

Anchoring Reform by Subordinating to Hegemony?

The Political Economy of EMU Enlargement.

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Abstract

The governments of most accession Central and Eastern European (CEE) countries have shown keen interest in adopting the Euro soon after EU accession. This interest is motivated above all by the desire for a strong political signal, namely of an irrevocable “return to Europe”. It is motivated as well by a search for a reform anchor that imposes a binding constraint on fiscal policy and wage bargains at home. This keen interest has been maintained despite the fact that the rules of the EMU club were written without considering the CEE countries’ future membership. This paper conceptualises hegemony as a specific transfer of political property rights. This captures both the use of delegation as a commitment device and the problématique of disenfranchisement that such delegation entails. The dilemma of CEE countries in joining a hegemonic club is explored with reference to Poland, the largest candidate country, which has experienced severe macroeconomic instability in the past.

1. Introduction

To mainstream political economy, hegemony is not necessarily a bad thing. While the term itself is not common, in a utilitarian world view or political Economy with a capital E, subordination may be the price to pay for enhancing a country’s welfare. The case in point is a government that joins EMU and thus delegates monetary policy to an independent central bank. The European Central Bank (ECB) has a mandate to be more conservative, ie. more focused on price stability than the delegating member state governments, to achieve a credible commitment to low inflation (Alesina and Grilli

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1994). This commitment is seen as empowering the median voter, keeping rent-seeking special interests at bay, and thus presumably enhances growth and innovation in the long run (Olson 1982).

By contrast, political economists who actually use the term hegemony to characterise an ‘asymmetric power relationship’ argue that hegemony is more problematic (e.g. Strange 1987). Political economy with a capital P as we may call it points to political costs of hegemony that the utilitarian world view ignores by assumption – namely the assumption that the commitment serves the median voter. By contrast, this school of political economy maintains that to give up sovereignty and subscribe to a mainstream paradigm of policymaking disenfranchises the electorate or precludes influence of legitimate organised interests in society. To take again the example of EMU, the interests of small business or trade unions in a more accommodating monetary policy may thus be systematically disadvantaged compared to the interests of wealthy asset holders or international finance (Martin and Ross 1999). This may lead to a backlash, for instance the rise of populist parties that use resentment against certain features of EMU to forward a much wider anti-integrationist agenda.

The accession process of Central and Eastern European (CEE) countries provides a unique opportunity to study the relevance of these two views of hegemony.¹ Accession requires the implementation of a huge and growing body of EU legislation, the notorious if arcane *acquis communautaire*. Given the detail or ‘thickness’ of this *acquis* in many crucial policy areas such as competition or agriculture, there was little room for alternative legislative templates (Grabbe, 2002). To put it bluntly, the best a CEE government could bargain for was a temporary suspension of the hegemonic onslaught in the guise of transition periods. However, as the recent referenda indicated to the surprise of many observers, there is a vocal majority in favour of - or at least not expressly opposed to - joining this hegemonic club with its 80,000+ pages of membership rules.

¹ An alternative to both views is Hughes, Sasse and Gordon (2004) whose case study on the ‘myth of conditionality’ in the accession negotiations about EU regional policy casts doubt on the effectiveness of subordinating to hegemony. My analysis is not necessarily in conflict with their assessment that an externally imposed and assumed policy paradigm may not be able to shape domestic policies in a specific and tractable manner – in fact, their findings highlight the puzzle I am concerned with, namely why governments conspicuously subordinate themselves if it is not a real constraint on their manoeuvring.

The sometimes rather low turnouts in the referenda suggest that there is possibly mere lack of interest, widespread resignation at worst with no uprising against the hegemon imminent. A similarly ambiguous and puzzling example for voluntary subordination to hegemony is monetary union as will be discussed below.

In particular this latter observation suggests to me that, in contrast to the two views outlined above, hegemony consists of both commitment and disenfranchisement. Even if in the beginning it is meant to be conspicuous tying of hands with regard to special interests only, the political costs involved are not given but endogenous, for inherent reasons likely to increase and to be borne increasingly by the median voter. The reason for this is that tying of hands in one policy area is likely to affect other policy areas, thus leading to 'precommitment creep'. In EMU, this was arguably the case of the commitment to sound monetary policy which was the pretext to constrain fiscal policy and is now affecting the permissible range of welfare state reforms. Another factor that may increase the political costs of hegemonic policy commitment under certain conditions is delegation to a fiduciary or trustee (Majone, 2001: 114) rather than an agent in the sense of an operator closely monitored by the principal. The institutionalisation of the ECB is arguably a case in point.

