 crisis, the Czech Republic was one of the more Euroskeptic member states. The first reason for this was that the Czech government did not believe much in the strategy followed by the European Commission, that Eurozone accession had to come first and only after that adjustment of the economy to make the country fit into the Eurozone better.(Vysehrad) The Czech government therefore wanted to reduce its fiscal deficit first in order to be more fit for Eurozone accession.(Vysehrad) In fact the Czechs wanted to do what many Mediterranean countries are forced to do now to save the Eurozone. In this sense, the Czech government can be said to have been quite visionary.

Another important reason why the Czech government was reluctant to seek Eurozone accession was the fact that a majority of the population was against Eurozone accession even before the crisis. Euroskepticism has always been rather strong in the Czech Republic and this is reflected in the policies of the main parties. The conservative ODS has always followed a rather Euroskeptic course and the social-democrat CSSD is only supportive of Eurozone accession to a certain degree.(BertelsmannStiftung 2,3) The only true Eurofile party is the conservative Top09, but this party is unable to turn the tide of Euroskepticism in the Czech Republic on its own. .(BertelsmannStiftung 2,3)

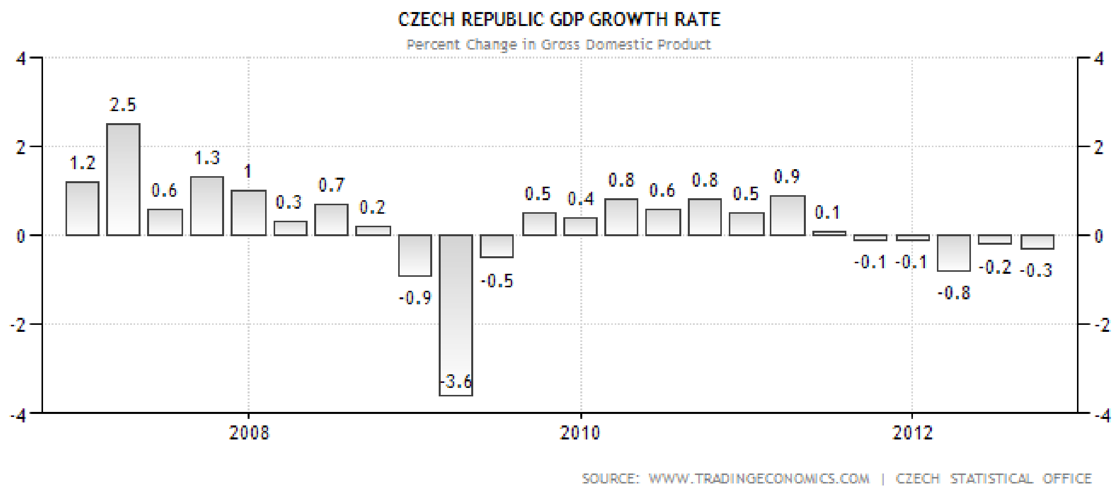
Logically the arrival of the Eurozone crisis did not help to cure Euroskepticism in the Czech Republic. The public opposition against the Euro increased even further from around 55% in 2008 to around 80% in 2011.(Appendix II) The Czech government stopped seeing Eurozone accession as a target to be reached after fiscal balance had been increased, and started to postpone the Eurozone accession indefinitely.(Bauerova) The official policy would become that even though the Czech Republic was formally obliged to join the Eurozone, it would do so on its own terms whenever the country itself felt ready, which in practice meant an indefinite postponement.(Bauerova)

Of course in politics things can change very fast after elections and the current policies of indefinite postponement might be dropped after a change of government, but it is extremely unlikely that with the current all time low of Eurozone support and the ongoing visible problems in the Eurozone, any new Czech government will actively seek Eurozone accession in the very near future. Politically, plans to join the Eurozone fast are dead, and Eurozone accession is something for the very far future in the modern-day Czech Republic.

Economy

Economically, the Czech Republic is one of the most advanced states of the new Member-States of 2004 and 2007. Before the crisis, the country was growing steadily, and even after a large shrinking year in 2009, the country recovered reasonably well. Even though the country does not experience the exceptionally high amount of growth neighboring Poland and Slovakia experience and is currently even experiencing a modest shrink, in terms of marcroeconomic stability the country is probably the most economically successful country of Central Europe.(TableC1) With regards to Eurozone accession there are both good arguments against and in favor of Eurozone accession. What arguments the people and the government tended to look at depended strongly on the circumstances.

Table C1



Before the crisis, Eurozone accession was economically viewed upon more favorably than after the crisis mainly because weaknesses in the Euro were not yet visible. The Czech economy was and is highly dependent on trade with the rest of the EU and therefore joining the Euro seemed like a reasonable step to embed the country further into the common market.(IMF) Even before the crisis however, there was already economic opposition towards joining the Eurozone. A first argument was that the Koruna was seen as a solid and reliable currency that gave the country more independence and flexibility with regards to monetary policy.(Richter) Also it was strongly believed that the country should meet the necessary fiscal adjustment to be able to join the Eurozone from a fiscally healty starting point. It was especially felt that the fiscal deficits had to be lowered.(IMF) Finally some people were afraid that joining the Eurozone would be a cause for inflation, as many other Eurozone countries had already experienced.(Beblavý)

Of course when the crisis hit, economic opinions in the Czech Republic that were already not unambiguously positive about Eurozone accession turned even more to the negative side. The most obvious argument against joining the Eurozone is the deep crisis which the Eurozone is currently experiencing. It is widely believed in the Czech Republic that it is unwise to join the Eurozone anytime before these problems are solved, which may take a long time.(IMF) On top of this, it also seemed that, at least in the early years of the economic crisis, the Czech Republic benefited from the fact that the country had an at least partially flexible exchange rate vis a vis the euro, the currency of many of its most important trading partners.(IMF) Originally, the Czech Republic also seemed to be schrinking as a result from the crisis, as we can see in the table below, making it even harder to fulfill the fiscal deficit criterium of Eurozone accession.

Again however, there are also strong arguments in favor of the Czech Republic joining the Eurozone, and even though at this moment these arguments are not dominant in the economic debate on Eurozone accession, they may become important in the future. The first important factor is that the Czech Republic depends for a large part of its economic growth on the export of real goods. Trade in these goods will become easier with the taking away of the uncertainty of a fluctuating crown that is getting a more and more expensive currency.(Richter) At the same time, the Koruna has been considered more and more as a safe currency to invest in, which causes a high interest rate.(Richter) This way actual confidence in the Czech Republic harms Czech exports, and Eurozone accession could solve this problem.(Richter) On top of this, there is of course the classic argument that Czech Eurozone accession will lower the transaction costs of trading with its most important trading partners. In fact, many transactions between the Czech Republic and their Eurozone trading partners are already done in Euro's. (Cameron)

The Czech Republic is a strong supporter of making the Eurozone more healthy and creating more solid fiscal rules for the Member-States.(IMF) It is clear to Czech economists that even though the country is not inside the Eurozone, there will be severe economic consequences for the country if the Eurozone falls apart. Also the only way the Czech politicians could ever gather enough support for joining the Eurozone, would be a Eurozone that is healthy and fiscally stable.

For the moment however, Eurozone accession for the Czech Republic seems to be still very far away. Even though the worst part of the Eurozone crisis has been cleared up, it will probably take many years before the Eurozone is stable and fully functional again. This condition has to be paired with the need to have a Eurofile government which is willing to adopt the euro. Since probably the reformed Eurozone will require members to give up even more monetary and fiscal souvreignty than ever before, it could be a very large obstacle to conquer for the Czechs to ever accept Eurozone accession.

Conclusion

Concluding, we can state that for the Czech Republic, Eurozone accession still seems to be a very long-term prospect. A strong basic Euroskepticism among the population, combined with several political and economic arguments against Eurozone accession and a general hostility from most major political parties make it hard to imagine that the Czech Republic will join the Eurozone anytime soon. As we have seen however, there are also good arguments for the Czech Republic to join the Eurozone, so in the future it might become attractive again for the Czech Republic to join the Eurozone.

Poland

Introduction

After 1989, Poland has been one of the more steady performers of the former satellite states of Central and Eastern Europe. After a short contraction, overall economic growth has been steadily developing. Also reforms in the Polish political system and government expenditure have been relatively smooth. Poland had to come from far, as the 1980’s had left the country in an economically disastrous situation, but recovery was swift. After the 2004 accession to the Eurozone this economic recovery started to move even faster, as inflow of EU funds and FDI, and opening of the European export and labor market made the country a top performer.

Most impressive in Polish recent growth has been the fact that despite of the economic crisis, Polish economic growth has never been in the red and even in the disaster year of 2009 was growing by an impressive 1,9%. Polish economic growth is stronger than any of its Central European partners since the crisis and this trend is not showing any signs of stopping. (Table PL1) Despite of this impressive growth, Poland has not always been overly enthousiastic about joining the Eurozone. In this section we shall try to analyze what the reasons are for this hesitation.

Politics

After entering the EU, Poland experienced accelerated economic growth and a massive inflow of EU funds and FDI.(Kornecki) Poland considered the EU as its chance to move further away from Russian influence and to tie its economy ever more closely to the West. As a big country, Poland is able to have considerable influence on the EU decisionmaking process which makes the EU project even more interesting for Poland. The fact that Poland is so dependent on trade with the EU and inflowing European FDI originally made joining the Eurozone the next logical step for the country.

Before the crisis, Poland was relatively active in pursuing Eurozone accession. A majority of the population was in favor of joining and so were the major political parties.(Appendix II) There were not many good arguments Euroskeptics had to oppose Eurozone accession and in 2008 prime minister Tusk expressed his wish to join the Eurozone by 2012, as soon as Poland was ready and made the necessary reforms for fiscal stability, this move was supported by a majority of Poles.(Slowikowska)

As we described earlier, when the crisis hit, the economy of Poland only slowed down, but managed to maintain impressive economic growth figures even in the worst crisis year of 2009. Polish enthousiasm for joining the Eurozone waned for the moment though, both politically and in public opinion.(Slowikowska) The Polish people could clearly see that the Eurozone was not as stable as it seemed, and the Zloty was considered to be a viable alternative.(Vysehrad) Polish economic growth did not seem to be too dependent on Eurozone membership either way.

