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European Union economic integration from the Central and Eastern European states socioeconomic development perspective: impossible trinity

Thesis MA International Relations, Global Political Economy

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Table of Content

Introduction 3

1. Literature Review 6

1.1. ***Economic security concerns in the light of EMU integration*** 6

1.2**. *Political economy of the CEE states developmental path*** 8

1.3. ***The importance of Eurozone crisis for structural changes in EMU*** 10

2. European Monetary Union and Economic Convergence: opportunities and challenges to the political sovereignty of CEE states 12

2.1. ***Democratic deficiency in the context of fiscal consolidation*** 12

2.2. ***State's interests against societal needs: increasing inequality in Lithuania*** 14

2.3. ***Preemptive action to maximize the benefits of EMU: Slovenia's success story?*** 17

3. Preservation of socioeconomic sovereignty: the inevitability of two-speed Europe? 22

3.1. ***Origins of the Two-Speed European integration and contemporary challenges*** 22

3.2. ***Developmental trap of monetary convergence: the case of Poland*** 24

3.3. ***Socioeconomic sovereignty during the time of economic crisis: lessons from Hungary*** 26

4. Future projections of the EMU development: to join or not to join? 30

4.1. ***Considerations for a complete integration of the non-EMU CEE states*** 30

4.2. ***Compatibility of the EMU's structural changes with CEE states' socioeconomic conditions*** 31

4.3. ***Compliance with the principles of the EMU : existential crisis in a wake of political contestation*** 32

Conclusions 35

Bibliography 37

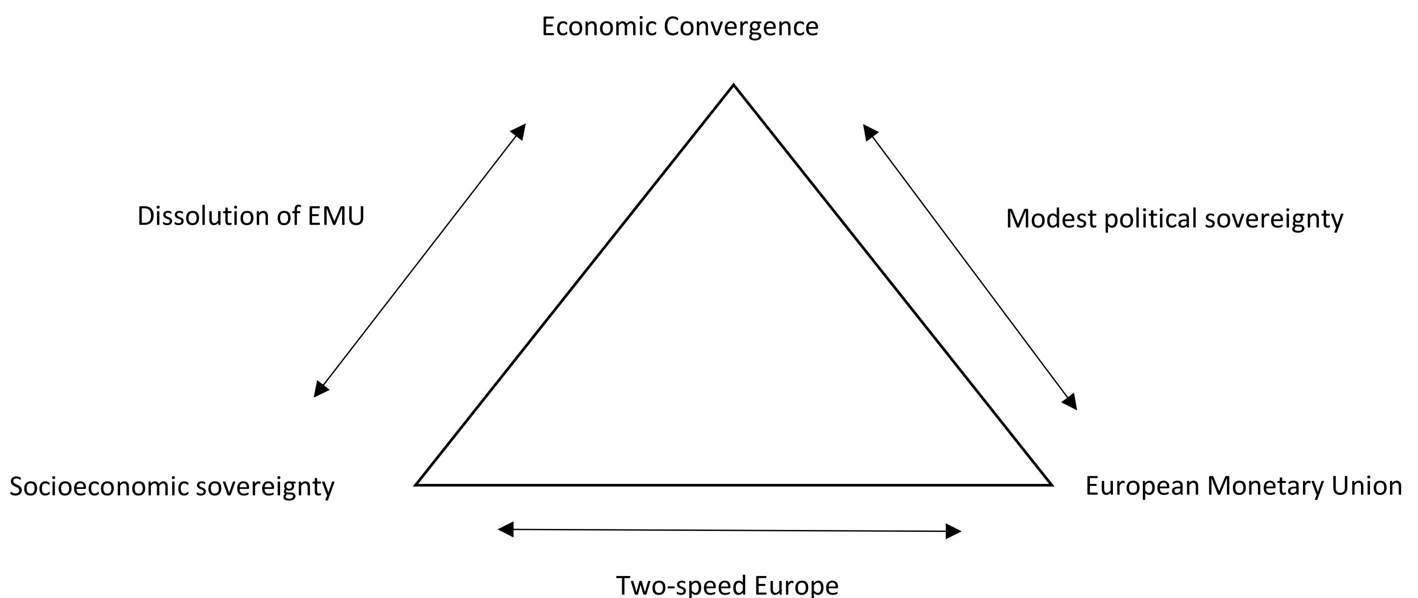
Introduction

Highly integrated market economies have created a demand for the global provision of the processes that function within the international system dominated by the nation-states. This phenomenon was quickly captured as being politically complicated to achieve, because nation-states, which are highly integrated into the global market found themselves in the position where independent fiscal policy and the associated administration of public‘s socioeconomic life is expected to be sacrificed for the more stable functioning of markets (Rodrik, 2000). The logic of this complexity follows a simple pattern – independent policy-making choices set by the electorate can compromise organic market relations, hinder capital flows and investment or simply can domestically deteriorate business-friendly environment. Eventually, misguided fiscal policy can alert market forces about the nation-state‘s problems to assure investment safety and profitability that could result in diminished market confidence and stagnating economic advancements. However, from the other side of this political process one can argue that particular socioeconomic conditions secured by the independent fiscal policy regime could also positevely affect nation-state‘s market attractiveness and economic growth as the Chinese big leap of the 21st century shows (Xiong et al, 2020). Naturally, the main challenge for the national government is to indicate in which economic and political contexts it is better to sacrifice some parts of the fiscal independency or to preserve them based on the existing accounts of each case. European Union (EU) is a special case in this regard, because it is the most economically integrated region in the world judging from the vast institutional and monetary network that is established to supervise union‘s economic life. At the moment, economic part of the EU consists of its own currency (Euro), monetary union (EMU), supervising political institutions (EC) and central bank (ECB).

Since the introduction of EMU in Maastricht 1992, monetary unification of the most advanced European states was a relatively easy endeavor since these economies are highly interdependent and integrated, giving feasible grounds to believe that fiscal autonomy cannot interfere with monetary cohesion and single-currency regime’s sustainability (Snell, 2016). However, a substantial obstacle introduced itself in the European integration pathway as possibly the most serious challenge yet to overcome – economic integration of the Central and Eastern European states (CEE) into EMU framework. The extensity of this problem reveals itself in the relationship with international institutional dynamics inside EMU and socioeconomic conditions in those states. First, after the Eurozone crisis, EMU is gradually transforming into the federal economic regime with little room for fiscal improvisation (Zsolt, 2012). Secondly, economic divergence between Western European countries and Post-Communist member states still prevails as the major problem for an effective

monetary adjustment. Indicators of total production level, income per capita and real labour productivity are still well below the core Eurozone member-states, which require specific socioeconomic development procedures to make CEE economies economically in tact with the core Eurozone countries if monetary integration is to be completed (Upchurch, 2012). From this point, one can see the evolving conflict for the CEE states between participation in the EMU as adjusting national monetary rules according to the Maastrich Criteria, socioeconomic sovereignty to formulate autonomous social policy as part of the independent fiscal system and economic convergence goals as an aspiration to economically match old-EU member-states. As you can see from the Figure 1 below, I will argue that participation in the EMU effectively takes away political sovereignty from the CEE states to respond to the social needs of its constituencies if these countries want to preserve their economic convergence goals. Furthermore, the EMU member-ship requires alternative monetary integration system that can create space for a more cohesive participation if CEE states want to preserve their already established socioeconomic structures and this would inevitably lead to establishment of Two-Speed EMU. Lastly, if socioeconomic sovereignty and economic convergence is prioritized by the CEE countries, then I will argue that possibility of joining EMU framework is minimal and even dangerous for the existence of monetary union.

Figure 1: Impossible trinity for the CEE nation-states



To prove theoretical credibility of the trilemma I will conduct case study analysis of the different states from the CEE region by seperately focusing on each corner of the triangle seen in Figure 1. Case study

analysis was chosen as the best way to empirically interact with the theoretical framework of this work as CEE region consists of states, which have joined EMU integration process since the EU accession and currently are members of the Eurozone club as well as some of them are not participating in any format of the European Monetary Integration. The former group consists of Slovenia and Lithuania while the latter group (non-EMU) is represented by Poland and Hungary. Therefore, the analysis of each state will also prove the validity of set theoretical preconditions in the trilemma by allowing the reader to draw conclusions based on the indirect case comparsion between EMU and non-EMU samples. In order to effectively analyse each case, the following research questions were developed in relation with each side of the triangle: to what extent participation in the EMU compromised political accountability of the governing institutions in Lithuania? To what extent socioeconomic structures in Slovenia are adaptable to the EMU framework and How it affected economic convergence goals? How socioeconomic sovereignty during the Eurozone crisis has affected Hungary's willingness to adopt Euro? What kind of implications monetary independence had on Poland's economic development and to what extent Polish socioeconomic architecture is compatible with EMU? Hopefully, answers to these questions will allow author to accomplish the main objective of this research that is to explain how CEE states can only choose two out of three options if they want to successfully participate in the EMU.