The next section conceptualises hegemony in a way that allows us to determine when compliance with externally imposed policies amounts to a disenfranchisement or an empowerment of the majority or the representative voter, which leads either to resentment or popularity of these policies. This will then be applied to EMU where the case that its framework established a hegemonic paradigm of macroeconomic policy making is obvious and both responses have been observed. The resulting dilemma for a CEE country in joining a hegemonic club will then be analysed with respect to Poland. It will hopefully shed light on apparently contradictory phenomena: that in the negotiations the political elites make their uneasiness with some expressions of EU hegemony public, yet in the domestic rift between a technocratic-utilitarian drive for subordination and a populist demand for national self-assertion they take sides for subordination. Moreover, the political setting is not consolidated yet, as fragile governing majorities and large ideological swings between elections indicate. This makes the credibility of policymaking a pressing issue and subordination to hegemony a possible, if contentious

solution. The last section concludes by stating the paradox and the practical dilemma to which these two views of hegemony lead.

2. Hegemony as a transfer of political property rights

Hegemony can be conceptualised as a transfer of political property rights under more or less external pressure and to varying degrees. *Political property rights* are ‘rights to exercise public authority in a certain policy area’ (Majone, 2001: 113; cf. Moe 1990). Such a transfer is *hegemonic* if the policy area is irrevocably delegated to an independent agency in whose design the representatives of the delegating country had no formal participation and whose preferences systematically differ from those of the median voter in this country. It is compatible with this notion of hegemony that the representatives of the delegating country voluntarily consent to such delegation and that the independent delegate is henceforth held accountable as regards the fulfilment of the mandate. Such a concept of hegemony allows for both views of hegemony alluded to in the beginning, namely as a beneficial long-term commitment that constitutes at the same time a problematic disenfranchisement of domestic - representative and not merely special - interests.

Seen as a longterm commitment, a hegemonic transfer of political authority provides a solution to the incomplete contracting that the democratic process is inadvertently confined to: elections at regular intervals bestow the authority of government only for a limited time (Linz, 1998). Thus, the present government cannot guarantee that subsequent governments will uphold its policies, regulations and institutions (Moe, 1990: 227). This incomplete contract that a democratic transfer of political property rights entails has the problem of imperfect commitment in its wake. The present government may renege on its commitment to a certain policy, out of fear or under the pretext that otherwise it will be voted out of office and the next administration will exactly do that, namely renege on the present government’s commitment. The imperfect contractual commitment may lead to dynamic inconsistency of policy where short-term incentives contradict longterm interests of the electorate. Transfer of the political property right to an independent agency can solve this dynamic inconsistency at

the cost of democratic accountability of the policy. Judicial reviews or reporting requirements to parliamentary committees replace elections of those in charge.²

Seen as a problematic disenfranchisement of domestic interests, a hegemonic transfer of political authority may preclude the democratic contest over conflicting goals. A standard example for such conflicting goals is the tradeoff between equity and efficiency that structures welfare economic analyses of policy choices. From the direct user's point of view, privatisation of public utilities institutionally favours efficiency over equity considerations – and vice versa, publicly managed utilities tend to prioritise redistributive goals over commercial ones, for instance create public employment in return for soft budget constraints. Comprehensive and possibly irrevocable commitment to a certain policy necessarily implies a leap of faith in terms of what the 'longterm interests' of the median voter are³ and can only be justified if the accountability of the delegate is proportional to its independence. Even so, democratic accountability is then replaced by non-majoritarian control mechanisms exercised by one professional elite over another professional elite. The hegemonic transfer of political property rights remains at odds with the principles of democracy.

Thus, the concept of political property rights not only gives common conceptual ground to two views of hegemony in political economy but argues that they are two sides of one coin. The tradeoff involved is one between dynamic policy consistency combined with non-majoritarian accountability, on the one hand, and policy flexibility combined with democratic accountability, on the other. In both views, hegemony is trading the latter off against the former to achieve consistency at the cost of democratic control or, in more skeptical language, to favour and preclude deliberation over certain policy choices.