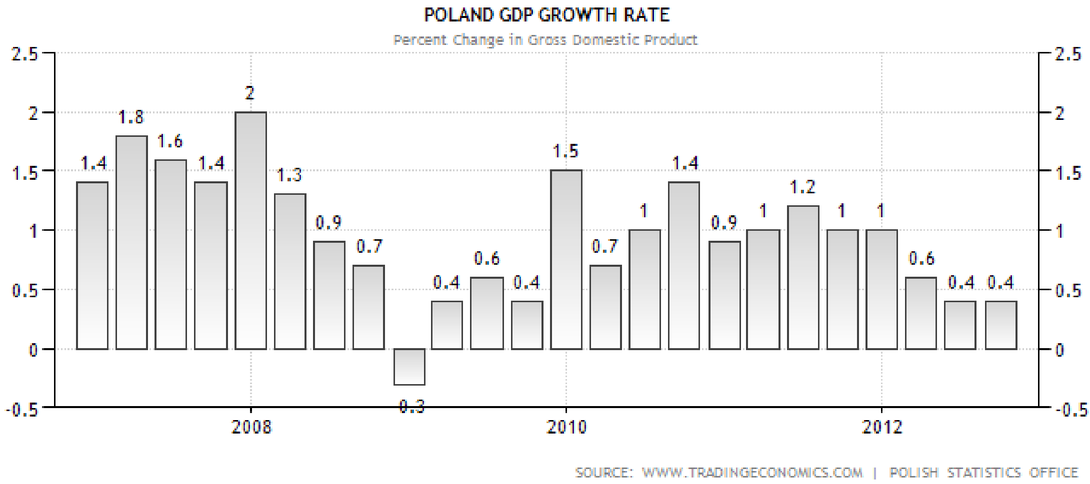
Poland realized at the same time however, that their economic success is for a large part dependent on a strong Eurozone.(Slowikowska) The country has participated strongly in reforms to make the Eurozone more healthy and the country is a forerunner in the constant search for solutions of the current crisis.(Vysehrad) As time progressed after the crisis and the Eurozone was making signs of recovery, Polish politics also started taking a more favorable view on joining the Eurozone.(Slowikowska) This more positive attitude is however still based on the premises that solid structural reforms are made first to make the Eurozone more viable and that it is in the interest of Poland to join.(Vysehrad) Poland realizes however, more than some of its neighbors, that in the long term it might be economically more harmful for Poland to stay out of the Eurozone than to be inside where it can influence the structural reforms more.(Slowikowska)

A major obstacle towards achieving Eurozone accession in Poland however, is that the Polish constitution needs to be amended before accession is possible, requiring a 2/3 majority in parliament, something which is, considering the current political landscape in Poland, tough to achieve.(Slowikowska) On top of this, a majority of the Polish people are at this moment still opposed to Eurozone accession, even though the amount of people that is against is steadily shrinking lately.(Apendix II) Whether Poland can access the Eurozone in 2017 like the government is currently planning, remains therefore to be seen.

All in all we can conclude that, although Polish politics and public opinion have more good will towards joining the Eurozone than some of its neighbors, complete confidence in the Eurozone is still not restored and major difficulties are lying ahead before Poland can successfully join the Eurozone. Therefore Eurozone accession will be a project for the far future (2017 the earliest) even in Poland.

Economy

Economically, Poland is one of the top performers of the new Member-States that joined in 2007. It has to come from a deeper hole and a lower GDP per capita than some of its neighbors, but its growth figures guarantee the country a steady catch-up with both its neighbors and the rest of the European Union. As we described, even the crisis did not slow down economic development in Poland and growth has never stopped since the crisis hit as we can see in the table.



After Poland joined the EU, already existing growth accelerated with great speed because of inflowing EU money, better access to the EU market and as a result of macroeconomic reforms made in order to join the EU.(Slowikowska) Because Polish economic growth was so closely interwoven with the European Union, Eurozone accession seemed only a logical next step from a Eurozone perspective. Before the crisis hit, Poland was therefore trying to join the Eurozone as soon as possible and a target date of 2012 was being followed.(Vysehrad)

After the coming of the financial crisis, it's no surprise that all of this changed. Poland, who was making large efforts to create more macroeconomic stability, had little interest in joining a Eurozone that was unstable and in considerable credibility problems.(Slowikowska) Economically, Poland was doing well exactly because it was not part of the Eurozone because of its currency devaluation vis a vis the Euro, the effect of which was even stronger than in the Czech Republic, because of the relative weight the Polish economy has. (Dunn, Mutti)

Despite of earlier described skepticism towards Eurozone accession, Polish economists are getting a stronger and stronger tendency to favor Eurozone accession in recent years again though, despite of low public support for joining the zone. (Slowikowska)These considerations come mostly from the fact that Poland realizes that it suffers as well from the crisis in the Eurozone that is hitting its trading partners. Also with the ongoing reforms inside the Eurozone to combat the crisis, Polish economists consider it very important to be part of the decision-making.(Slowikowska) Poland could have a relatively big influence on the reshaping of the Eurozone, but can't influence anything while it is outside of the Eurozone. Poland is very committed to make the Eurozone healthy by the same kind of fiscal reforms the country had to make internally to be able to join the EU and influence inside the Eurozone decisionmaking is therefore very important.(Slowikowska)

We can conclude that economically the crisis only temporarily disheartened Poland to join the Eurozone. Of course Poland demanded and will demand in the future that the Eurozone is healthy and fiscally stable before it would consider joining so, but the country is highly committed to participating in ensuring that the Eurozone will be reformed in an economically wise way. In fact, the wish by Poland to participate in these reforms is one of the main reasons why economists believe that Poland should be in the Eurozone. There are still considerable obstacles ahead and it will certainly be a long term project, but from an economic perspective, Polish economists now generally feel that Poland should aspire to join the Eurozone

Conclusion

The financial and economic crisis gave Poland the same change in perspective towards the Eurozone as the Czech Republic originally. Public support for joining the Eurozone plummeted, politicians abandoned the programmes to join the Eurozone as quickly as possible and economic interest in the project faded away. Poland did quite well economically without the Eurozone, and joining the Eurozone for a while seemed like economic suicide.

At least from an economic perspective this tide seems to have turned recently though. Although public support for the Euro is still very low in Poland and politicians have postponed Eurozone accession to at least 2015, voices in support for joining the Eurozone have grown stronger. These voices come mostly from economists and some top politicians, the public opinion still has to follow. The trend towards less Euroskepticism does look very promising though.

Hungary

Introduction

Hungary is the last of the countries to be analyzed in this chapter with regards to perspective changes with regards to the Eurozone. Although this country clearly belongs in Central-Europe, modern-day Hungary is in many ways different from its fellow Central-European brothers. Politically the country knows much stronger extremism compared to its brothers for example, and economically the development of Hungary is going much less rosy than the other Central-European countries.

Nonetheless, Hungary joined the EU in 2004 and Eurozone accession is definitely on the agenda for Hungary. The country has seen some major political changes over the last years and therefore it is very likely that also the perspectives towards Eurozone accession have changed to a large extent. In this chapter we will analyze to what extent these perspectives have changed as a result of the current crisis.

Politics

It is a strange situation that countries like Poland and Czechoslovakia that had a relatively hard-line communist regime before 1989 grew rather well out of the crisis, both economically and politically (maybe with the exception of Slovakia in the 1990's), while Hungary, which had known a relatively liberal regime before 1989, had a relatively problematic transition. Where in the 1990's, politics in Hungary developed itself relatively stable, in the first decade of the 21st century, Hungarian politics was threatened by more and more extremism.

When the question of Eurozone accession came up in Hungary, a social-democratic government was ruling the country. This government was very favorable towards joining the Eurozone and chose quite ambitious accession dates. Originally even 2007 or 2008 were picked as target dates for Eurozone accession.(Czajbok, Rezessi) Also the Hungarian public was relatively positive about Eurozone accession, especially because the people felt that the Euro could bring some monetary stability in the otherwise economically unstable country.(Appendix II)

The main reason why Hungary did not join the Eurozone in those early years was not political will, but rather the inability to meet most of the Maastricht criteria.(Vysehrad) We will cover the economic situation in Hungary in much more depth in the next chapter, but because of large economic instabilities, the Eurozone accession date had to be postponed to 2010 already before the crisis.(Czajbok, Rezessi)

In the wake of the crisis, the social-democrat government got replaced by a more conservative government, which postponed Eurozone accession to at least 2020 and thereby effectively put the whole project on a standstill.(Budapest Business Journal) Considering the current economic crisis, the government does not consider it helpful for the country to join the unstable Eurozone, and also the Eurozone is less receptive for newcomers considering the current problems.(Vysehrad)

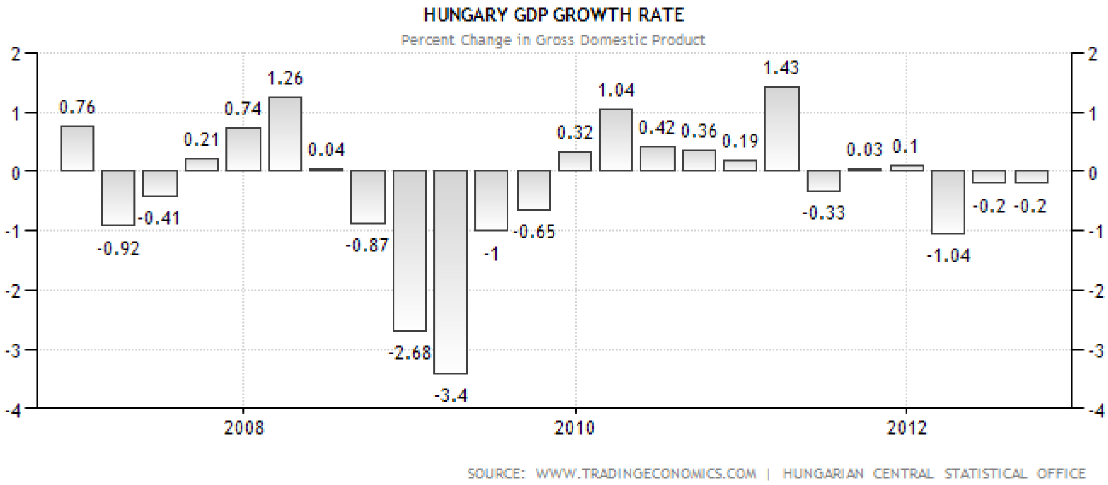
Despite of government skepticism, strangely enough, Hungarian public support for the Eurozone project is still relatively high, especially compared to other Central European countries.(Appendix II) This fact indicates that the current political opposition to accessing the Eurozone project might change very quickly when there is a government change. The change of political will however does not mean that Hungary is also economically able to join the Eurozone quickly.