1. Literature review

1.1. Economic security concerns in the light of EMU integration

The creation of the European Monetary Union (EMU) in 1992 at Maastricht and Eastern Enlargement of 2004 could arguably be two most ambitious European Community (EC) integration projects to date. For the lesser developed Central and Eastern European (CEE) states it created a good opportunity to not only secure political interests orientated towards the west, but also to converge the developmental gap between them and their western counterparts. However, we are already witnessing challenges that underlie the relationship between EMU and its implementation in the CEE states as only five nations out of eight original eastern enlargement countries have adopted the Euro as their currency. While it is successful in itself that Lithuania, Latvia, Estonia (Baltics), and Slovenia, Slovakia (former socialist states) are now in the eurozone, the biggest and most influential CEE markets are still carefully observing the possibility to join single monetary framework of EMU. The countries of Poland, Hungary, and the Czech Republic constitute only 5,7% GDP share of the European Union (EU) economy (Eurostat, 2017). However, all of the three nation-states are the biggest and fastest-growing economies from the CEE region in Europe with an average GDP growth rate between 1996 and 2018 being 4,0% (World Bank, 2018). This makes biggest and leading CEE economies a highly valued asset to the future of European Monetary Integration project and EC in general, coming as far as Jaroslaw Kaczynski, the head of leading Poland's ruling Law and Justice (PiS) party claiming that at the end of the next two decades (2040) CEE states will catch up with Germany in terms of GDP per capita ratio (DW, 2019). If at first, it seems not plausible, it is estimated that if Poland alone will continue growing the way it did from 1992 to 2018, by the beginning of 2030 country will reach "old-EU" GDP per capita average (SGH, 2019). Having this in mind it is necessary to understand why discrepancies among the CEE nation-states exist regarding the adoption of Euro and academic literature is a good way to start.

Existing scholarly literature is rich and broad in its scope when it comes to assessing the possible dangers and benefits of entering the Eurozone. Nevertheless, this assessment can be broadly summed up as economic security concerns, which further can be divided into the categories of monetary independence, competitiveness, and fiscal sovereignty. However, it is important to understand how each of these categories interacts with each other in manifesting coherent explanatory body, which could represent academic literature's stance on CEE states' relationships with EMU.

First of all, scholars emphasize the importance of monetary independence for the CEE states as an instrument to protect domestic markets from the asymmetric shocks that could arise due to the volatile nature of markets. However, market volatility argument can be used both, in favor and against EMU. For example, Kolodko (2017) stresses that Poland is missing out on foreign investment due to disorientation among the entrepreneurs in deciding whether their investment will prove to be profitable as the uncertainty of the exchange rate's ratio results in weaker investment dynamics. He argues that these tensions can be alleviated from the Polish economy by introducing Euro: "the introduction of the euro would eliminate these factors" (Idem, 2017, p. 4). Stryjek (2013, p. 56) comes to the same conclusion - open, trade and export-orientated Polish economy is suffering from the exchange rate volatility and adoption of Euro can potentially benefit state's exports: "Due to a high level of exchange rate volatility, Poland has an opportunity to substantially increase trade after the introduction of the euro". As we can see, monetary mechanisms are important to balance trade-offs between domestic market interests and foreign market fluctuations.

While there is a joint conclusion that accession into the Eurozone can help to increase exports some authors are skeptical about the existing independent monetary policy in non-EMU states from the CEE region. Premises for this position is based on the same acknowledgment of the nature of highly open and small economies, which have very highly integrated financial markets with the Eurozone counterparts. These characteristics decide exchange rate regime's flexibility to an extent where it does not distort economic relations with the dominant market in the area: "By contrast, a monetary authority may not enjoy much monetary autonomy even under a more flexible exchange rate regime if it lacks credibility or if the economy is highly integrated financially with a larger monetary area such as the dollar or the euro area" (Fratzscher, 2002, p. 190). Germany is a leading importer of goods and services from the non-Eurozone members of the CEE club (OEC, 2019) making them to adjust their domestic currencies' exchange rate so it would fluctuate less against Euro (Goczek, Mycielska, 2013). 'Fear of floating' phenomena makes open economies of the non-EMU CEE states to target inflation similarly to the fixed exchange rate regime seen in the Eurozone: "This would suggest the occurrence of the problem of fear of floating since there is no clear difference in monetary policy between the behavior of real interest rates in inflation targeting regime and a managed exchange rate regime. This means that interest rates respond to changes in inflation similarly in the case of inflation targeting and floating exchange rates" (Idem, 2013, p. 4).

However, empirical research challenged the above-mentioned assumptions by analyzing real level convergence between Hungary, Poland, Czech Republic, and the Eurozone economies. Assessment of real level convergence is important because it challenges the optimum currency area theory, which complements assumptions of the business cycle convergence between EMU and non-EMU

CEE economies, and in turn associates their lack of commitment to join Eurozone to the Eurosceptic tendencies or economic nationalism (Kolodko, 2017). To decide whether it is economic nationalism or Euroscepticism at play, one first has to conclude that economically, Eurozone creates a safer space for the CEE countries to operate as the theory of optimum currency area would suggest. However, Hallett and Richter (2011) found that business cycle convergence between CEE states and Eurozone occurs only in short cycle lengths while in the longer term it tends to diverge, forming two different economic clusters between Germany and the periphery. This is a key finding in terms of understanding how market volatility can be tackled by the introduction of Euro. It implies that economic benefits stemming from the reduced market volatility in the single currency area are only present as long as the states' economies are well integrated in terms of real convergence.

Nevertheless, Buti and Turrini (CEPR Policy Portal, 2015) explained that real convergence in the EMU between core and periphery coincides with a structural socioeconomic divergence between the two sides: "In a nutshell, real convergence during the first EMU decade largely coincided with structural divergence. The structure of the economies at the center and those at the periphery of EMU become increasingly different". This conclusion supports the findings of Hallett and Richter (2011), which show that convergence between CEE states and the Eurozone is mostly based on the trade and exports, and not in terms of real level convergence. Therefore, CEE states are too reliant on foreign demand, which makes them too prone to asymmetric shocks under the single currency framework as domestic monetary tools are unavailable in the EMU. Monetary independence in this case can serve as an instrument to mitigate potential shocks stemming from the foreign markets. As we can see, literature is mixed at best in assessing the relationships between monetary independence and possible benefits of monetary integration for the market stability in the CEE states.

1.2. Political economy of the CEE states developmental path

Secondly, to fully understand what dangers and opportunities arise from the possible introduction of Euro in the non-integrated CEE states it is important to recognize the context in which the respected countries operate their economies. After the dissolution of the Soviet Union, CEE states structured its economic functioning to achieve the Anglo-Saxon liberal free-market model (Hall, Soskice, 2001). Implementation of a liberal free-market model meant that there will be little institutional space for governments to systematically approach negative externalities of economic growth as well as less flexibility to increase competitive advantage of the domestic industries without deteriorating the socioeconomic welfare of the citizens. Furthermore, under these conditions

government from an open economy state is forced to be a reactionary power to mitigate negative outcomes from the occurring international pressure, leaving it with only limited capacity to increase its competitiveness by the usage of wage policy and regulatory easing (Katzenstein, 2003). This model differs substantially from the old-EU states, which are very similar in terms of their GDP per capita level, labour relations, and regulatory framework, making the monetary convergence process between these states relatively easy. Thus, trade relations between the developed states were conducted on an intra-industry basis while Enlargement introduced backward competition of inter-industry trade as the CEE region became a hub of labor-intensive, technologically undeveloped production (Pitelis, 1998). Also, Eastern Enlargement exposed undeveloped industries for competition against the more productive and efficient Western companies. This exposure required alternative solutions for the CEE countries to make exports more cost-efficient and to attract investments. This left CEE states with the decision to approach a problem by implementing strategies of monetary and social dumping to cover the adjustment costs of penetrating the European Single Market and attracting Foreign Direct Investment (FDI). According to Ricci (2019), monetary and social dumping created a comparative advantage for the CEE states, reducing labour-costs per unit of product. This strategy has proven to be effective since Poland, Czech Republic, and Hungary share an average of 43,4% of the value added by the production of foreign-controlled enterprises when the EU average is 24,3% (Idem, 2019). However, a highly dense network of foreign ownership comes at cost of path dependency, which prevents CEE states to reform their institutional design to increase real competitiveness. Real competitiveness is: "the ability of a country (region, location) to deliver beyond-GDP goals for its citizens" (OECD, 2013) and while FDI can foster short-term living standards of CEE citizens, in the long term this development can be hindered by the inability of the local competitor to withstand foreign competition and by this, deterring alternative forms of economic development, which could create space for the more independent market economy (Pitelis, 1998). In order to induce change and prepare economies for the competition under a new currency regime, CEE states first need to improve the level of innovativeness and this way narrow technological gap between national and foreign enterprises to maximize FDI absorption and ensure maximization of competition in the domestic markets (Stryjek, 2013). Nonetheless, in the absence of such change, CEE economies need to rely on the instruments that their national monetary policy provides to maximize inward investment and minimize potential shocks in the time of crisis. The latter assumption is especially accurate in the non-eurozone countries from the CEE because monetary dumping has increased during the financial crisis in 2008-2009 even though before the crisis monetary convergence with the EU increased (Ricci, 2019). Judging from the shift towards monetary divergence it is evident that the attractiveness of Eurozone is dependent on the ability of

Euro to prove efficiency against domestic currencies in the time of crisis. But academic literature emphasizes structural inefficiencies of EMU, which could negatively affect nation's fiscal authority and discourage non-EMU members from joining Eurozone.