² Moravcsik (2002), in his defence of the EU's 'democratic deficit', rightly emphasizes that an agency and the policy area for which it is responsible can still be held accountable by other than democratic means, just like judges or the police are held accountable for their exercise of public authority.

³ The median voter model depends on a number of questionable assumptions, in particular that voters' preferences are continuously differentiated and vary marginally, so that the median is indeed a fair representation of what the majority wants. If the polity is more fractious and voters differ fundamentally on certain policies (say abortion), disenfranchisement becomes even more of a problem. But I accept the median voter model of the democratic process to argue that *even if* it is granted, the commitment may clash with democracy.

The two views differ in their assessment of the political costs that this choice necessarily incurs.

If one sees these views not as competing interpretations of hegemony but as inextricably linked, a paradox that translates into a policy dilemma arises: A transfer of political property rights is supposed to make policies in democracies 'credible' in the sense of consistent over time, yet the commitment creates a 'democratic deficit', namely a government irresponsible to contestation and demands by the electorate. The resulting policy dilemma shows up in concessions with respect to both and inconsistent policy choices that do not result from broken promises – as the literature beginning with Kydland and Prescott (1977) assumes -- but from the accommodation of conflicting demands along the lines of Rodrik and Zeckhauser (1988). This will be illustrated by the case of Poland and her prospective EMU entry.

What motivates the subordination to hegemony? Governments may wish to commit credibly to a policy that raises welfare in the long run but which shortterm incentives of the political process do not allow them to achieve. A well-known theorem to explain time inconsistency is the logic of collective action (Olson, 1982: ch.1). Because of the public goods nature of political involvement, democracies tend to have a biased representation of social interests: the narrower these interests, the more likely they find representation. This amounts to government failure analogous to market failure in the provision of public goods. Models of credible commitment narrow the logic of collective action down to one of government capture, so that the preferences of the authorities are systematically different from those of the median voter. However, it is not clear how such a 'captured government' ever succeeds in delegating its policy authority to an agency that has preferences which are clearly opposed to these special interests.

In line with Rodrik and Zeckhauser (1988), it seems more coherent to see government not as captured suppliers of inconsistent policies but as respondents, perhaps weak and unprincipled, to legitimate as well as illegitimate demands of their constituencies. A government that knows its weakness can try to *strengthen*, rather than tie, its hands by committing to rules or international agreements that constrain domestic policy choices. This external empowerment argument turns one of the lessons from

Putnam's two-level game on its head (Putnam, 1988): while the latter shows that governments have a strong bargaining position in international negotiations if they can claim that they face stiff opposition at home and therefore have little room for manoeuvre, it is now the apparent toughness of the ECB and the SGP that provides governments with the strength of an inflexible bargaining position at home.

Delegating a major policy, such as monetary policy, to an independent agent may thus be one tool to get the reform process started. It amounts to an exercise in Schumpeterian 'creative destruction'. This may be acceptable, first of all, because of a general readiness to do something about the policy area to be delegated. In the context of EMU, it was the experience of high inflation in the 1970s and 80s and the availability of the German role model. This provided the ground for a consensus that independence of the central bank leads to better monetary policy (McNamara, 1998: ch.3). Moreover, the link between delegation of a particular policy area, here: independent monetary policy, and the need for welfare state reforms may not be obvious so that delegation does not immediately ring alarm bells or discredits their ringing as alarmism of those who benefit from the status quo. In fact, there may not even exist a link in economic terms: generous and lean welfare states are equally compatible with stability-oriented monetary policy as can be observed in the EU today. Yet politicians may choose to create that link, for instance to make the political case that other elements of the post-war compact have to adjust, now that interest rate policy can no longer accommodate the outcomes of corporatist bargains. Delegation of monetary policy is thus made a reform lever but also a reform anchor around which everything else has to evolve. Italy and Greece are classic examples of this strategy of 'vincolo esterno' or 'external empowerment' of technocratic policymaking (Featherstone, 2001).