We can conclude that because of the current crisis, political support for joining the Eurozone has waned. On top of this, also receptiveness of the Eurozone for newcomers and the economic ability for Hungary has made short-term Eurozone accession for Hungary even more unlikely. Also certain parties that receive considerable public support are still very determined to block Eurozone accession as strongly as they can. As long as public support remains relatively strong though, the prospect of Hungary trying to join the Eurozone might change quite quickly.

Economy

Hungary has been one of the weaker Central European countries both with regards to their economic recovery and transformation in the 1990's, and with regards to its economic growth in the first decade of the 21st century. Even though Hungary experienced steady growth between 1994 and 2008, the country never made the impressive growth figures of Slovakia and Poland, and also fiscally, the country developed much less stable.(Table H1) The impact of the crisis was also deep on Slovakia, as especially currency stability and public debt were way outside the Maastricht criteria boundaries.(Ecofin 3-4) The question is how this change influenced Hungary's position on constructing the Eurozone.

Table H1



Before the crisis, in Hungary the question of Eurozone accession was more a question of how, instead of when. Hungary valued the Eurozone just as much as the other Central European countries but was simply unable to fulfill the required criteria.(Ecofin 3-4) Especially Hungary's monetary policy was problematic in this case, leading to high interest rates and a Forint that was fluctuating too much.

The crisis worsened Hungary's interest rates and public debt problem, as fiscal deficits rose.(Ecofin) Both from the Eurozone side, and from Hungary's side, interest waned with regards to Hungary joining the Eurozone.(Vysehrad) With the coming of the stability and growth pact and several other measures to strenghthen the future Eurozone, fulfilling the necessary criteria for joining the Eurozone became harder and harder for Hungary.(Ecofin) On top of this, as with every other Central European country, instability in the Eurozone itself made it also temporarily less attractive for Hungary to join.

At the same time however, studies are showing that the Eurozone could be a solution to Hungary's constant problems with monetary policy and would greatly increase foreign investment in the country.(Vysehrad) These arguments have not been forgotten during the recent crisis, and in the case the economic tides are turning for the better again in the world, the double effect of Hungary's economic situation improving and the Eurozone becoming more receptive for receiving new members, might considerably fasten the whole process.

For the moment however, Eurozone accession is not an economic priority of Hungary and it is likely that even the possibility of Hungary passing the criteria for joining will take many years to come true. Despite of all this however, Eurozone accession remains on the agenda for Hungary as economists agree it will provide considerable economic benefits if the country would join, as well as a solution for its ongoing monetary policy problems.

Conclusion

More than any other country dealt with in this chapter, for Hungary, Eurozone accession is not only a question of will, but also of possibility. Next to the considerable political opposition towards Eurozone accession, there are also severe macroeconomic problems that have to be solved before accession becomes reachable for Hungary. These two factors became stronger after the crisis, but were already existent before the crisis.

Exactly the fact that accession is difficult for Hungary however, in a way also makes it more attractive for the country than for some other countries dealt with in this section. Many Hungarians consider that making the reforms needed for Eurozone accession and embedding their economy in the Eurozone as an excellent way to finally rid the Hungarian economy from some persistent monetary and fiscal problems. The coming of the crisis made this argument less valid for a while, but the more the Eurozone is on its way back to success, the more Hungarians begin to get back to this view.

All in all, although the crisis hit the Hungarian economy severely, it did not substantially change the perspective taken towards the Eurozone. The biggest burden for Hungary remains its deep political devision and its problematic economic situation. The crisis only made existing problems with regard to these two problems worse, but did not essentially change them. Although in the current political and economic landscape Eurozone accession in the near future seems unlikely, relatively high public support for the Eurozone project might change this picture in the short term.

Conclusion group I

In our analysis of the changes in opinion in Slovenia, the Czech Republic, Slovakia, Poland and Hungary, we have found both differences and similarities between the countries. Essentially though, we have seen a clear trend in every country that despite of all the problems in the Eurozone, most countries keep supporting at least the principle of the Eurozone, and no country has yet openly protested against the fact that they will have to join the Eurozone. We can also see an interesting trend towards more Eurozone support, as the worst crisis for the Eurozone is coming to an end.

Because of relatively low public support and prominent Euroskepticism in politics there is on the other hand strong and persistent rethoric against the Eurozone. The crisis has worsened distrust for the Euro in many countries and therefore long postponements of accession dates are not unusual. Politicians mostly follow or even initiate these trends and interestingly enough, this Euroskepticism happens in both countries that are performing economically well and countries with bad economic performance as a result of the crisis.

In the end, we can see that political views towards Eurozone accession can be highly volatile and that therefore economic policies regarding the Eurozone also become volatile. We have seen for example how Poland recently changed from being highly Euroskeptic to being much more accepting towards the Euro.

In the region we can see that academic economists are very often much more enthousiastic about the Eurozone than the actual politicians. They often consider the Euro to be the best economic option for these countries in the long-term. For several reasons, these considerations often are not taken over by politicians. It does not fit their political agenda, it is not supported by general public opinion, or economists are too unclear or disagree too much among each other to give the right advice to policymakers. In any case, it seems formal economics is very often only thinly related to policymaking in these countries.

Group II: Estonia, Latvia, Lithuania, Romania and Bulgaria

Introduction

Our second group of analysis consists of the three Baltic States that were part of the Soviet Union during the Cold War, and the two joiners from 2007; Romania and Bulgaria. Even though these countries are historically and culturally far removed from each other, they share the fact that they are all in the furthest periphery of the Eurozone and are among the economically least developed countries of the European Union. Only Estonia was able and willing so far to join the Eurozone from this group.

The differences between these countries are mainly economical. Even though the former Baltic states were part of the Soviet Union not so long ago, their closeness to Scandinavia and their open economies have ensured them to experience considerable economic growth. Romania and Bulgaria however still experience major economic hardship. On top of this, Bulgaria and Romania have much stronger problems with regards to corruption than the Baltic States, slowing economic progress.

In this chapter we will compare the attitudes of these countries towards the Eurozone. Even though the obvious differences between these countries, we might be able to find a common ground as well because most of these countries had to come a long way after 1989 in their ‘return to the West’, and for all of them, Eurozone accession was an important question they had and have to deal with during their integration into the EU.

Estonia

Introduction

Like all three Baltic states, Estonia is a relatively small state of about 1,3 million inhabitants. This fact has proven to make the country highly adaptable to reforms and very flexible. Because the country is very small, it depends for a very large part on trade, which gives the country much less space for closedness and Conservatism, compared to some other European countries. This necessity towards openness also has fastened the transformation of the country towards a market economy and integration into the EU and its market. The countries negative history with regards to its occupation and interference by Russia has made their commitment even stronger to integrate fast into the West and the European Union.

Becoming a Member-State of the Eurozone is an integral part of this process, and as a result the country joined on the 1st of January 2011, in the midst of the financial crisis. In this chapter we will try to analyze why the country decided to make this bold move, and whether they regretted doing so after almost two years.

Politics

Estonia's wish to join the EU has always been strongly politically motivated. Its earlier mentioned wish to move away from the East and towards the West has been a strong wish ever since independence was reached. Recent oil and gas wars between Russia and some of its neighboring countries have shown that this wish is not completely unfounded. As a 1.3 million people country it stands no chance against Russia on its own, but integrated into organizations like the NATO and the EU it can ascertain its independence.

From this perspective, public and political support for joining the Eurozone and the EU was strong before the crisis. (The economist) EU accession in 2004 guaranteed an investment boom which created sizable growth figures, because of this, support grew even stronger.(Table E1) Estonian politics is strongly directed towards openness and market freedom, the only way to keep the small country growing and competitive on the international markets.(The Economist) Eurozone accession therefore was just a next logical step for the country in this process of becoming a country with Western welfare standards.(The Economist)

After years of impressive growth, Estonia experienced an heavy economic shrink at the beginning of the crisis.(Table E1) It became very clear that the countries flexibility and openness was both a strength and a weakness. While the country was doing exceptionally well during the success years after EU accession because of its openness towards international investment and money, the country was now also suffering a lot because of its dependence on international trade and investment, which suffered a turndown as a result of the crisis.(Ummelas, Eglitis)

Politicians, and according to public opinion polls also the public opinion, realized however that this did not change the fact that there was no other way for Estonia but openness, and that in economic isolation the country would suffer even in the short term, and would deprive itself of all growth and Western integration in the long term.(The Economist) Therefore, even in the heat of the crisis, support for the Euro and the Eurozone experienced only a mild downturn and plans towards joining the Eurozone remained popular.