1.3. The importance of Eurozone crisis for structural changes in EMU

Last, but not least, fiscal sovereignty plays a significant role in the considerations of joining EMU as the Eurozone crisis augmented critical perspectives on the role of supranational institutions to effectively deal with domestic challenges in the Eurozone. One of the possible approaches seen in the academic literature is based on Rodrik trilemma where European supranational institutions require direct rule over nation-state fiscal policy to ensure monetary sustainability of the Eurozone. But as Snell (2016, p. 162) correctly points out: "Because of domestic political constraints, even many of the core countries had to resort to one-off measures or rely on a liberal interpretation of the rules to qualify [Maastrich criteria]". However, Kramer (2019) assumes that exactly fiscal authority over the domestic institutions allowed Hungary to be more flexible in dealing with sovereign debt crisis and recession, ultimately pushing state out of the crisis even though at the start of 2010 Hungary was in even worst position than Greece. While Hungary was able to negotiate with both, EU and International Monetary Fund (IMF), Greece was left entangled in the ever-increasing European Commission (EC) and European Central Bank (ECB) powers. According to Weber and Forschner (2014), the Eurozone crisis catalyzed ECB to increase its fiscal authority over the peripheral Eurozone members by committing itself to buy sovereign debt in secondary markets and dictate banking behavior to provide unlimited support for the troubled governments. In Greek case, this resulted in strict conditionality from the EU institutions to reform Greece's socioeconomic structure or otherwise unlimited support will transform into limited willingness to help. In the words of Kramer (2019, p. 616): "The Hungarian case <...> serves to illustrate that there are real differences in crisis management conditions inside and outside of the Eurozone with respect to fiscal sovereignty". It sends a clear message to the non-integrated CEE states that socioeconomic sovereignty will not be taken into considerations if it will be deemed insufficient to preserve the sustainability of EMU.

The academic literature is mixed in its conclusions about the possible benefits that could await Hungary, Poland and the Czech Republic if these countries will decide to join Eurozone. There is an agreement that it could benefit their export-orientated economies, but at the same time, these assumptions are based on the respected countries' abilities to restructure domestic markets to make

them more competitive before the monetary convergence. However, current economic models upon which non-EMU CEE economies function make them dependent on backward competitiveness of the monetary and social dumping. Monetary independence in this regard is a key instrument to foster economic growth. Furthermore, the Eurozone crisis and its management by the supranational European institutions signaled that fiscal sovereignty can be easily neglected if external market pressures require implementation of such measurements.

2. European Monetary Union and Economic Convergence: opportunities and challenges to the political sovereignty of CEE states

2.1. Democratic deficiency in the context of fiscal consolidation

Fiscal consolidation in the European Monetary Union (EMU) follows simple logic in the highly complicated context, which is to ensure that nation-states will follow common supranational monetary policy by adjusting their national fiscal arrangements to primarily balance the public debt and budgetary deficit (EC, 2017). The complexity comes from the vast institutional networking, which is held responsible to control the common European Monetary framework and to manage relations between national, supranational, and financial institutions. Currently, there are seven supranational actors, who are responsible for supervising Eurozone member-states and their compliance with the Maastricht criteria. The existence of an immense supranational network to monitor EMU, especially the role of the European Council to set main monetary policy orientations, shows that considerable political leverage is held within the domain of these institutions, which can take action against the will of a democratically elected national government.

Nevertheless, supranational organizations will not interfere with national politics as long as EMU member-state can ensure the following of the principles in Delors Report (European Council, 1989). The most significant part of the Delors Report was dedicated to the idea of real economic convergence between the European Union member-states if they will sacrifice monetary independence. Economic convergence in this regard is perceived as a necessity to ensure the harmonious functioning of the European single market without the need for excessive obstruction in the domestic political or economic developments of the member-states (Franks et al, 2018). However, the institutional building of EMU to accommodate Delors's vision triggered a process where capital markets no longer treated individual Eurozone countries accountable for their own monetary and fiscal failings. It has encouraged developed member-states like Germany to seek more control and provision over the fiscal policy and public spending balances of the economically weaker Eurozone countries (Fuest, Heinemann, 2015). Milton Friedman pessimistically reflected this development of interdependent relationships between EMU member-states in the context of maintaining a sustainable single-currency regime. He based his negative outlook on Euro by pointing to the lack of existing federal regime of the United States type, which could mitigate the negative effects of having common currency to the lesser developed EMU states (Hall et al, 2012). This outlook was formed at the time when Southern

European states were showing economically divergent tendencies, falling at an increasing rate behind the European core nation-states (Boltho, 2020). Meanwhile, at that same time, the European Union was concluding its Eastern Enlargement with Central and Eastern European nation-states signing 'Aquis Communautaire', which obliged new-comers to adopt Euro whenever they feel ready. Freshmen states from the CEE region have entered the European Union as staunch leaders of economic growth-orientated socioeconomic regimes, determined to catch-up with the core EMU countries (Schandler et al, 2006). However, the peculiar link between economic convergence and sustainability of EMU as a Mediterranean downturn even before the financial recession showed, requires a strict fiscal regime capable of repelling democratically determined policies, which might compromise the stability of the monetary project. For this reason, it is important to assess systemic implications of the EMU on the national fiscal flexibility and what impact it might have on the hesitant non-EMU members from the CEE region as well as how it already has shaped fiscal independence in the Eurozone states from the same region.

According to Streeck (2015), the fiscal consolidation regime in EMU is inevitable and leads to asymmetrical international relations due to uneven capacity between economically strong Northern European countries and their southern and post-communist counterparts to finance the functioning of EMU. Therefore, systemic arrangements of EMU solidified hard currency regime and low-interest rates suitable for the Germanic, export-led economic hegemony, which is the main financial beneficiary of EMU (Frankel et al, 2004). However, a hard currency regime that requires fiscal austerity measures to avoid over-indebtedness together with low-interest rates, has compromised social contracts between the state and vulnerable social groups throughout economically less developed nation-states. For example, Spain and France relied on the ability to occasionally manipulate their currencies in order to devalue public debt and this way maintain social commitments, which ensure political cohesion (Hall, 2012; Sultana, 2011). Similarly, countries from the CEE region, especially the ones closer to the German border like Hungary and Poland use their monetary independence to foster the competitiveness of the domestic companies and economic growth without sacrificing its socioeconomic obligations to protect citizens from the exposure of volatile markets (Csaba, 2012; Aidukaitė, 2011; Katzenstein, 2003).

Following instrumental utilization of the monetary independence in CEE states, participation in the EMU can compromise both, established agreements between the state and economic losers of the transition period and faster rates of economic growth (Aspalter, Jinsoo, Sojeung, 2009). Regarding the latter, participation in the EMU presents a choice – either to have a backward economic convergence at the expense of domestic enterprises' competitiveness and socioeconomic obligations or to maintain

both by borrowing and accumulating foreign debt. This is exactly what happened in the Mediterranean states after they have entered the Eurozone. Refusal of Southern European countries to relinquish generous welfare-state programs, high-wages unrelated to the real productivity, and subsidies to the domestic private actors have resulted in the accumulation of unsustainable foreign debt levels (Colton, Neaime, 2003). For the supranational EMU organizations, it is important to showcase debt as a result of incorrect socioeconomic rationale derived from the entrenched political status-quo of national politics that requires outsourcing of the domestic fiscal management from electoral reach. This way lenders can weaponize debt to demand domestic fiscal reforms, which best suit the stability of the international monetary system.

EMU systematically neglects any political regime, which was developed over the years in a way to find an equilibrium between societal needs and economic performance. Even without initial external interference in domestic politics, democracy immediately becomes a luxurious practice, which is monetized by foreign borrowing. Such developments could discourage non-EMU CEE states to join Eurozone because fiscal consolidation presents a dual-threat to democracy and its socioeconomic instruments. Nonetheless, some European Union officials (Darvas, 2018) stress that Southern-European developments should not be an example for the CEE countries – a position, which implies that interventions were carried against the reckless governmental behavior and that coexistence between EMU design and economic convergence is possible without the substantial decrease in democratic accountability. To understand to what extent participation in the EMU can benefit economic development towards convergence and its impact on the socioeconomic flexibility to meet popular demands – comparison of Lithuanian and Slovenian cases will be analyzed in the next two paragraphs.

2.2. State‘s interests against societal needs: increasing inequality in Lithuania

Lithuania as a country, which has joined the EU in 2004 and decided to participate in the EMU as soon as the Maastricht criteria is met, presents an interesting case in terms of its economic performance. The small state is nicknamed as Baltic Tiger in the international community while at the same time being notoriously famous for the high rates of poverty and emigration. In other words, Lithuania is determined to continue its journey towards the economic convergence with the rest of the EU at whatever cost. However, IMF working paper (2015) pinpointed that this fixation on economic growth can paradoxically damage Lithuania's ability to sustain its convergence goals in the long-term

due to negative social outcomes, which stems from low social expenditure and substantial parts of the population left in the margins of increasing GDP pie. This in turn might have negative consequences for democratic cohesion as European Commission (2012) fears that populism can infiltrate Lithuanian politics from the Visegrad region, especially neighboring Poland, which successfully utilized increasing public expenditures to target unsatisfied groups for electoral gains (Kukolowicz, Gorecki, 2018). Nevertheless, it is worth analyzing the impact of fiscal consolidation measurements, which were implemented in Lithuania to the political sovereignty of national institutions and economic convergence goals.