In sum, a hegemonic transfer of policy authority to an independent agent with different preferences can be a tool of reform politics. This may be in the interest and even find the consent of the median voter. Yet it is elitist or technocratic if the decision to delegate a particular policy is meant to induce changes in other policies that are not transparent and open to contestation. This indicates again that there is an inextricable link between hegemony as a 'beneficial commitment' and hegemony as 'democratic disenfranchising': the reform of the policy area to be delegated impacts on other policies

and there is no guarantee that this ‘commitment creep’ is in the longterm interest of the median voter.

3. EMU as a hegemonic club and reform anchor

Monetary union provides a unique opportunity to study the relevance of this view of hegemony. Presumably, EMU accession means subordination to the hegemony of a particular paradigm and practice of macroeconomic policy coordination. The new EU members did not apply and therefore did not get an opt-out from EMU like the UK and Denmark. Yet, interest in joining the monetary union is so far rather one-sided. The candidate countries would like to join fairly soon; the incumbent member states, the Commission and the European Central Bank (ECB) show little enthusiasm for monetary enlargement any time soon. It begs explanation that the subjects apparently welcome the prospect of joining a hegemonic club while the collective hegemon is not exactly keen to exercise its rule.

Bronk (2002) interprets the convergence of interest rates as interim gains of enhanced credibility that countries joining the EU or the monetary union receive as tangible advantages of accession. They carry forward the benefits of enlargement that otherwise would accrue in a distant future only and thus outweigh any existing costs of enlargement at the margin. This is an ingenious interpretation of how commitment improves the (unfavourable) time pattern of (immediate) costs and (future) benefits of enlargement. However, the argument takes political costs as exogenously given and not as endogenously arising with the very operation of the commitment technology, namely the cost of disenfranchisement.⁴

In what sense is EMU a hegemonic club? I will explore this with respect to the macroeconomic mix of monetary and fiscal policy. This mix is the result of two very different methods of coordination. Their analysis thus covers a whole spectrum of integrated policy areas. For instance, the case of monetary policy also applies to

⁴ Moreover, the empirical finding of a rising spread of the 10-year domestic currency yield over the 10-year Euro reference rate in new member states since October 2003 (!) indicates that EU entry in May 2004 was seen as risky (IMF 2004: 5). The new member states in general and Poland in particular apparently do not enjoy these interim benefits of credible commitment just yet.

competition policy with its strong mandate for the Commission to act as the guardian of its implementation. Fiscal policy is de facto softly coordinated by an intergovernmental Open Method, at least post November 2003 when the Stability and Growth Pact (SGP) was suspended in all but letter. The reform proposals of the Commission, which followed the European Court of Justice ruling in July 2004 that declared this Council decision of 25 November 2003 to be invalid, argue for such a softening and adaptation to country specifics (Commission, 2004).

In line with the definition above, for policy integration to imply a *hegemonic* transfer of political authority, the following criteria must be met:

1. Delegation to an independent agency is irrevocable for the time being;
2. Representatives of the delegating country had no influence on the design of this agency;
3. The preferences of this agency (by mandate or self-selection of agents) systematically differ from those of the median voter in the delegating country.

I will first assess separately for monetary and fiscal policy whether their integration follows a hegemonic pattern and then whether the mix results in a hegemonic determination of the policy stance.

In contrast to all other harmonised or coordinated policies, monetary policy is unified and does not foresee any role for the European Commission. It is the ECB and, at the operational level, the European System of Central Banks that have the sole responsibility for monetary policy and are explicitly immunised from outside interference (TEC Art,108): ‘When exercising the powers and carrying out the tasks and duties conferred upon them [...] neither the ECB nor a national central bank shall seek or take instructions from Community institutions, [...] any government of a Member State or any other body.’ The independent conduct of monetary policy by the ECB could only be constrained by the Council’s prerogative of choosing the exchange rate regime. If the Council were to decide, for instance, that the ECB has to peg the Euro to the US-dollar, conventional economic wisdom tells us that there could be no independent monetary or inflation targeting, the interest rate must then be used to maintain the peg. Yet, the

Council's prerogative is itself constrained by the stipulation that the exchange rate regime must not impair the ECB's ability to maintain price stability.