Because Estonia remained economically flexible, economic reform to make Eurozone accession possible were also easier to make than in the bigger EU member-states and so Estonia could make deep and painful reforms fast, making Eurozone accession by the 1st of January 2011 possible.(The Economist Although these reforms caused a strong rise in unemployment, support for the government and its Eurozone project remained, which was suprising, but shows the understanding and discipline of the Estonian population, and how different historical backgrounds result in a completely different attitude towards Eurozone accession.(Ummelas, Eglitis)

After joining the Eurozone, the Estonian economy recovered quickly, showing impressive growth again in 2011. (Ummelas, Eglitis) It became therefore clear that the country certainly did not make a bad decision, at least in the short term, by joining the Eurozone. As a result, political parties that support more European integration remain to be elected and public support for the Euro stays big enough. (Ummelas, Eglitis) Estonia can now play an active role in reforming the Eurozone, and making it stronger.

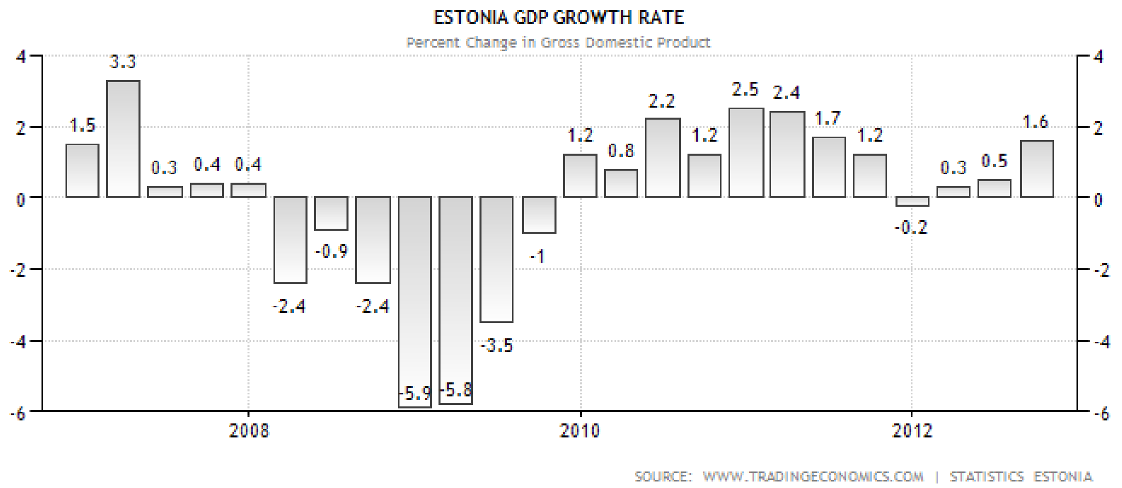
We can conlude that Estonia is one of the countries that felt, and keeps feeling Eurozone success and national success to be one and the same thing. Estonia simply needs a united and strong EU and Eurozone for its national development and therefore remains willing to help build and reinforce the Eurozone project. Estonia simply has no choice as it is caught between a rock, which is

Russia, and a hard place, which is the EU, and according to recent growth figures in Estonia, the EU is not even such a hard place after all.

Economy

As already described in earlier sections, Estonia is a small, open economy that is highly dependent on foreign trade and investment. Therefore, much of its reforms after gaining independence were directed towards creating a stable, investment friendly environment. Because the country was small, and many institutions had to be build up from the ground, as a result of gaining independence newly, the country was much more flexible in making reforms than many bigger former satellites of the Soviet Union. This gave the country a distinct advantage.

Table E1



From the beginning, the country put a large effort on creating an economic environment that was as stable and attractive as possible for foreign investors.(The Economist) A stable and reliable currency was an integral part of this.(The Economist) When the Euro came into existence, the Estonian government made a lot of effort to peg the kroon to it to give foreign investors the faith that devaluations would not happen. (Ummelas, Eglitis) This peg remained in place all the way up to the Eurozone accession in 2011, so in a practical sense, Estonia was already strongly tied to the Euro even before it became a member because of this. (Ummelas, Eglitis)

As already mentioned, before the crisis, little sensible arguments could be made against Eurozone accession in Estonia, except for maybe the fear of inflation as a result of accession. The country was already so strongly tied to the EU common market and the EU economy that joining the Eurozone would just be a next logical step. Because of the earlier mentioned necessity of openness for Estonia, the country was already making the fiscal reforms necessary to keep the country competitive, and the targets towards joining the Eurozone had already been closely met.

When the crisis hit, Estonia took an extremely strong economic hit (a shrink of approximately 1/6 of the economy).(Table E1) This however did not lower the motivation of the country to join the Eurozone.(The Economist) It was clear to many people that the shock in Estonia was just external and that in principle the reforms made and the desire to integrate closely with the European economy had nothing to do with it. Even in the midst of the Economic crisis in Estonia, reforms continued to be made to prepare the country for Eurozone accession, at the cost of high unemployment. (Ummelas, Eglitis)

These reforms proved fruitful however, and the government that created them got reelected. (Ummelas, Eglitis) Estonia continued its impressive growth in the course of 2010.(Table E1) Even though the Eurozone itself might be in difficult times, for Estonia, Eurozone accession means an even stronger and more reliable investment space for foreign investors, and the reforms the country had to make to make Eurozone accession happen made the country economically stable and healthy. (Ummelas, Eglitis)

We can conclude that economically, Estonia has little to no alternative to Eurozone accession, and is therefore a continuing supporter of this project. The country has proven to be willing to make considerable fiscal reforms and show considerable economic discipline in order to achieve accession, and this has proven to be the right choice. In the face of the current crisis, Estonia is growing again and the Euro seems to be at least partially responsible for this.

Despite of the recent Eurozone problems, Estonia's commitment to the euro project did not wane as a result of the crisis. Partially this continuing strong support for the Eurozone is coming from the fact that Estonia has no real alternative to strong integration into the Eurozone, being a small open economy. The strong political will to integrate as deeply as possible into Western organizations and the Western economy to create distance from Russia has made this solidarity feeling even stronger. Now that retrospectively, Eurozone accession is working out rather well for Estonia, at least in the short term, Estonian support for the common currency project couldn't be stronger.

Latvia

Introduction

Latvia is the second Baltic EU member that has to deal with the question of Eurozone accession. In matters of demography and economic factors, the country does not differ much from Estonia. The country is also relatively small in both territory size and population size, and is economically also highly dependent on foreign trade. Just like Estonia, the country is eager to create distance from Russia politically by integrating into the West, and to integrate strongly into the Western economy to ensure prosperity and economic growth for the country. In this chapter we will analyze whether there are any differences with regards to Eurozone accession with regards to their neighbor Estonia, and if yes, what these differences are.

Politics

Politically, Latvia has always strongly supported integration into the West, ever since the country gained independence. There has always been broad public support for this project, both for the idea of deep integration into the west, and for the reforms necessary to make this integration happen. When the country joined the EU in 2004, this was seen by a large majority as being a milestone in the history of the country and the economic prosperity that followed seemed to confirm this.

Before the crisis, Eurozone accession could count on a sizable majority in public support.(Appendix II Of course, as in many other countries, there was a slight fear of inflation upon accession, but the sizable economic growth (more than 10% in some years) brought to Latvia by the EU made it clear to a majority of people that Eurozone accession was just a valuable next step to the country, creating even more prosperity and an even deeper integration into the West.(Table LA1) The government could therefore also count on support for deep reforms to stabilize the country fiscally and privatize the economy.

The impact of the crisis was eventually just as tough for Latvia, as it was for Estonia. The second largest bank defaulted and the economy shrank by 18% in 2009, and unemployment rose to unequalled heights.(Table LA1) Just like in Estonia, many people still viewed painful reforms and austerity measures as a necessary step towards Eurozone accession and the government kept reforming deeply into the economy, just to keep the currency pegged to the Euro and make early accession possible. (Ummelas, Eglitis)

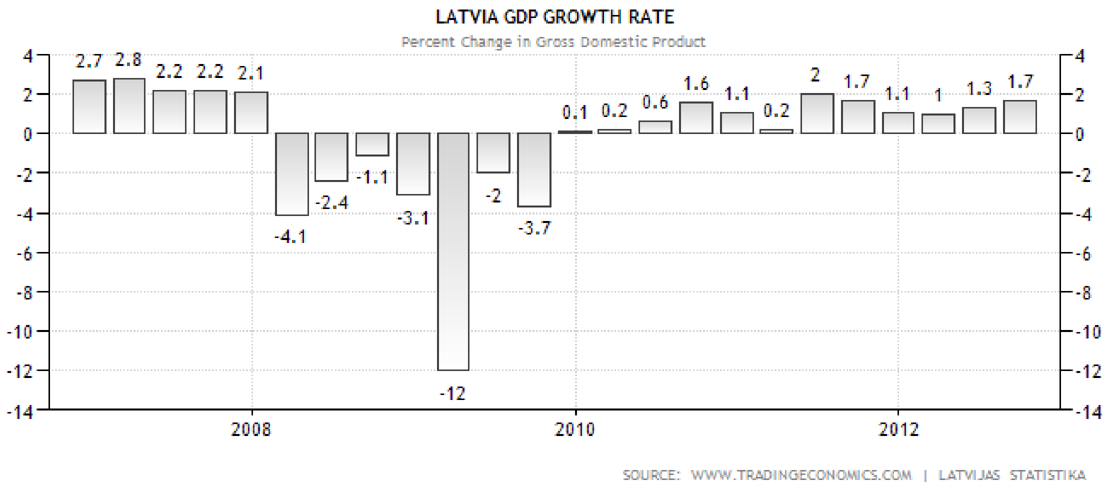
Even though the country is currently growing again and seems to be out of the crisis, over time, support for the Euro has fallen.(Appendix II) Returned growth does not yet guarantee low unemployment, and many people see the cracks in the Eurozone as a threat to their own country, in case it would join the Eurozone.(Crawford) People in general express the opinion that they would rather wait a bit longer until the biggest problems in the Eurozone are gone.(Crawford The government however, does not yet give in to these doubts and keeps striving for Eurozone accession in 2014. (Ummelas, Eglitis)   If we look at the case of Estonia, we can ask ourselves whether a small country like Latvia really has a choice in the long-term and if it is not the best for the Latvian economy to join as fast as possible.