It is worth noticing that the data surrounding Lithuania and its socioeconomic performance is conflicting in the broader, regional context due to methodological inconsistencies that most scholars fail to address. However, as we will see these inconsistencies are at the epicenter of both, overly positive representation of the state's ability to maintain economic convergence with Eurozone members, and IMF's projected pessimism towards these aspirations. For example, the percentage of people, who live in the severe material deprivation in Lithuania from 2005 to 2013 shows a more positive trend compared to other CEE states (Darvas et al, 2015). The same goes for other indices of the unemployment rate, people in education or skill-development programs, and underage children, which are living in jobless households (Idem, 2015). These variables are presenting a positive deviation from the regional CEE trends even after the financial recession of 2008, which can have confusing implications. Numbers demonstrate that the fiscal austerity regime in Lithuania was more successful at mitigating negative outcomes of economic deterioration during the crisis period in contrast to neighboring regional counterparts, which adopted a different approach of combating crisis (Aidukaitė, 2012).

Nevertheless, results are misleading, because of the methodological shortcomings as they are not adjusting data to net migration rate and poverty line indicators, arguably covering the real scale of social deficiencies in Lithuania. The baltic country is a regional leader in population loss due to emigration. Since 2004 Lithuania is at the vanguard of intra-EU migration, surpassing any CEE state besides Latvia in terms of population decrease due to emigration (EMN, 2019). Immense emigration from Lithuania according to Staut (2008) positively affected the domestic labour-market by driving down unemployment rates that in turn put upward pressure on wages because of the increased competition between domestic firms for labour. Furthermore, a vast population living abroad provided remittances for the family members back home, which positively improved Lithuanian consumption-rating in the eyes of the market due to a budgetary increase from the value-added tax collection

(Aidukaitė, 2012). All of these developments statistically improved Lithuania's position in comparison to other CEE states.

However, emigration from Lithuania was and still is primarily an outcome of fiscally austere socioeconomic management that degraded living conditions for the population (Thaut, 2009). The tightening of fiscal space is partly associated with the government's decision to join the Exchange Rate Mechanism (ERM II) as soon as possible (Bank of Lithuania, 2004). It generated incentives for migration by solidifying austere fiscal policies in a form of the regressive tax system, which targeted socioeconomically weakest segments of the society (Ubaravičienė, van Ham, 2017). Furthermore, low wages and insignificant social protection for the working-age population led to the deteriorating family composition with one of the parents working abroad, creating a cycle of family reunification in the host country when children graduate from high school and come of age (Balkytė, Tvaronavičienė, 2011). In contrast, countries like Slovenia are remarkable achievers in terms of the minimum wage size and public spending levels, outperforming Lithuania in a lower population size that lives at the risk of poverty and lower level of emigration rate (Aidukaitė, 2011). Also, most of the expansionary fiscal programs in the neighboring CEE states were developed during the crisis period, suggesting that participation in the ERM II mechanism limited the government's ability to increase public spending. Rat and Szikra (2018) indirectly support this claim by proving that the introduction of family allowances in Hungary and Poland coincided with states' decision to not pursuit requirements of Maastricht criteria. Also, the choice to expand social security networks for families as opposed to the implementation of fiscal consolidation measurements in the non-EMU CEE states is strongly associated with Eurosceptic attitudes towards European Social Model (ESM) as Aidukaitė (2014) argues. According to the author, it was precisely joint interest between Lithuanian political elite and European monetary organizations to cooperate in preparing the public for the fiscally austere regime, which is necessary for the sustainable introduction of Euro (Idem, 2014, p. 68). However, the price of fiscal austerity measurements implemented in Lithuania during the crisis period and after it in preparation of Euro (2009-2015) is a loss of 336,592 citizens in the nation of 3 million people (EMN, 2019). It is worth noticing that the sharp decrease of emigration after the economic stabilization in 2013 was followed by the steep increase in 2015 after the introduction of Euro, peaking in 2016 with approximately 50 000 people leaving the country that year. Damage was also done to the democratic credibility of national political institutions as trust plummeted to record lows with 56,9% of the population not trusting political party system and 52,2% distrusting Parliament’s ability to defend national interests (Vilmorus, 2020).

In comparison with the non-EMU neighbors, Lithuania consolidated fiscal austerity regime at the expense of democratic support, having many citizens 'voting with their feet' after the introduction of Euro. Therefore, empirical data suggest that overly positive representation of socioeconomic trends in Lithuania can be explained through the high rates of emigration, which positively influenced variables regarding employment, number of people living in material deprivation and etc. Fundamentally, the preparation for Eurozone accession by enforcing austerity measures proved to function against the societal needs in highly fragile socioeconomic space like Lithuania. State interest to pursuit monetary convergence with Eurozone members might invoke better opportunities for domestic companies to attract more investment. But at the same time as the Lithuanian case demonstrates, it deteriorated societal cohesion through family displacement and have disintegrated national politics from the electoral representation, which manifested in massive alienation and distrust on the part of the citizens towards the government.

Regional divisions inside Lithuania further supports the notion of declining political sovereignty concerning fiscal consolidation of the public sector as an outcome of joining EMU. According to the IMF (2015), Lithuania inevitably has to modernize and relatively expand its public sector. The working paper is advising to reduce the number of teachers in the depopulated regions, consolidate school infrastructure, review the education nexus, curb health infrastructure, reduce the number of bureaucrats, and so on (Idem, 2015). However, these measurements carry high political costs as the Conservative government, which implemented liberal reforms in the public sector and modernized bureaucracy apparatus during the crisis years – remained locked in the Parliamentarian opposition ever since. A highly educated and materially prosperous population in the urban areas determines that modernization will mostly affect peripheral regions where the elderly population concentrates after decades of immense emigration of the working-age population and where poverty is most present (OSP, 2019). However, the demographic transition towards the aging population and associated epidemiological concerns will determine any government to appropriately respond (Ubarevičienė, van ham, 2017). Having this in mind, the main question remains is how to balance fiscal expansion with economic growth goals within the EMU framework as to not deteriorate national political sovereignty?

2.3. Preemptive action to maximize the benefits of EMU: Slovenia's success story?

Slovenia is considered the most developed out of all the new member-states, which were accepted in the EU after Eastern Enlargement. In terms of GDP per capita, income equality, GINI

coefficient, and wage convergence with old-EU countries, Slovenia is a role-model for the post-communist CEE states (Weyerstrass, 2007). Therefore, as a country, Slovenia can showcase a different type of convergence story where fiscal consolidation was not carried against the will of the nation, but rather relied on the ability of different actors to reach a collective agreement and decide which areas require improvement or sacrifice to softly land in the EMU (Stanojevic, 2010).

On the one hand, Slovenia can benefit the assessment of the existing relationship between economic convergence and participation in the EMU as a contrasting account of the state's ability to maintain its commitments to both, national and international actors through smart application of the domestic political instruments. On the other hand, it is also interesting to see whether the theoretical arrangement of the triangle can withstand against the Slovenian case as a systemic explanation of the irreversible process towards diminishing political sovereignty when a CEE state joins Eurozone. Nonetheless, I will argue that even Slovenia's neo-corporatist model of socioeconomic management is effectively not sufficient to withstand external pressures deriving from the EMU. Furthermore, the substantial success of economic transition by implementing sequencing policies rather than exposing economy and society to the shock therapy of socioeconomic liberalization - put Slovenia under the same bad political equilibrium that deteriorated Mediterranean public finances.

Historically, Slovenia differs from the before mentioned Lithuania in terms of a socioeconomic route that country has chosen to successfully develop a free-market economy. The main difference from the post-Soviet states is that Slovenia enjoyed relatively more liberal economic management and cooperation with Western markets amidst the Yugoslavian era (Adam et al, 2009). Yugoslavia during the Tito era deviated from Moscow's centrally-planned system of economic organization, introducing worker councils, which represented collective interests of both, employers and labour (Guardiancich, 2016). Self-management to the extent that it allowed workers and employers to reach collective agreements without the interference of a state was unimaginable in the Soviet Union. These features of the socioeconomic organization ultimately ensured path-dependency throughout the transition period, which acted as a safety net for labour interests against the hard-lined market liberalization that took place in most of the other CEE states. After the dissolution of Yugoslavia, worker councils gradually were transformed to mimic German *betriebsräte,* shaping Slovenia's neo-corporatist character by introducing tripartite bargaining of wages and other social policy mechanisms – the so-called 'social pacts' (Greskovits, 2007; Norkus, 2007).