Arguably, all three criteria that define hegemony apply: Joining EMU means, so far and for all practical purposes, an irrevocable transfer of authority over monetary policy to a supranational agent. Late entrants to EMU do not have influence on the ECB constitution. This is, however, not different for successor governments in founding member states and it is characteristic of international treaties which must have supremacy over domestic law if they are to be at all binding. In combination with the last criterion it is telling, however. The narrow mandate of the ECB enshrines a difference in policy preferences, namely a bias towards price stabilisation and relative neglect of other goals such as high employment or external balance. In fact, the transfer of political authority over monetary policy to the ECB and its member central banks is so complete that it is a fiduciary or trust rather than an agent that can and should be monitored by the principals, even if imperfectly (Majone 2001: 114). The ECB 'owns' monetary policy and is held accountable for fulfilling its open-ended 'duty of care' by peer review from a select audience only (Majone, 2001: 117; Lohmann, 2003).

How about fiscal policy? In contrast to monetary policy, fiscal policy coordination among EU members already resembles that between EMU members. It is the central pillar of the economic policy co-ordination under the Broad Economic Policy Guidelines (BEPG). The coordination method is 'soft' in that the guidelines are politically binding but not legally enforceable (Directorate-General, 2002: 10). Members as well as non-members of the Euro area have to submit stability or convergence programmes, respectively, in line with the coordinates of the Stability and Growth Pact (SGP): budgets should be 'close to balance or in surplus' in the medium-term and must not have a deficit of more than 3% of GDP unless there is a severe recession. Non-members like the UK will merely be warned but not sanctioned under the Excessive Deficit Procedure if they violate the 3%-criterion. If budgets are in the steady state of 'close to balance or in surplus' which the Maastricht entry criteria stipulated, fiscal policy primarily uses automatic stabilisers to smooth aggregate demand and facilitate employment

adjustments.⁵ If budget balances are off the steady state, the BEPG will have to make sure that all processes, such as the Luxembourg process (concerning labour markets) and the Cardiff process (concerning commodity and capital markets), are consistent with the need for fiscal consolidation so that a dynamic equilibrium can be reached.

The question thus arises whether EU membership already means fiscal hegemony so that EMU entry does not make any material difference. A check of the three criteria suggest to me that the hegemonic nature of fiscal policy coordination is less clear cut, even if we stick to its strictest form. First, the row between Commission and member states over the decision of the Ecofin Council in November 2003 not to follow the recommendation of the Commission can be interpreted as a conflict over how irrevocable and wide-ranging a transfer of political authority the SGP and, consequently, the BEPG is. The Council's refusal to open the Excessive Deficit Procedure against France and Germany implicitly declared the transfer of partial fiscal authority to be revocable. The Commission saw this as a material breach of the Treaty and thus sought a judicial review of this decision which, according to most observers, the Commission has won. The legal ruling asserted the irrevocable nature of the transfer and the Commission's role as the guardian of the Treaty. However and somewhat ironically, this made reform of the Pact (and again by implication, the BEPG) all but a foregone conclusion (Begg and Schelkle 2004). Even EMU outsiders considering entry may have an impact on the design of fiscal policy coordination right now. This is illustrated by the UK's proposal to replace the 3% deficit criterion by a Golden Rule-type of fiscal constraint that would allow unconstrained borrowing but for public investment only. It may be different for the CEE countries, however, whose accession is still some way off.

The third and arguably crucial criterion for hegemony, namely an institutionalised difference in policy preferences, depends on the actual operation of the SGP. It reveals a credibility-enhancing difference of preferences if the Pact or the BEPG is binding and has the disciplining effect it is supposed to have. The evidence on that is mixed: for some

⁵ Automatic stabilisers are taxes and transfers that vary countercyclically with the business cycle, eg. income taxes that fall and unemployment benefits that rise in a recession and vice versa in a boom. Cf. Buti, Eijffinger and Franco (2003: 2) for the steady state perspective of fiscal policy rules in EMU.

member states this is the case; for a rising number it is not.⁶ More fundamentally, the institutional set-up, namely delegation to a self-regulating body like the Ecofin Council, suggests to me that fiscal policy coordination was not meant to enshrine fundamentally different preferences because that would require independence of the agent. No such independent agency was created and the Commission was given only the weak mandate to recommend but not to initiate sanctions.