In the end, we can see a perspective change towards Eurozone accession that is a little bit stronger than the one in Estonia, at least when it comes to public opinion. A majority of people in Latvia is now against too quick Eurozone accession and would rather wait until the biggest storm in the Eurozone has calmed down. The government however, does not yet follow this trend and tries to set Eurozone accession at 2014. It is clear that the crisis made a perspective change happen in Latvia, but because of the Latvian economy and its close connection to the EU economy and the Euro, it remains a question whether the country really has an option to not join the Euro on the long term.

Economy

In an economic sense, Latvia is hardly any different from Estonia. Both economies are small, very open and very dependent on foreign trade and investment. (Ummelas, Eglitis)   Since independence, both governments have followed a policy of deep reforms to make the country economically healthy and competitive. (Skrūzkalne, Kazāks) Like in Estonia, so far these reforms have been successful in transforming the Latvian economy for a large part from centrally planned to privatize and from fiscally unbalanced to fiscally balanced. (Skrūzkalne, Kazāks)

Table LA1



Before the crisis, Latvia realized impressive growth figures and a considerable expansion of foreign trade and investment inflow, especially after joining the EU in 2004. (Ummelas, Eglitis) The country could make the most of its openness and appeared to be a very attractive investment location for foreign companies. (Ummelas, Eglitis) Eurozone accession was believed to facilitate this inflow of foreign investment even more, as well as to provide a boost to foreign trade. (Skrūzkalne, Kazāks) Fears for inflation because of Eurozone accession was put back. Preparations were made to quickly join the Eurozone and many reforms were executed. Like in Estonia, Latvia pegged its currency to the Euro successfully. (Ummelas, Eglitis)

After the crisis hit, a considerable shrink of the economy and a high rise of unemployment led to the defaulting of the second largest bank of the country and almost to devaluation of the Latvian currency. (Skrūzkalne, Kazāks) The government showed tremendous fiscal and monetary stability though and managed to maintain stability despite of the impact of the crisis. (Skrūzkalne, Kazāks) Public support for Eurozone accession however took a hit.(Appendix II)

The crisis impact for Latvia was intense but short-lived. In the course of 2010, the economy started growing again with impressive speed and preventing the devaluation of the Latvian currency proved to be the right step. (Skrūzkalne, Kazāks) It enabled to government to keep working on Eurozone accession in 2014. (Ummelas, Eglitis) From an economic perspective, joining the Eurozone is probably the only right choice for Latvia in the long term. For this reason, the Latvian government is still pursuing quick Eurozone accession, despite of the wish of a larger and larger part of the population that wants to wait for the troubles in the Eurozone to blow over before seeking accession.(Appendix I) Whether politics or economics will win in the end remains to be seen. The recent positive developments in Latvian economic development might turn the tide in the favor of the government and economic arguments.

In the end we can see that when it comes to economics, Latvia has just as little choice as Estonia when it comes to Eurozone integration. Once it chose to seek more distance from Russia and integrate into the West, the countries became dependent on this choice. They are too small to create a position of their own, and therefore integrating further into the west seems to be their only option, whether the Eurozone fails or succeeds.

Conclusion

We can conclude that Latvia is, like Estonia a country that is so deeply integrated into the West, that in the long term the country has little choice but to integrate into the Western economic and political structures. Therefore we cannot really speak about solidarity when it comes to the Eurozone, but rather about outright necessity. Even though public opinion might oppose Eurozone in the short term, in the long term economic necessity will most probably also turn the opinion of the public favorable towards Eurozone accession again.

Lithuania

Introduction

As Lithuania is in many ways similar to Estonia and Latvia, this section might be rather repetitive. For the sake of completeness however, a separate analysis of all three states is important to give us an enough detailed overview of the economies of these countries, especially because there are still subtle differences between the countries that can be important with regards to their Eurozone attitude.

Lithuania is the biggest of the three Baltic states both in population and economy size. Like the two other Baltic states it has chosen to distance itself from its former occupant by integrating into Western Europe as fast and as deep as possible. The country quickly reformed itself from a centrally planned to a free market economy for this purpose, and in the first decade of the 21st Century, Nato and EU accession was gained. How all these changes formed and affected the countries attitude towards joining the Eurozone will be assessed in this section.

Politics

Both Lithuanian politics and public opinion has strongly been supporting the 'return to the west' ever since the country gained independence in 1991. This has resulted in a great drive to reform politically and economically to be accepted in the Western political organizations. Of course these reforms were also meant to improve the economy of the country. Even though Latvia is the biggest of the Baltic economies, it is still relatively small and extremely dependent on foreign trade and investment for its well-being.

As in Estonia and Latvia, Lithuania also benefited greatly from EU and Eurozone accession and achieved considerable economic growth during the first years of membership.(Table LI1) Important reforms were made to liberalize the economy, stabilize the country in a fiscal sense and making the country more competitive on international markets. (Venkataramany, Miller 27-28) These reforms had huge support at that time, because they seemed to create huge increases of income, employment opportunities and welfare for everyone. (Venkataramany, Miller 27-28) Despite of the fact that support for joining the Eurozone was never very high, the country also saw Eurozone accession as an important political goal and part of the many reforms the country was making. (Seeder).

The crisis hit Lithuania just severely as its neighbors, and for a short time, left a considerable impact on the country. (Venkataramany, Miller 27-28) Just like its neighboring countries, support for the Euro fell in public opinion, but also in Politics.(Appendix II) Eurozone accession is still a goal of the Lithuanian government, but they are less eager than its two fellow Baltic states. (Seeder) The government keeps the target date of accession close, but is unwilling to give a clear goal accession date. (Seeder) The government just stated that it will join the Eurozone when both the country and the Eurozone are ready for this.

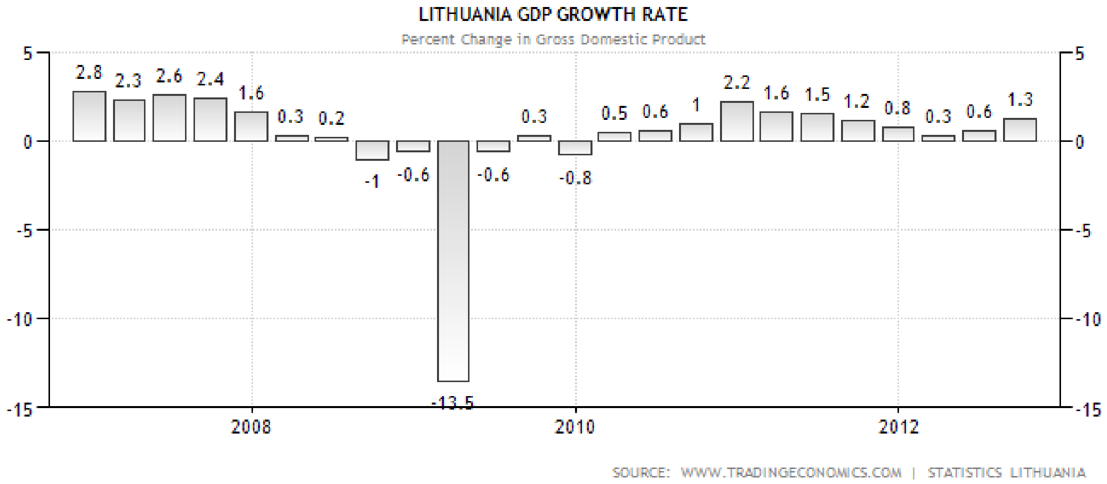
Lithuania is now recovering from the crisis and economic growth is starting again.(Table LI 1) Therefore it is possible that public and political support for Eurozone accession will start increasing again. Like in other EU countries however, it is far from certain that this recovery is permanent, and therefore it not only remains to be seen if the growth will really improve public opinion, but this uncertainty also affects public opinion itself. (Seeder) In fact, one of the main reasons why Eurozone accession gets so little support in countries like Lithuania, is because people want to see first whether the Eurozone survives before making the decision about joining. (Seeder)

Concluding, we can state that the crisis did change the perspective of Lithuanian public and political support. From being a country that got rejected by the Eurozone in 2006, the country is now hesitant itself on joining. Even though politics has not postponed the accession target date to a point in the very far future like some other countries, and public opinion does not outright reject Eurozone accession, the country has lost some of its positiveness towards the Euro project. It went from the group of countries eager to join to the group that is more hesitant.

Economy

Lithuania is the biggest of the Baltic economies but still relatively small for a Eurozone economy. The fact that the country grew slightly less than the other two Baltic states before the crisis, and also shrank slightly less after the crisis came, indicates that the country is a little less dependent on international circumstances than its two brother countries. This difference is however smaller than the big commonalities Lithuania has with its two fellow Balkan countries with regards to dependence on foreign trade and investment and exposedness to international circumstances.

Table LI1



Before the crisis hit, the country experienced the same kind of big growth as its two brothers, although this growth was a bit less spectacular as its two neighboring countries.(Table LI1) Joining the EU was one of the long-term goals of the country, and with this, also the goal of Eurozone accession was strong. (Venkataramany, Miller 27-28) Lithuania tried to join in 2006 but was ultimately rejected. Because the EU seemed to be so beneficial for the country though, the goal of Eurozone accession remained high on the agenda of the country. (Venkataramany, Miller 27-28)

As already described, the crisis changed public and political support for the Euro. Just like the other Baltic States however, politics has not dared to postpone Eurozone accession too far, because just as is the case with the other Baltic States, the country will probably have no other choice than to join the Euro in the long term.(Seeder) The main question remains how long the country will want to wait for the Eurozone to recover. Politics and emotional arguments will be just as important here as economic matters.