In terms of impact tripartite system had to the socioeconomic development of Slovenia, it fundamentally ensured equilibrium between macro and micro-level economic advancements, which

prevented the state to act against the interests of its nation during the era of economic transition. In other words, negotiations between trade unions, employers' confederations, and state solidified democratic nature of economic development, which secured two main goals. First, domestic companies that were partly state-owned received state-aid to successfully infiltrate into international markets, preparing Slovenia for the competition in the EU's single-market (Aristovnik, Meze, 2010). Secondly, a dense network of trade-unions allowed domestic labour to achieve favorable conditions regarding employment security, pensions, and various other forms of public investment that benefited the overall welfare of Slovenian workers (Stanojevic, 2010). Against the argumentation line of Balcerowicz (1994), the neoliberal turn of shock-therapy at the time when Slovenia was softly transitioning to free-market, has not proven to be a universal truth for economic growth. In the period before accession into EMU, from 1996 to 2007, Slovenia reached 87% of EU-27 average GDP per capita as well as sustained positive net migration rate (Razpotnik, 2018). Other indices such as the GINI coefficient, income equality, and GDP growth in the same period evidently portrayed the success of economic sequencing. Citizens were protected from the market volatility while at the same time state's economy was rapidly heading towards economic convergence with the Eurozone counterparts (Adam et al, 2009). In short, Slovenia preemptively utilized social pacts to coordinate between the two extremes – developing a competitive economy and minimizing upcoming social shocks prior to the Eurozone accession. Trade unions in the social pact of 2003-2005 agreed to stagnate their wage growth behind increasing rates of total productivity to alleviate inflationary restraints from the state's economy and increase competitiveness of the manufacturing industry before the introduction of Euro (Stanojevic, 2010). Willingness on the part of labour to sacrifice wage growth in order to stabilize the economy and promote the competitiveness of Slovenian domestic companies signified consensual agreement between different actors of a tripartite council that Euro is beneficial for all.

The arguments for Euro at the time when the country was already in probationary period of ERM II were mainly of macro-economic nature. For example, elimination of transaction costs, improved price transparency as a result of increased domestic competition and lower country-risk premium altogether should cement Slovenian convergence with the Eurozone (Weyerstrass, Neck, 2008). Similarly, the liability of entering Eurozone was associated with the loss of monetary independence – especially instruments of the nominal exchange rate mechanisms, which in the context of loose business-cycle convergence among EU member-states were seen as an effective tool to mitigate asymmetrical shocks (Hsing, 2017). In other words, macro-level arguments in the Eurozone accession debates showcased the confidence of Slovenian policymakers, which believed that a single-currency regime cannot undermine domestic political arrangements and that tripartite can freely navigate through changing

contexts in the international EMU system. However, the same benefits mentioned above was a primary impediment for Slovenia's economic recovery after the recession of 2008. Initially, after the adoption of Euro, Slovenia witnessed an economic boom, which was a result of favorable market treatment due to a single-currency regime's elimination of country-risk premium, granting cheap lending for state-owned enterprises and government. But as Guardiancich (2016) argues, possible risks were deliberately ignored due to cozy political relations corporate elite had with the political elite that allowed them to be awarded loans and subsidies without real enhancement of economic productivity. Therefore, when the financial crisis hit Slovenian economy, the government found itself trapped in a bad political equilibrium because corporate elite was not willing to find alternative ways of financing its investments and relied on cheap foreign lending granted by the markets, which were correctly betting on the inevitable bail-out of Slovenia's state-owned banks (Idem, 2016). Furthermore, trade unions did not oppose the corporate elite as harmful lending practices essentially were supporting generous welfare benefits and job security for labour (Stanojevic, 2010). As a result, public expenditure exceeded economic output, surmounting public debt that adjusted to per capita is the second largest in Eurozone only below Greece and substantially above the threshold of Maastricht criteria (OECD, 2019). According to Guardiancich (2016, p. 215): "Its [Slovenia] protracted gradual transformation failed to uproot the cozy relationships between politicians, state-owned bank directors and state-owned enterprise managers, thereby locking the country into a partial reform equilibrium that required a trigger to be fully exploited". This trigger appeared to be EMU, which acted as a catalysator for the domestic agents to negatively exploit the benefits of a single currency regime. Throughout the recession period Slovenia was not able to contract its public expenditure, quite contrary as from 2008 to 2014 it increased by 5% while at the same time witnessing a 10% decrease in GDP output and fiscal deficits reaching 14% of GDP in 2013 (IMF, 2015). From this perspective, Balcerowicz‘s inescapable universality of shock therapy proves to hold ground if adjusted to a more international context that Eurozone is. Slovenia in 2019 is still behind the GDP per capita rate of EU average at 87% and slow economic growth rates that are below 1%. In contrast, fiscally consolidated Lithuania in 2019 is at 81% of EU GDP per capita average together with average growth rates after the recession exceeding 3% (Eurostat, 2020).

In conclusion, Slovenia demonstrates how hard it is to maintain independent fiscal mechanisms in the Eurozone, regarding commitments to the domestic actors, which solidified their interests in a consensual democratic manner. While the tripartite system and with it associated gradual economic transformation during the post-socialist transition allowed Slovenia to successfully adopt Euro without socioeconomic disintegration, it impeded state‘s economic growth and convergence with the Western

counterparts. Path-dependent features inherited from the transition period sealed Slovenian flexibility during the crisis to economically adjust its vast public sector to accommodate the new fiscally demanding environment of EMU. In order to rebound from the economic stagnation, Slovenia has to circumscribe powers, which state-owned enterprises and actors possess over the economic organization – effectively meaning restriction of democratic processes that can block the path to reformation. IMF forecasts paint a grim picture for the Slovenian future if radical reforms will not take place in the near future. Suggested reforms ought to substantially decrease pension contributions, early retirement, optimize healthcare and education sectors as well as loosen-up job security to boost labour-market efficiency and productivity (IMF, 2015). Nevertheless, cases of Lithuania and Slovenia presents two different accounts of the same development. While Lithuania was gradually losing its political sovereignty to respond to the population's socioeconomic needs in the pursuit of economic convergence with Eurozone countries, Slovenia economically diverged from them in its struggle to preserve socioeconomic commitments to the society. Therefore, both cases support the theoretical framework of impossible trinity, which explains that CEE states in the EMU can pursuit economic convergence only at the expense of political sovereignty. So what is the alternative if CEE nation-states wish to preserve their independent socioeconomic development models in the EMU?

3. Preservation of socioeconomic sovereignty: the inevitability of two-speed Europe?

3.1. Origins of the Two-Speed European integration and contemporary challenges

From the perspective of monetary integration, the idea of two-speed Europe was addressed by the European political elite amidst Maastricht talks. Representatives from the low-inflationary states like Germany and the Netherlands were concerned with the stability of EMU if high-inflationary countries from Central and Eastern Europe will be included in the Eurozone. The main issue was that while low-inflationary countries primarily wanted to eradicate transaction costs and reduce the presence of the asymmetrical shocks, counterparts from the CEE suffered from high-inflation and indebtedness, making EMU a desirable option for attracting more market confidence (Martin, 1995). Essentially this meant a possible problem of free-riding by the states, which were not economically yet converged nor fiscally prepared to form an effective optimal currency area together with Germany and other highly developed, competitive countries (Artis, 2003). For this reason, one of the proposed solutions was to create a two-speed monetary development project, which would only partially integrate lesser-developed states into the EMU, allowing them in the meanwhile to accommodate macro-economic elements for the successful integration. Some of the mechanisms, which derived from the idea of two-speed EMU are still present today – Maastricht criteria for the public debt levels and budgetary deficits as well as the probationary ERM II period were created for the gradual monetary integration before full Eurozone accession becomes available. However, there are two main problems regarding the notion of two-speed European integration.

First, even after member-state fulfills Maastricht criteria and successfully maintains its monetary obligations during the ERM II period, it does not eliminate incentives for the economically inferior countries to take advantage of common treatment by the markets after the accession into Eurozone. Eventually, this deteriorates fiscal balances after a member-state involves itself with excessive borrowing that gradually applies fiscal pressure onto a particular socioeconomic model that nation-state developed over the years. As the case of Slovenia displayed, ultimately it is the systemic pressure coming from EMU that targets fiscally loose socioeconomic models, negating relevancy of monetary parameters to assess the eligibility of member-state to join Eurozone. In other words, the optimum socioeconomic model, consisting of a fiscally austere social policy strategy exists for the state's cohesive functioning within the EMU framework. Therefore, the initial design of two-speed integration is outdated and does not address the real problem of ill-functioning Eurozone, which

essentially has to deal with member-states' fiscal discipline. A Second problem consists of the political principle on which the European Union was built. Article 4 of the Treaty of European Union states: "The Union shall respect the equality of Member States before the Treaties" (EUR-Lex, 2008). Since the EU is better known for its output, rather than input legitimacy, the constitutionalized principle of equality serves as legal insurance for the smaller nation-states that more powerful members of the Union will not take advantage of their power-position (Weiler, 2012). However, the existence of real equality among member-states can be questioned and is often challenged by the occurring contemporary problems in the EU (Walsch, 2018). In the case of EMU, a two-speed integration design can pose real threat to the cohesive functioning of the whole EU project. Especially, regarding the incorporation of CEE states that historically played a huge role in legitimizing the creation of a single currency area as the next step of European unification. Femke van Esche (2012) argues that the Eastern European revolution of 1989 that inspired the fall of the Berlin wall made German Chancellor Helmut Kohl's pursuit of European monetary integration possible. The debate at the time consisted of two sides – the german financial elite that emphasized the sound economic consolidation of EMU between relatively equal member-states, and political elite. The latter were afraid that if economic arguments will be put forward it could effectively exclude lesser developed Eastern Germany from the real unification within the German state. Therefore, fall of the Berlin wall created a window of opportunity to put economics aside to the benefit of creating universally applicable EMU without first of all economically discriminating Eastern German's political aspirations to unify and then setting precedent for the rest of lesser developed member-states to participate in Eurozone (Idem, 2012). From this perspective, the implementation of two-speed EMU integration is destined to fail, because it could signal CEE states that essentially the question of eligibility to join Eurozone is the question of political will by the core countries to accept potential risks that they were historically happy to do for their national benefit. Fundamentally, this course of action would eliminate the legitimacy of Article 4 as technically it would be unequal treatment of the non-EMU member-states.