In conclusion, it seems to me that EMU fiscal policy coordination in its present form does not require a hegemonic transfer of political authority. This assessment does not rest solely on the evidence of the present conflict but rather takes this conflict as indicative. This would change if the reform of the Pact were to create an independent fiscal committee or give the Commission a role as in the classical Community Method.

What about the policy mix then, if it is the result of a hegemonic transfer of political property rights in the case of monetary policy but not necessarily in the case of fiscal policy? Does the combination that inadvertently comes with EMU make for a hegemonic determination of the macropolicy stance? I think it does. The economic policy framework is supposed to operate in a hierarchical way (Directorate General, 2002: 4-6):

- Central bank policy sets the overall macroeconomic stance to be followed (if necessary anticipated) by fiscal policymakers and wage bargainers.
- If the stipulations of the SGP are binding, the respective government is not supposed to contemplate how it can achieve a complementary fiscal stance but must focus on national budget consolidation.
- If the Pact is not binding, ie. the budget close to balance, economic policy coordination can concentrate on medium-term structural reforms.⁷
- Lastly and operating through the weakest process of the entire framework, the Macroeconomic Dialogue acts as a forum to communicate, in particular to wage

⁶ At the time of writing, six EMU member states were in breach of the 3% deficit criterion, namely France, Germany, Greece, Italy, the Netherlands, and Portugal.

⁷ This is implied by the recent European Council decision to streamline the BEPG with the Cardiff and Luxembourg processes.

bargainers, the ECB's assessment of the macroeconomic situation as well as the thrust of governments' reform plans over the course of the year.

Thus, monetary policy is at the top of the hierarchy, in game theoretic terms a Stackelberg leader that is institutionally poised to make others - fiscal policymakers, wage bargainers or structural reformers - adjust to its actual or anticipated course of action.⁸ What can possibly motivate such a transfer of political property rights as regards the determination of the macropolicy stance? The commitment device idea gained prominence first with respect to exchange rate coordination in the European Monetary System (EMS). The 'advantage of tying one's hand' was presumably that high inflation countries could thus signal a regime change by maintaining a peg with a low inflation country (Giavazzi and Pagano, 1988). This commitment device obviously did not work, EMU meant that monetary policy was taken out of national authorities' hands altogether. The commitment argument now proposes that maintenance of stability-oriented central bank policy requires fiscal hands to be tied, because governments have preferences for actions that if unconstrained would not be in the best interest of all members. Subscribing to the hegemonic policy framework is thus a public commitment to pursue fiscal policies as a matter of common concern in line with the stipulations of the *acquis*. The weakness of this argument is 'that it solves the problem of credible commitment by assuming the solution.' (Lohmann, 2000: 397) The move from the EMS to EMU as well as the demise of the SGP indicate that assuming a solution is not good enough in practice.

Can the hegemonic determination of the policy mix be explained as providing a reform anchor? It has certainly strengthened the bargaining position of governments vis-à-vis the wage bargainers, in particular unions. This does not necessarily amount to a dismantling of the corporatist social fabric. Even before the formal beginning of EMU, external empowerment seems to have led to a new variant of social pacts, namely one that enforces and organises wage moderation to gain external competitiveness (Hassel

⁸ The characterisation of the ECB as a Stackelberg *leader* is in contrast to Collignon (2004: 914) and others who see the ECB as a Stackelberg *follower* because the monetary authority decides monthly on its stance, presumably waiting for what the fiscal authorities do. However, unlike a Stackelberg follower, the ECB has shown little inclination to accommodate fiscal policies. The actual temporal sequence of setting policies is immaterial to the Stackelberg game since its equilibrium is one in (rational) expectations. On the contrary, being able to make a move after others have made theirs or to adjust more quickly may be the very reasons for leadership, ie. one's actions have to be anticipated by others.