Lithuania is in the end strongly bound by economic realities. In the end, it's economy is for an immense part dependent on the success of the Eurozone, and therefore it it seems to be in Lithuania's best interest to join the Eurozone and take an active part in reforming it, whether the public and the politicians like it or not. For the moment however, the economy of Lithuania is growing despite of the Eurozone crisis, making the matter of joining the Eurozone less urgent at the moment.

Conclusion

Even though some details about Lithuania differ from the other two Baltic States, circumstances are roughly the same. The Eurocrisis has slightly affected the public and political support for the Eurozone project. In the case of Lithuania, in contrast to the two other Baltic States, even the government itself is showing some hesitation towards joining. In the end, joining the Eurozone is economically so important for a small open economy like Lithuania, that there is little other choice. Therefore it is likely that the current crisis has only dampened Lithuania's enthusiasm for the Eurozone in the short-term.

Romania

Introduction

After analyzing the three small Baltic states, we now return to bigger economies with the two 2007 EU joiners. Our first country of analysis will be Romania. This country is with regards to political and economic development a few steps behind most other EU member-states, but this does not mean that the country is committed to make the necessary reforms to catch up. Its transition towards a privatized economy in the 1990's did not go smoothly and a major shrink of the economy was the result.

If we talk about Romania and the Eurozone, our analysis is not focusing only on the willingness of the country to join the zone, but more importantly, also on its ability to do so. Even though Romania has seen times of spectacular growth ever after joining the Eurozone, the country still has a long way to go before it catches up with the west. In this chapter we will analyze how far-reaching the support for this catching-up process is, especially when it comes to the specific purpose of joining the Eurozone.

Politics

After the demagogical years of Nicolea Ceaucescu, it was a big challenge for Romania to reform the state structures and create a well-functioning democratic political system. With EU accession as a target, Romania has made considerable headway, but there is still a long way to go, as especially corruption still runs high. With the influence of more and more contact to Western Europe however, step by step this situation is improving.

When it comes to Eurozone support, the government is making considerable effort to join as soon as possible. Originally there was high support for accession as soon as possible, and an adoption date if 2014 was set.(Appendix II) The continuing targets of reforms for more EU integration were seen as being very beneficial in the countries reform process and public support for joining the Eurozone was high(Appendix II). As mentioned already, joining was more a matter of ability for Romania than truly a matter of support.(Euractiv)

Even though Romania took the austerity demands for the Eurozone very seriously, the crisis still hit the country hard, resulting in considerable economic decline. As in most Central and East European countries, this slightly dampened the enthousiasm for the Euro in Romanian public opinion.(Appendix II) Public support for the Euro is still relatively high in Romania though.(Appendix II) Romanian politicians for the time being were slightly disheartened to take further measures towards Euro adoption because meeting the economic demands of the Eurozone required to join the Euro became harder and harder, making it also easier for politicians to postpone accession to the long-term, especially because the country could use the monetary freedom it still had very well to cope with the crisis.(Lever)

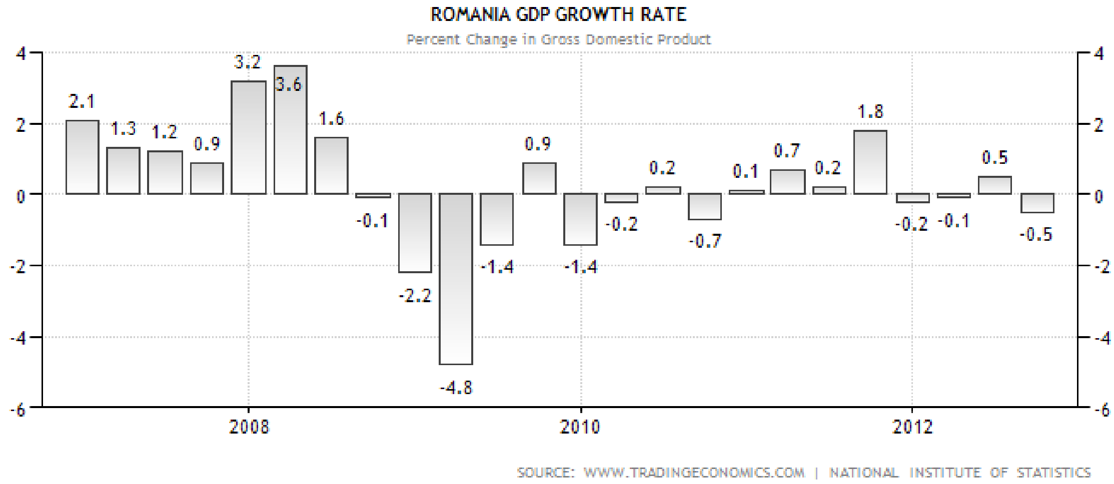
At the same time however, public support for the Eurozone is still strongRomania, and as a result, the government also still does not postpone Eurozone to the very long term or indefinite future, like some other EU countries.(Lever) The government and the public is striving to join the Eurozone as soon as Romania is ready and the ambition is certainly still alive in Romania.(Euractiv) Romanians realize that when everything is functioning normally, the Euro is essential to attract growth and investment to the country.(Lever) Trying to join the Euro will be an investment in the long term for Romania.

We can see Romania having the same decrease of Eurozone support as most new Member-States, but faith has certainly not been lost. Romania is closer to the Baltic States than to the Central European states in this sense of Eurozone support, and there is no doubt that if the country has met the Eurozone accession demands and the Eurozone itself has been restored to a greater degree of stability, Romania is still in full favor of joining the zone. Therefore, the crisis has not destroyed faith in the Eurozone and only meant a temporary diminishing of Eurozone enthousiasm.

Economy

As we already mentioned, Romania is one of the weaker new EU member-states when it comes to economics. This weaker position was one of the main reasons that Romania only joined the Eurozone in 2007, and not 2004. The country has been trying very hard to fulfill all the economic demands that EU and later Eurozone accession wished for, and slowly but steadily, Western investment is also coming Romania’s way, and the country has started to show considerable economic growth.

Table R1



Before the Eurozone crisis arrived, Romania was experiencing considerable economic growth.(Table R1) The government at the same time, made a lot of important economic reforms that would make the country more stable from a macroeconomic perspective.(IMF 2012) These reforms were also made with the goal of making Eurozone accession a reality in the short term, which seemed to be just a couple of years in those days.

The crisis painfully showed Romania that the country was not as macroeconomically solid as it tried to be. Especially inflation proved to be a persistent problem in the country.(IMF 2012) As an emerging economy, the country has had large inflow of foreign capital, causing this inflation, as well as a growing public debt. This in turn has caused the government to start with large austerity measures to make the economy healthy again. (IMF 2012) The great political instability and corruption however, are a cause on its own to make economic confidence in the country low.(IMF 2012) This could very well be Romania's biggest problem for the future.

Despite of a gloomy economic landscape, Romania is still striving to join the Euro. (Lever) The Euro seems to be a way to stabilize certain macroeconomic factors such as the persistant inflation, and will allow the inflow of FDI to increase and to be less destabilizing for the macroeconomic balance. Fulfilling the Maastricht criteria will not be easy for Romania considering recent economic results, but the motivation and the will to join is there, as is the willingness to make painful reforms.

Conclusion

Romania is an ambitious country, once turned practically into a third world country by the Ceausescu's, the country is now a proud member of the European Union. Even though economic tides have been hard for the country ever since the crisis started, public and political will to join the Eurozone has remained strong and solid. This means that even though the country might be in an economically disadvantaged position, compared to other EU member-states strength of will by the people and politicians makes Eurozone accession within reach within the next 5-10 years. In a way the crisis has only made the will of Romania to find stability and protection within the Eurozone stronger.

Bulgaria

Introduction

Even in the times of the Cold War, Bulgaria has been a country that is economically relatively dependent on surrounding countries. Strategically placed at the Black Sea, the country trades heavily and its economy is highly dependent on the inflow of foreign raw materials. As an emerging economy, the country has sought deeper and deeper integration with the West, and therefore it joined the EU in 2007. How did developments in Bulgaria go after that, especially with regards to the Eurozone.

Politics

Ever since Bulgaria got rid of the shackles of communism, it has been an internationally oriented country that was highly eager to join the European Union. With the risk of being isolated between a war-torn Balkans and an unstable Russia in the 1990's, the country looked towards the EU for its economic development, and support and political will to join the European integration project was high. Eurozone membership was also part of this ambitious project.

Before the crisis hit, Bulgaria was very successful in implementing the necessary reforms and building their economy to join the Eurozone. As a much smaller and more adaptable economy than its neighbor Romania, it was easier for the country to deal with reforming its economy. After successfully joining the EU in 2007, Eurozone accession seemed within reach. Successive Bulgarian governments kept it as their ambition to make their economy suitable and this was supported by public opinion.