Nevertheless, the key problem to address on the part of non-EMU member-states is to understand, which socioeconomic conditions and economic developments in their respective nation-states are giving grounds to believe that the two-speed integration process is inescapable if they choose to join Eurozone? In the next sections, the case of Poland and Hungary will be assessed through the prism of an impossible trinity, showcasing that preservation of socioeconomic sovereignty within the EMU framework requires an alternative system of integration, more suitable for the already existing socioeconimic models in CEE states.

3.2. Developmental trap of monetary convergence: the case of Poland

It is safe to say that from all of the non-EMU CEE states Poland is the most important one in terms of its market size, economic growth and soft-power measures it possesses over the neighboring countries that could have a positive impact for the evolution of EMU in the case of Poland's Eurozone accession. Nonetheless, the journey towards Eurozone seems to be halted for Poland. Since joining the EU, Poland is still not in ERM II exchange rate regime and recently, the ruling party's chairman Jaroslaw Kaczynsky said that Poland will adopt Euro only when nation's wealth will reach German level – statement, which was supported by the Prime Minister Mateusz Morawiecki and the Polish Central Bank (Obserwator, 2019). The position of Polish political leaders and the state's leading monetary policy institution shows that Poland is cautious about the possible negative impact Euro can have against the endeavor to economically catch-up Germany. While there is an accentuation of economic concerns coming from the Polish side of the debate, academic literature is quite critical of it. Riedel's analysis (2017) of the evolution of Polish Central Bank's views on Eurozone membership finds a correlation between the ruling party's political perception of EU integration overall and Central Bank's discourse regarding Poland's eligibility to join EMU. However, this kind of analysis cannot take into account whether it is the ruling party's political stance or economic trends in the EMU itself that determines Central Bank's rhetoric on Euro adoption. After all, Central bank is an independent institution, and having this in mind it would be more beneficial to delve deeper into economic intricacies, which surround Polish discreet behavior towards Euro. There are particular socioeconomic characteristics on which the Polish economy was built that could trap state's development in the context of European monetary integration. The developmental trap of monetary convergence in the Polish case represents a set of policies required for cohesive integration and functioning in the EMU that are inverse to the initial socioeconomic principles, which have solidified Poland's economic growth. To put it more simply, in order to maximize the benefits of Euro Poland has to curb its implemented backward socioeconomic development strategies that come at expense of public investment and improvement in absorption capacity. However, reforms that could improve absorption capacity and require expansion of public spending can retard economic growth, which Poland prioritizes as means to accumulate enough wealth for later redistributive needs (Tomaszewicz, Trebska, 2015).

One of the main components of Poland's socioeconomic development is the prioritization of economic growth and competitiveness over the substantial increase of its citizens' welfare (Idem, 2015). To achieve higher rates of economic growth and domestic market competitiveness, Poland is limiting its

labour-costs by widening wage-gap against the EU counterparts. In particular, nominal unit labour cost is depreciated by lowering welfare benefits, wages, and taxes on employment (Ricci, 2019). This indicates existing social dumping practices in Poland at the expense of polish labour‘s welfare. While in Slovenia wage growth was purposefully put behind real productivity levels to maintain domestic market competitiveness in the European Single Market – labour was compensated by generous welfare provisions. In Poland, it is primarily welfare provisions that are targeted to maximize the benefits of labour cost competitiveness. However, according to Stryjek (2013), the maintenance of the Polish labour cost competitiveness is unlikely due to the upward wage pressure that foreign companies put on the domestic Polish markets to attract employees. The state's accession into EU in 2004 has already contributed to a gradual loss of labour-cost competitiveness and the trend is likely to continue due to Foreign Direct Investment (FDI), which is influencing real economic convergence between Polish and European markets (Idem, 2013). Ricci (2019) is also aware of this phenomenon as his empirical research demonstrates a downward trend of Polish labour-cost competitiveness over the last 16 years of state‘s EU membership. For this reason, monetary independence for Poland has become even more important as it provides a second channel to increase comparative advantage against foreign enterprises in the context of ever-growing domestic wage pressure.

The monetary policy in Poland is being conducted against the position of European Central Bank (ECB), which seeks to pursuit parallel development between monetary and real convergence (Egger, 2003). Monetary convergence of interest rates, inflation and other nominal variables in the eyes of ECB is not perceived as hindering real convergence. In contrast, Poland inversely applies this logic by manipulating monetary policy instruments to gain comparative advantage, which in turn converts to higher rates of economic growth. As Ricci’s (2019) research indicated there is a negative correlation between social and monetary dumping in Poland. While social dumping is losing its significance due to wage-level and welfare benefit improvements, monetary dumping has become more important as real currency appreciation or depreciation against Euro made Polish exports and manufacturing more competitive. However, backward socioeconomic development in Poland effectively alleviated incentives for the Polish government to improve the real competitiveness of its domestic enterprises by improving innovations and the application of technologies. As Lacko (2013) argues, there is little convergence between Polish and Western European labour productivity, because the government has little budgetary capacity to invest in research and development and subsidize purchases of the technology in Polish agricultural and manufacturing sectors. In other words, low levels of taxation and monetary manipulation of domestic currency are confining the development of Polish economy in the vicious cycle where real improvement of competitiveness is scarce as an outcome of backward

economic growth policy. This phenomenon paradoxically promotes the need to maintain monetary independence as it is cheaper for foreign private actors to invest in Poland as long as the government is not fiscally expanding financial resources, which could help cover the bills of real economic productivity improvements required for a rewarding experience in the EMU.

As a result of scarce government resources – Poland ranks at the bottom of the European innovation scoreboard (2019) in terms of conducted research and development programs. Cooperation between governmental and private sectors in developing these programs is also almost non-existent. Scoreboard indicates that Poland is substantially lagging even in comparison with other CEE countries. Especially the ones, which have adopted Euro (Lacko, 2013). Judging from lack of attention towards the creation of productive labour force and drawn resources to improve the innovativeness of Polish economy it is unlikely that the current EMU framework is conforming to the socioeconomic development strategies applied by Poland. Therefore, in the case of possible Eurozone accession, an alternative system of European monetary integration is required if Poland is to maintain its implemented socioeconomic models in pursuit of economic convergence with Western European states.

3.3. Socioeconomic sovereignty during the time of economic crisis: lessons from Hungary

As with most of the CEE states, domestic attitudes towards the adoption of Euro in Hungary is highly intertwined with the socioeconomic developments during the post-socialist transition period. Naturally, in the first years of EU's accession, the question of adopting Euro in Hungary became an issue of state's ability to preserve socioeconomic networks of welfare provision while facing accommodation of Maastricht criteria as Greskovits (2008) argues. Therefore, Hungary's weak fiscal position in the early 2000s' was a result of political contestation between the national parties in their efforts to maximize electoral support by stretching welfare state apparatus and increasing wages for government service workers (Dandashly, Verdun, 2016). Sound fiscal policies were sacrificed for the political gains at the time when euphoria from the EU's accession could have helped the Hungarian government to tighten up fiscal spending to make a monetary adjustment for participation in ERM II more realistic.

Following ECB guidelines, the Central bank of Hungary (MNB) designed an act in 2002 to set Hungary on track of monetary convergence for compliance with Maastricht criteria (Johnson, 2006). However, the socialist majority under the leadership of Peter Medgyessy was blaming MNB's monetary policy as grossly increasing interest rates and this way boosting government expenses (BBJ,

2006). Eventually, Medgyessy's government was unable to reach budget deficit targets, surmounting budget deficit of 9.3% while inflation rates went beyond tolerable levels of Maastricht criteria in the year of 2006 (Dandashly, Verdun, 2016). Inevitably, relations between MNB and Parliament deteriorated and tensions peaked when Prime Minister Medgyessy together with Parliamentarian support amended MNB act (Idem, 2016). However, this was not enough to settle disagreements between the government and central bank as Hungary found itself in the political deadlock, which prevented the consolidation of economic reforms required to enter ERM II. Since then, Hungarian forint is still not tied to Euro in the preparatory period of ERM II.

MNB rhetoric has significantly changed from the time when socialists were in power. Today central bank supports ruling party Fidesz and its outlook on Euro, which is not that different from the neighboring Polish stance. The head of the MNB Gyorgy Matolscy addressed the issue of Eurozone accession by saying that Hungary might adopt Euro in the upcoming decades and only if state's GDP per capita will reach 90% of the Eurozone average (Hungary today, 2019). This position subtly prompts that the adoption of Euro could put additional negative pressure on the state's socioeconomic capability to foster economic growth and sustain a healthy balance between fiscal policy and public needs. There are particularly two key aspects, which could prove the fruitfulness of this assumption. First, the availability of unorthodox measurements as a result of the state's socioeconomic independence from the supervising institutions of EMU has helped to mitigate effects of the Eurozone crisis. And Secondly, diminished public support for Eurozone integration as Hungarian perception of Euro is linked with socioeconomic conditions that regressed in the EMU member-states during the crisis period.