Originally, when the crisis hit, Bulgaria took a firm blow, just like most European countries.(Table B1) This blow did however not change the support for the Eurozone originally.(Appendix II) People kept their faith in the European integration project, and supported the countries austerity measures to join the Eurozone.(Parkinson The country seemed successful in making the necessary economic reforms, and Eurozone accession in 2015 seemed within reach for Bulgaria.(Parkinson)

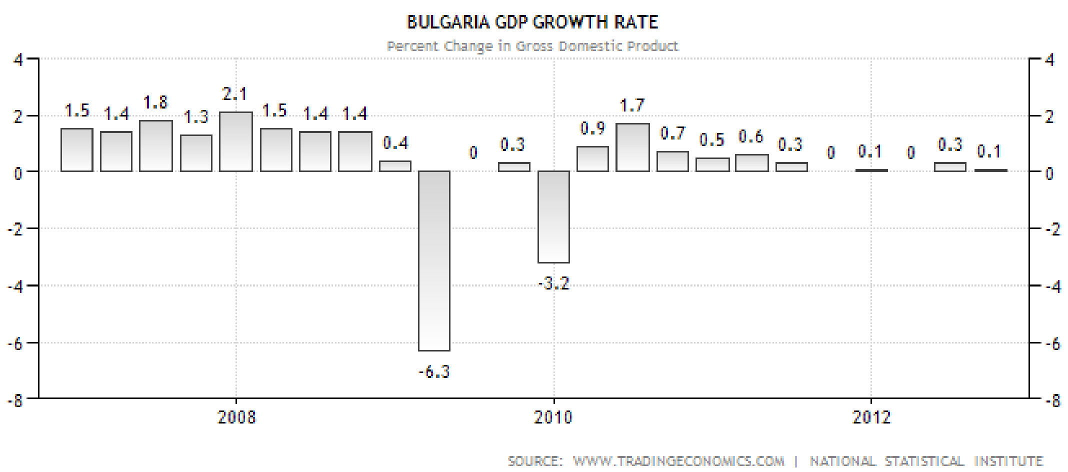
As the Euro crisis worsened however, public and political support turned against the Euro.(Appendix II) This was not originally because the country lost belief in the concept of the Euro, but rather the uncertain situation surrounding the Eurozone.(Parkinson) With new uncertainties every day, and stricter and stricter rules with regards to the Eurozone block, especially the Bulgarian population stopped supporting Eurozone integration more and more.(Parkinson) Because the economy is still growing and the fiscal situation in the country is relatively stable, the public sees no reason to join the Eurozone with all its problems right now, and therefore in September 2012, the government postponed accession.(Parkinson)

We can conclude that, for good reasons, the Eurocrisis has recently changed Bulgaria's support for the Eurozone towards a more negative position. This stance is similar to the one of many other member-states, namely that Eurozone is unwanted as long as the zone is in such a deep crisis. Therefore it is unlikely that Bulgaria will join the Eurozone any time soon when it comes to public and political support.

<u>Economy</u>

Bulgaria is not the first country people think of, if one talks about the new tigers of the European Union. It is economically still behind many new Member-States in Central Europe, but this does not mean the country is performing less. It's growth figures have been impressive, and the country has shown to be surprisingly able to reform and privatize its economy.(Parkinson) Compared to the faltering Romanian economy, Romania is in a better shape economically. (Table B1)

Table B1



Since Bulgaria joined the EU in 2007, the country is a steady economic performer. Europe's concerns for Bulgaria are more in the political sphere than in the economic sphere, and Bulgaria has shown to be a very good economic reformer, even in the face of the current crisis.(Parkinson) Before the Eurocrisis, Bulgaria was focused on making the necessary economic reforms to join the EU, which already brought a lot of economic stimulus. After joining the EU, the country kept reforming in order to be able to join the Eurozone.

Bulgaria occasionally was hit by the crisis just like almost any other EU country, but it was able to restore growth and the country showed a high flexibility in taking austerity measures.(Table B1) The country is now well underway in meeting all the Maastricht criteria and getting able to become a Eurozone member.(Parkinson) In the region, the country is unique in its quick recovery after the crisis and its stable currency, solidly pegged to the Euro.(Parkinson)

The precise fact that Bulgaria is doing better than its neighbors and the rest of the Eurozone makes the country hesitant to join the Eurozone. The country benefited from having its own currency during the crisis and is now doing well economically without Eurozone membership.(Parkinson) The country certainly sees the benefits of joining the Eurozone, but it is hesitant to import all the problems and uncertainties of the Eurozone, as these can also destabilize their national economy.(Parkinson) Therefore, the country has put any plans towards joining the Eurozone on hold for the moment.

We can conclude that economically, Bulgaria has temporarily lost its interest in the Eurozone, for many good reasons. Its economy is stable and steadily growing at the moment, and joining the Eurozone would only mean importing its problems. Whether this will change in the future probably depends both on the performance of the Eurozone and on the state of the Bulgarian economy.

Conclusion

Both in public and political support, and from an economic viewpoint, the prospect of Bulgaria joining the Eurozone is dead for the moment. Economic uncertainties within the Eurozone combined with economic success inside Bulgaria makes it rather unattractive for the country to join the Eurozone at this time.

Conclusion Group II

After analyzing the second group of five countries we selected, we have seen interesting interconnections between economic growth on the one hand, and Eurozone enthousiasm on the other hand. Most of the countries analyzed resisted the Eurozone crisis better than the states from Western Europe and yet these countries follow very different preferences and strategies when it comes to their stance towards the Eurozone.

Like in the first group, dominant politics in these countries don't openly reject the Eurozone or stop believing in it. This however tells us little about the true feeling about the Euro. In all the countries, public support for joining the Euro has lessened in all five countries as a result of the crisis, even in Estonia, already having the Euro and performing very well economically despite of the crisis. Strangely enough, in politics this has had very different results.

In the Baltic states we have seen that politicians are generally more positive about the Euro than their peoples, partially because these small, extremely open economies are highly dependent on the Eurozone success, whether they are in the zone or not. Estonia has shown that Eurozone accession for these states does not have to be bad, even during the crisis. Joining therefore may be more inevitable then for bigger economies. Because these countries are highly flexible and reform-minded, it is also relatively easy for them to meet the Euro accession criteria.

With Romania and Bulgaria, it is interesting that Bulgaria, which is performing relatively well economically, recently decided to postpone Eurozone accession and is not overly enthousiastic about the Eurozone project in general, while Romania, which is performing relatively poorly in economic terms, always had high support for the Euro project and is still enthousiastic about the prospect of joining.

In the end, we see again though, that Eurozone enthousiasm is based more on the changing climate of national politics mixed with public opinion, combined with short-term national economic prospects. We cannot see any clear vision or long-term plan with regards to what to do with the Eurozone project. Accession dates are being made in several countries, but these dates are just as easily abandoned later on, as politicians change. With formal economists disagreeing so fundamentally about what the future of the Eurozone is, we cannot really blame them.

Conclusion

After a thorough and long research along the paths of both the academic and the political world, it is now time to draw our conclusions and provide our final judgments about the three hypotheses we covered as well as answer our research question. We will start by combining our findings from the first part about the OCA theory, and the second part about the changing perspectives towards the Eurozone in selected Member-States. After having done this, we hope to be able to draw some conclusions about what are the real dynamics behind policymaking in crisis-time in the Eurozone.

In the first part it became clear that due to several practical and theoretical weaknesses, a grand theory like the OCA theory is unable to be of much practical use with regards to the details and developments inside the eurozone. The main implications of the theory were not necessarily incorrect, it was mostly the lack of detail and operability that made this theory useless to policymakers that have to make quick decisions in the constantly changing environment of the Eurozone being in crisis.

When it comes to our three hypotheses, we can answer them systematically:

1. The Optimum Currency Area (OCA) theory is unfit to give us policy directions in the wake of the Eurozone crisis

In the first part we analyzed the Optimum Currency Area framework and its link to actual policymaking in the Eurozone. It became clear that large a large part of the theory was and is being ignored by actual policymakers, and that the parts that are not ignored, are not adequate enough to give any clear answers to the given problems in the modern day Eurozone.

These problems start already from an academic perspective. The OCA theory is not precise, operable and coherent enough to be able to give us clear and unambiguous data on which real policy designs can be based. The second problem is of a practical nature. The OCA is not always coherent as we have seen, and many times, individual criteria are conflicting. Also the theory as a whole is inherently unable to tell when a monetary union is an optimum currency area or not, at least as long as overwhelming evidence in one direction is not available. Politically, the theory is too open for interpretation and too unclear to be popular by policymakers.

We do need to note at the same time however, that although the OCA framework might not be very useful during the current crisis for policymakers during the current crisis, the theory still gives us interesting insights in the functioning of a monetary union. The theory might have many flaws, but it can still make us understand the elaborate and complex functioning of a monetary union better. This at least makes it understandable that the theory is more popular in the academic domain than in the policy-making domain.

Despite of this excuse, in the end we have to state that the OCA is, for many reasons, not very useful when it comes to giving policy directions in the wake of the Euro crisis. With regards to the first hypothesis we can thus conclude that the OCA theory is indeed not very fit to give policy directions during the current crisis, apart from maybe a few general guidelines based on some of its very broad criteria.

2. Member-state and EU policies aimed at solving the Eurozone crisis are for a very large part dependent on ad hoc politics influenced by public opinion

We have made an elaborate comparison between ten new member-states of the EU, and in some cases also of the Eurozone. This comparison was meant in the first place to find out how these member-states form their opinion and policies with regards to the Eurozone before and after the crisis arrived. Even though these member-states are all in a different economic and political situation, we could identify certain trends between them that can give us valuable information about how these countries stand vis-à-vis the Eurozone.

A first important matter is that despite of countries with very different political orientations towards the Eurozone (from a rather Euroskeptic Czech Republic to a very Euro-enthusiastic Slovakia), we have seen that without exception, all these states have continued supporting the Eurozone. The furthest certain member-states went was postponing Eurozone membership to a period in the very far future. No state has yet rejected its contractual obligation to join the Eurozone.

A main reason for this continuing support is that all these states have a lot to gain by a healthy Eurozone. Even if these states are sometimes not willing to join the Eurozone right now, they all realize that the EU and the Eurozone is maybe the most important single factor responsible for their welfare. Therefore they are all forced to a certain degree to keep supporting the Eurozone and to participate in the creative thinking needed to help the Eurozone recover from its current crisis. In the end, no politician and no public opinion can escape from the fact that a collapse of the Eurozone would make the member-states worse off in many ways. In this sense, the Eurozone is really too big to fail.