The initial plan to combat the financial crisis in Hungary was set-up by Troika (ECB, IMF and European Commission). While IMF has primarily functioned as a financial institution that held its negotiation power within the framework of financial aid conditionality – the ECB together with EC tested boundaries of their direct judicial power and political influence over EU member-states and their socioeconomic sovereignty to deal with the crisis. For example, European Commission enacted restrictions regarding the accessibility of cohesion funds for Hungarian government, because EC was not convinced of government's dedication to efficiently follow ECB fiscal adjustment guidelines established in the Six-Pack program (Csaba, 2012). Although this decision was not of financial significance in terms of cohesion fund necessity for combating the crisis, it effectively demonstrated EC's capability to interfere with Hungarian sovereignty as certain fiscal discipline prerogatives were demanded by cutting-off unrelated financial assets. After the initial collapse of budgetary talks with the IMF and EU, Hungary's Prime Minister Viktor Orban proposed a new perspective on state relations

with international financial institutions (Financial Times, 2010). Primarily, nationalization of the compulsory private pension pillar and tax on foreign banks were the first signals of counter-intuitive endeavor that Orban took to stabilize public finances. To everyone's surprise, the nationalization of private pension pillar harnessed substantial financial revenues for the government from 2010 to 2013 and taxation of foreign banks delivered more than 600 million euros annually, putting Hungarian budget in the position of 4.3% surplus (Csaba, 2012; Reuters, 2014). Hungarian fiscal independence and unorthodox socioeconomic decision-making proved to be the main source of attracting market confidence as the government was able to sell its bonds with low-interest rates and this way assure further financing of state's economic recovery (Kramer, 2019). Hungary managed to return to its pre-crisis economic growth levels in 2014, sustain budget deficit within Maastricht criteria and keep the unemployment rate well below 10%, which was hardly the case in the Eurozone countries of similar size economies (Statista, 2019; Vidra, 2018). As Snell (2016) puts it, Eurozone crisis was a primary cause for the EC and ECB to put international economic integration above the fiscal sovereignty of EMU countries. EMU member-states were unable to utilize domestic currency devaluation as non-EMU states could as well as alternative fiscal policy measurements for financial resource allocation could not be implemented due to legal obligations to follow fiscal discipline pacts established by the EC and ECB.

Secondly, at the beginning of the financial recession, average Hungarian held a pragmatic perception of Euro and evaluated the possibility of joining EMU on the grounds of its possible impact on wages, pensions and welfare benefits (Eurobarometer, 2009). In other words, the Hungarian public was not aware of EMU's institutional complexity that intertwines nation-states with EU institutions in the political contestation over domestic socioeconomic management. Throughout the first years of crisis, public opinion on Euro adoption was relatively positive and public support stayed around the threshold of 40% (European Commission, 2009, 2010). However, the enthusiasm of adopting Euro evaporated among Hungarians as they witnessed harsh reality of Southern-European struggle to preserve political sovereignty against supranational organization interference that often resulted in political stalemates at the expense of public socioeconomic interests (Dandashly, Verdun, 2016). These public concerns complemented government's position on the Eurozone accession as more Hungarians are favoring the slow adoption of Euro (European Commission, 2016).

In the end, socioeconomic sovereignty has proven to be a deciding factor for the Hungarian state's successful return to pre-crisis economic position. It would be hard to imagine EMU member-state nationalizing private pension pillar or targeting foreign banks with a special tax as one of the main ECB and EC concerns was to regain market confidence to help countries sell government bonds and

relieve them from the foreign debt illiquidity. However, unorthodox measurements have not resulted in disciplinary market response and Hungary was able to sell government bonds at the substantially lower interest rates compared to Eurozone member-states (Kramer, 2019). This suggests that socioeconomic sovereignty is essential for quick recovery and is not necessarily incompatible with the conditional financial aid provided by international organizations. Ultimately, smart socioeconomic management allows economically weaker nation-states to find alternative channels for financial resource accumulation. In the case of Hungary, these assets were used to retain market confidence and have put the country in a better position to withstand international pressure regarding aid conditions, which the government founded intolerable for its national interests. Judging from this relatively successful outcome of not being in the EMU during the financial recession, it is hard to imagine Hungary joining Eurozone anytime soon. Especially witnessing implications of the ECB and EC decision had to transfer fiscal policy management from national to international level for Greece economic recovery. Political elites in Hungary are aware of systemic design flaws in the EMU, which throughout the crisis period have manifested in the disintegration of both, socioeconomic flexibility to pursue more effective economic growth strategies and political sovereignty to respond to the societal needs. Therefore, reacting to the current structure of EMU that is incompatible for the socioeconomic dynamics in the CEE states as analysis of Polish and Hungarian cases suggest – MNB invites us: "to create version 2.0 of the Maastricht criteria together. If we are to create a strong Europe that builds on dialogue and internal cohesion, it is important to give the countries of this region the opportunity to explain their position regarding a decision as momentous for our shared future as the introduction of the euro.“ (MNB, 2020).

4. Future projections of the EMU development: to join or not to join?

4.1. Considerations for a complete integration of the non-EMU CEE states

According to the Ben Crum (2013, p. 614) the last Eurozone crisis has exposed the conflicting balance between monetary integration and socioeconomic diversity that reflects in the policy-making structures within EMU member-states. This observation is supported by the key findings in the comparative analysis of different member-states conducted earlier in this work. It seems that fiscal independence can remain only in the presence of socioeconomically austere policy-making if country is a member of the Eurozone regime. Otherwise, Eurozone member-state risks to be penalized by the systemic structure of the EMU as Slovenian accumulation of public debt has evidently showed in sharp contrast to Lithuania that managed to sustain public debt and budget deficit levels within tolerable levels defined in the Maastricht criteria. However, the cost of fiscal austerity in Lithuania gradually became an issue of state's diminished responsiveness to the citizens' social needs, which reflected in the ever-increasing migration, and plummeted levels of public confidence in governing institutions' ability to secure national interests. Therefore, socioeconomic developments and economic situation inside EMU after the crisis has signaled potential member-states from the CEE region that successful introduction of Euro rests heavily on their willingness to either sacrifice political sovereignty due to structural changes in socioeconomic modeling that assures cohesion between the monetary and fiscal domains, or they have to potentially lower economic convergence expectations by increasing absorption capacity at the expense of backwardly competitive economic strategies. While the former is to certain extent already established as the natural developmental piece of liberal free-market regime that focuses on attracting foreign direct investment, the latter seems to be less likely to happen, because monetary and fiscal independence have proven to be a deciding factor for both, relatively quick recovery after the financial recession as Hungarian case proves as well as for the economic convergence that Polish growth rates and improvements of living standards indicate.

Judging from the discussed conditions, the incentives for the non-EMU CEE states to join Eurozone lies in the ability of EU institutions to reformulate goals of the monetary integration as to assure preservation of socioeconomic diversity observed in these states. If an alternative system will not prevail, non-EMU CEE states concerned with economic convergence can indefinitely postpone their entry into Eurozone. However, there is a connection between monetary integration and political credibility of the whole Eurozone system, which means that in the *Rodrikian* sense EMU either fully

integrates all of the EU member-states or it has to surrender its aspirations of the single-currency regime in favor of a more humble economic union without Euro (Delatte et al, 2017) . Nevertheless, the future of EMU depends on its governing institutions‘ capacity to come-up with innovative ideas, which could accommodate CEE states interests to preserve original socioeconomic structures that are responsible for the economic convergence. For this reason, the relationship between socioeconomic sovereignty and economic convergence needs to be assessed through structural changes that already took place in the EMU as well as what kind of changes are proposed by European governing bodies and scholars alike.

4.2. Compatibility of the EMU's structural changes with CEE states' socioeconomic conditions

First of all, it is unlikely that socioeconomic sovereignty will continue to coexist with monetary integration goals set up by the EMU institutions. Feld et al (2016, p. 48) argues that any imaginable version of the Eurozone architecture is inextricably linked with shifting economic and fiscal competencies from national to European political domain. Authors (Idem, 2016, p. 50) indicate that fiscal stability within EMU member-states is a precondition for stable monetary framework and to ensure this development the establishment of: "an effective central decision-making authority at the European level endowed with the power to enforce tax increases, spending cuts and structural reforms, i.e., labour market and social policies in a country if necessary" is required. Basically, a central governing power positioned at the European level needs to be established to effectively enforce fiscal austerity measurements if member-state starts showing signs of fiscal disintegration. This logic follows the notion of counter-cyclical fiscal policy that reduces public spending and increases taxes during an economic boom period while recession is followed by the reduction in taxes and increased public spending. Instruments, which could ensure counter-cyclicality inside EMU are already present with the introduction of Six Pack and Two Pack programs by the EC, which allows international governing institutions to have a more straightforward supervision over fiscal parameters in Eurozone member-states that are obliged to manage their budgets within the framework of counter-cyclical fiscal policy (EUR-lex, 2011; 2013). However, the main problem of establishing counter-cyclical fiscal prerogatives by the European-level institutions is that it does not conjoin with the most of CEE states fiscal developments, which are pro-cyclical. The only current Eurozone member-state that managed to sucessfully implement counter-cyclical measurements before adoption of Euro was Lithuania (Gyorffy, 2015). But as discussed earlier, the cost of reduced public spending and increased taxation throughout the economic boom period was deteriorated socioeconomic conditions that left Lithuanian government incapable to mitigate the effects of poverty and diminishing social cohesiviness, which

prevailed in the society before and especially after the financial crisis. Other countries from the CEE region seems to be aware of counter-cyclical fiscal policy shortcomings as Poland, Hungary, Slovenia, Slovakia and Czech Republic have chosen pro-cyclical approach of socioeconomic developemnt and fiscal tightening during the recession. The results of this approach differed among non-EMU and Eurozone countries. While Hungary and Poland were able to successfully interconnect their monetary and fiscal independence from the EMU framework to have smaller negative effects from financial recession, same pro-cyclical tendencies disintegrated Slovenian socioeconomic system together with economic convergence goals (Idem, 2015). These findings support negative perception of Fed et al (2016, p. 58) on EMU's ability to counter-cyclically consolidate Eurozone, because: "such reforms are difficult to accomplish given the opposition of insiders in those markets obtaining rents from the current rigidities". Slovenian case is a perfect example of state's impotence to adjust public spending and taxes in order to alleviate public debt constraints from the economy as political rents for the key market agents prevented necessary changes from happening. The counter-cyclical approach is an important strategic move for EC, because domestic preparation of fiscal policy instruments to counter negative effects of the potential crisis creates more space to direct socioeconomic management by the member-states themselves without interference of ECB. Therefore, the application of Six pack and Two pack programs for member-states' budgetary supervision can be interpreted as a symbolic position by the EC to not commit itself with full-fledged federalization of the Eurozone fiscal policy and to settle with 'excecutive federalism' (Crum, 2013).

4.3. Compliance with the principles of the EMU : existential crisis in a wake of political contestation

Secondly, the success of excecutive federalism relies heavily on the political will of member-states to follow the rules defined in the requirements of signed programs, especially the more significant economies in Europe such as Germany, France and Italy have to set an example for other member-states. In other words, member-states need to withdraw political contestation from the fiscal domain if monetary integration is to be a sustainable process. However, the experiences inside EMU shows a divergent development as Fed et al (2016, p. 57) demonstrates: "temporary deviations, for example, in the cases of France being granted longer time to achieve the deficit limit under the SGP's corrective arm and Italy for compliance with 1/20 debt reduction rule under SGP's preemptive arm is a repetition of past mistakes <...> which continue to hamper economic recovery and cast doubt on the stability of the Monetary Union". Crum (2013, p. 622) similarly explains how fiscal compact is being constantly jeopardized by the political processes inside EMU: "initially an 'excessive deficit' was defined as any

deficit above 3 per cent of their GDP. However, after several reviews Fiscal Compact now sets the line at a ‘structural deficit’ of 0.5% of the gross domestic product at market prices. This train of events demonstrates how any percentage is eventually open to political contestation”. Eventually, fiscal policy discretion by the leading Eurozone member-states sets a negative pattern where compliance with institutional game rules strongly depends on particular powerful agent’s political will to do so, otherwise the power can be used to converse initial institutional arrangements for satisfactory results as described above. Furtherome, these developments create asymmetrical power relations between core Eurozone countries and periphery, because inferior member-states that are indebted fundamentally sacrifice significant part of their fiscal independency against the certain national interests while the creditor states like France and Germany can solidify repayment of their loans without necessarily following the same institutional guidelines.

Finally, as we can see, current EMU design disproportionally harms fiscal position of weaker Eurozone countries while preserving relatively independent consolidation of public finances at the national level for core member-states. From the perspective of non-EMU CEE states, this institutional development compels them to sacrifice significant part of socioeconomic sovereignty for an unequal participation in EMU if they would decide to adopt Euro. Judging from the future projections, a more federal approach is still being advocated by both, EU beaurocrats (Larch, van der Wielen, 2020) and scholars (Crum, 2013; Fed et al, 2016; Delatte et al, 2017) alike. The key idea is to present a central fiscal capacity regime, which would allow member-states to share liabilities in case of major financial recession as well as to offer a shared space for political debate that could assure equality among member-states in the formation of monetary politics. In short, economic federalization of EMU needs to be followed by the political federalization, but the future looks bleak for the European monetary integration as introduction of Two and Six pack programs clearly indicate shift towards a more humble Eurozone. Furthermore, these programs are programming monetary union to be a counter-cyclical fiscal space where liabilities of the future are covered by the more modest socioeconomic conditions at the present whilst non-EMU states from the CEE region found socioeconomic equilibrium by effectively utilising their monetary independence that allows them to meet increasing public demands without sacrificing economic growth rates. In short, comparison between current Eurozone members of the CEE club and their neighboring counterparts that are not participating in any kind of EMU integration process, it is clear that if the latter group of states want to pursuit economic convergence with the old-EU states and be in a better command of their socioeconomic policy-making without deterioration of political accountability, then the most sensible decision is to not join Eurozone. However, this decision can have broader implications for the existence of EMU project itself. If current

non-EMU CEE states will prove their capability of economically converging with the Eurozone average, then new EU members from the Balkans can take this example as a more suitable development model to economically catch-up the West. In other words, lack of monetary unity inside Eurozone can morally devalue European Social Model (ESM) overall effectively eradicating incentives for the EU to further push ESM as best means for the lesser developed member-states to economically converge with the Western counterparts. Fundamentally this indicates two possible scenarios: first, EMU can be concluded at the current stage, informally creating two-speed EMU that will require political changes in terms of EU Treaty‘s Article 4 or if current EU political framework remains in tact, then EMU has to relinquish its aspirations of preserving single-currency regime.

Conclusions

The findings in this work support the existing impossible trinity, which binds states from the CEE region to ultimately choose two options between participation in the EMU, socioeconomic sovereignty and economic convergence. Countries, which are currently involved in the EMU integration and are members of the Eurozone club have seen their political sovereignty contract as fiscal consolidation of the public sector diminishes government's capacity to respond to the needs of its citizens. The case of Lithuania showcased how fiscal preparation throughout the first stages of the EMU integration deteriorated state's socioeconomic conditions as government was unable to expand its welfare provision. However, implementation of fiscal austerity measures has assured Lithuania rapid economic growth levels, which managed to sustain steep trajectory even after the Eurozone crisis, indicating that fiscal consolidation is a precondition to increase likelihood of economic convergence with old-EU states if country chooses to enter Eurozone. The conclusions stemming from the Lithuanian case can further be supported by the findings in Slovenia's case study analysis. As Slovenia's socioeconomic development model is based on the negotiations between the various formal groups, which are represented by trade unions, employers confederations and governmental institutions – it is especially hard for Slovenia to retain the system that originally was built around democratic consensus. After Slovenia gave up its monetary independence and was exposed to the accessible cheap credit, original socioeconomic agreements crumbled as inefficient institutional structures, which were supporting them refused the passing of fiscal consolidation measurements through legislative chambers. This has resulted in accumulation of immense public debt and measly economic growth rates, which show incompatibility of any socioeconomic development strategy other than austerity for participation in EMU if state is not the most developed or biggest economy there is.

In the opposite spectrum of socioeconomic development Poland and Hungary found themselves in a more favorable position to continue economic growth orientated monetary policy as both countries have chosen to not join EMU. In the case of Poland, monetary independency assured relatively better conditions for competitiveness of domestic enterprises as devaluation of national currency allowed the state to gain comparative advantage in its export-based economy against the ever-increasing wage growth pressure stemming from the foreign direct investment. Nevertheless, the cost of backward competitive growth strategies for Poland is lack of absorption capacity for the possible adoption of Euro that could help this country to fully utilize the benefits of single-currency regime, which inevitably would expose Poland to a more direct and fierce foreign competition. Lack of absorption capacity as a result of little investment in public sector and innovation sector paradoxically made

Poland more reliant on the socioeconomic structures that can preserve backward competitiveness of Polish economy. Increases in taxation and larger redistribution base of public budget can mitigate Polish economic growth rates without necessarily ensuring safe passage towards economic convergence within EMU framework as Slovenian case in comparison suggests. For Hungary, the question of joining EMU is not that much intertwined with preservation of monetary autonomy as it is a matter of fiscal sustainability. Analysis of Hungarian case portrayed an evident account of fiscal independency being a cornerstone of pushing state out of the financial recession despite Hungary being the second hardest-struck country after Greece in the first years of crisis. Fiscal autonomy allowed Hungarian state to find alternative channels to stabilize public finances and gain confidence from the markets while at the same time relatively generous welfare provision in the regional context was sheltered from the fiscal consolidation. Therefore, both, Polish and Hungarian cases reflect the necessity for an alternative monetary union where socioeconomic sovereignty could be preserved in the light of Eurozone accession, but considering the design of existing framework, this alternative union would effectively create two-speed integration process.

Last but not least, judging from the future projections of the EMU development the possibility of joining Eurozone for the non-EMU CEE states is minimal. EC and ECB already pushed for a change by adopting two and six pack programs, which are narrowing space for fiscal and automatically – socioeconomic sovereignty that is supporting CEE states' liberal free-market framework. Essentially, in the absence of complete integration of non-EMU CEE countries into Eurozone – the credibility of European Social Model can be put on the edge. If Poland and Hungary will manage to prove monetary autonomy as the main condition for economic convergence, then all of the new member-states will have a developmental alternative to follow. At the same time EMU will have to either conclude its economic integration or dissolve under the pressure of lacking commitment from the member-states to go further with economic assimilation as the existing alternative of having no central power for the monetary policy might look more attractive. However, it will depend how successful non-EMU states will be in their strife to economically catch up Western European counterparts.

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