On top of this, even though there is no conclusive proof, the Eurozone membership of Slovakia and Estonia prove the arguments that it is better to stay out of the Eurozone for at least as long as the crisis is over, increasingly wrong. Slovakia's economy is in a better shape than ever economically, and also Estonia did not suffer from becoming a Eurozone member. Many of the new member-states are seeking access to the Eurozone and as a result, the countries that keep resisting membership could very well be increasingly left out of the common market and the inflow of FDI because of their refusal to join the Eurozone.

The result of all of this dynamism is that politicians both on the EU and on the national level, have to take into account a lot of different things when creating their policies, and not just academic theories. We have seen therefore that in reality, policymakers take into account more the short term economic situation in their country and the status of public opinion than long-term economic considerations. Even if politicians try to take the long-term into account economic reality or a changing political environment can still create sudden change, as we have seen with many of the countries we have analyzed.

3. Economic theory is only a minor factor in the policy considerations of policymakers dealing with the Eurozone crisis.

In answering our last hypothesis, we have to start by making a very important separation towards what on the one hand policymakers say, and what on the other hand they actually do. Of course, no Eurozone policymaker would say that he does not base his policies on economic theory. In practice however, we can see a different picture, especially on the member-state level.

We can see one of the main causes in the fact that in the academic world, a deep disagreement exists about the true meaning of the Eurozone crisis and how it should be solved. The phenomenon of a crisis of this magnitude in a monetary union of this magnitude is new for researchers and a broad consensus therefore has not come into existence yet. If academics do not agree, it is even harder for politicians who operate in a dynamic daily changing environment to take the conclusions of these academics into account.

On top of this, we have seen that public opinion and changing economic tide often take away the space from policymakers to be consequent and to try long term experiments based on economic theory. Even if they have the honest ambition to do so, there are so many dynamic variables around them, that it is hard for these policymakers to keep following their line. On top of this, there are always several conflicting economic interests that weaken the interest for certain academic conclusions by policymakers.

Flexibility is also a necessary virtue of politicians who operate in the dynamic world of the Eurozone crisis. With changing national economic performance, changing answers are needed to resist the crisis. Because the Eurozone circumstances are uncertain, it could be harmful if politicians are too dogmatic with regards to following a specific economic theory. To cope with the day to day situation, they have to be realists, and this requires discipline.

We have seen that the chaotic world of policymaking and the orderly world of academic theory do not find each other very well in the wake of the Eurocrisis for several reasons. Therefore we can state that economic theory is not consequently used by policymakers while solving the Eurocrisis. And often only form an ad hoc excuse for certain policies. Even though this is a sad consideration for some, there is very little that can be done about it, because decisions still need to be made and the academic world is not able to provide one consequent advice on how to make these decisions.

After answering these three hypotheses we can now get back to our research question: To what extent is formal economics useful and relevant for the policymaking process when it comes to the current Euro-crisis? In this paper we have covered many aspects of Eurozone policy and their relation to academically founded economics. As always with such complex topics, it is hard to find clear patterns inside a complicated web of information, we did find some interesting trends in Eurozone politics though.

Our answer has to be two-fold in this case. Firstly we need to acknowledge that of course the policies dealing with the Eurozone crisis most of the time have a foundation in economic theory. On the basic level, economics is used as a justification for meeting political goals, on a more advanced level, the long term rescue of the Eurozone is founded in economic principles quite strongly. We need only think about the requirement of austerity and the fear of moral hazard continuously present in Eurozone politics.

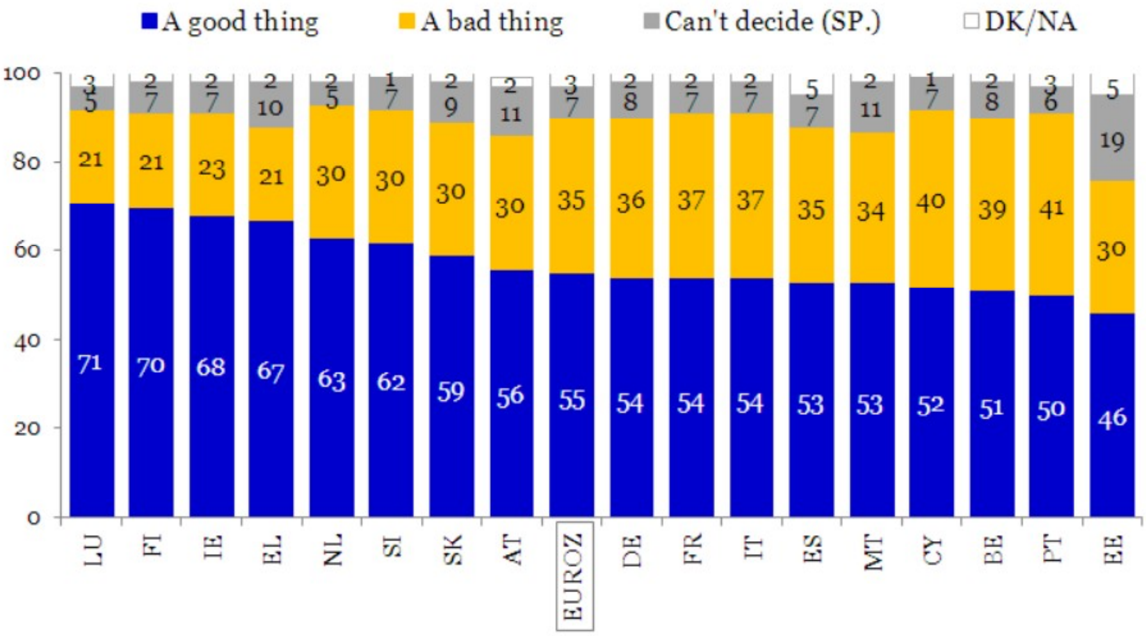
At the same time however, we can see a myriad of different and conflicting economic principles applied on different levels of policymaking all the time. This is not suprising, firstly because economists seem to disagree to a large extent among each other when it comes to the question of the future of the Eurozone, secondly because the environment of the Eurozone crisis is so new and dynamic that it is hard to create hard economic research in time to give good policy advice. We can separate policymaking on the EU level and policymaking on the member-state level. In the member-states, policymaking is very often more about politics and appeasing the public opinion than about following economic principles, at least in the short term. On the EU level, this is different, and there seems to be more economic vision to support different policies.

As we assessed however, in the long term, national governments in the member-states have little maneuvering space because of the economic circumstances their countries are in. The Eurozone proves to be too big to fail for the EU economy and therefore member-states have to make ex-post policies to reform and rescue the Eurozone. These policies find their foundations in economics but are often taking only parts of these theories while other parts are ignored.

Grand theories like the OCA have little relevance in these circumstances as we have assessed. Their implications are at the same time meaningful for the Eurozone though, even though they are not being used for lack of practical purpose. In fact, it is possible that the current Eurozone problems would be less or would not have happened at all if Eurozone members would have used economic theory less in an ad hoc way and more in a long-term visionary way.

Appendix I

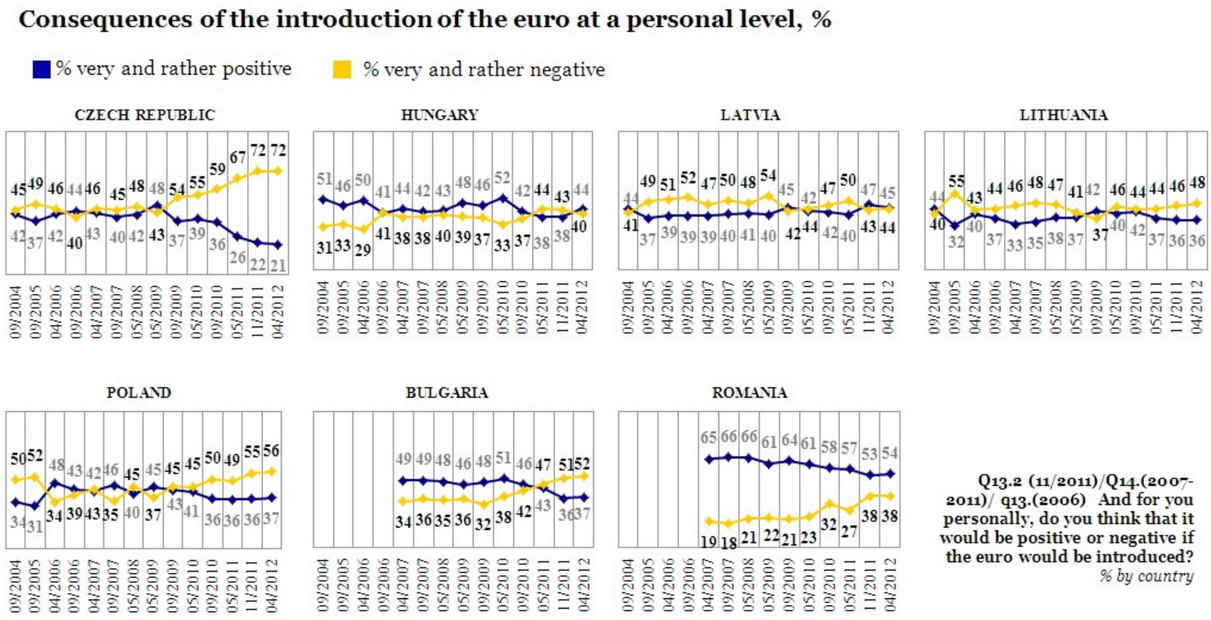
Consequence of having the euro for the country



Q1.1. Generally speaking, do you think that having the euro is a good or a bad thing for your country?

Base: all respondents, % by country

Apendix II


Consequences of the introduction of the euro at a personal level, %
% very and rather positive
% very and rather negative
CZECH REPUBLIC
HUNGARY
LATVIA
LITHUANIA
POLAND
BULGARIA
ROMANIA
Q13.2 (11/2011)/Q14.(2007-2011)/ q13.(2006) And for you personally, do you think that it would be positive or negative if the euro would be introduced?
% by country

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