2003). These new arrangements can thus be portrayed as serving reforms of the supply side, namely increasing competitiveness by reducing wage costs. However, one has to explain why this does not simply lead to recession and shrinking employment. This can be avoided only if they succeed as *demand* side policies, following a mercantilist strategy to achieve export surpluses by real devaluation. This has several advantages. Demand-side stabilisation in the disguise of a liberal supply-side rhetoric sounds, first of all, less anti-integrationist ('beggar-thy-neighbour') and more like 'integration begins at home'. The rhetoric for the microeconomy is also consistent with the macroeconomic austerity discourse, apt to rein in expectations of expensive employment programmes. In this sense, EMU was a reform anchor that changed the focus of corporatist agreements for some time and was, where it succeeded, even popular. But the new social pacts did not survive the onset of the monetary union (Hancké and Rhodes, 2004).

4. The dilemma of joining a hegemonic club: The case of Poland

The governments of most CEE countries have shown keen interest to adopt the Euro soon after EU accession (European Parliament, 1999: 13-14). Lithuania was first and submitted on 3 March 2004 a formal application to join the monetary union. This interest is motivated, for one, by want for a strong political signal, namely of an irrevocable 'return to Europe'. It is motivated as well by a search for a reform anchor that imposes a binding constraint on fiscal policy and wage bargains at home. This keen interest has been maintained despite the fact that the rules of the EMU club were written without considering the CEE countries' future membership. Nor do present discussions indicate that the reconstruction of the Maastricht policy framework takes their particular concerns into account (Schelkle, 2004).

In the following, I will explore the dilemma that joining a hegemonic club creates for a country like Poland. The country has not yet a consolidated party system, successive administrations rule with notoriously fragile majorities and there are large ideological swings between elections (Innes, 2002: 94-95). Thus, Polish governments face severe credibility problems and are particularly suspect of dynamic policy inconsistency that the democratic transfer of political property rights in any case implies.

This section will first sketch the apparent problems of the macroeconomic policy mix in Poland. This is to identify the need for credible commitment that EMU accession may serve to fulfil, but also to identify the issues which would become immunised against partisan or democratic contestation. Then I discuss how suitable the present EMU policy framework is for a political economy like Poland to assess whether its hegemonic nature, in particular the institutionalisation of systematically different policy preferences, is problematic.

For better or worse, the Maastricht criteria have become the benchmark for assessing the macroeconomic performance of members and aspiring candidates. Thus, we can look at Poland's track record as regards the performance criteria to spot any real or apparent problems in the policy mix.⁹ The country has fulfilled the structural criterion in that the central bank was made independent.

⁹ The fifth performance criterion is to stay within a band of ± 15 percent of the central parity to the euro for two years.

Table 1. Poland's performance as regards the four Maastricht criteria

	<i>2001</i>	<i>2002</i>	<i>2003e</i>	<i>2004e</i>
Inflation Poland	5.3	1.9	0.7	2.5
Maastricht reference value ^a	3.1	2.9	2.7	2.4
Interest rate Poland	10.7	7.3	5.9	6.9
Maastricht reference value ^b	6.9	6.9	6.1	6.4
Public debt Poland	40.3	46.0	50.1	53.2
Maastricht reference value	60.0	60.0	60.0	60.0
Fiscal deficit Poland	-5.3	-6.3	-5.8	-7.2
Structural deficit	-4.8	-4.9	-4.5	-6.3
Maastricht reference value	3.0	3.0	3.0	3.0

e: estimate as of July 2004 (IMF data) and August 2004 (Eurostat), respectively.

a: Average rate of inflation of the three best performing EU member states plus 1.5%

b: Average rate of longterm interest rates of the three best performing EU member states plus 2%

Source: European Commission (inflation and interest rate), IMF (fiscal indicators, for 2003 estimated and for 2004 projected).

The IMF notes in the country report of June 2003 that Poland's 'fiscal-monetary policy mix remains a problem' (IMF, 2003: 8). This shows up in an inflation rate that was then even lower than the average of the three best performing EMU members and bordered on deflation. The fiscal deficit, in contrast, is very high; even the structural deficit that takes the endogenous rise of the deficit caused by the current recession into

account is above the threshold of 3 percent and rising, thus adding rapidly to the stock of public debt. The problem shows up in a persistently high real interest rate of over 5 percent that stifles domestic investment.¹⁰

Does this suggest that Poland has given in to monetary hegemony by its independent central bank while the government still insists on fiscal sovereignty, a mismatch which makes for sluggish growth? It is significant that the National Bank of Poland (NBP) has just announced that it will pursue, from 2004 onwards, an inflation target of 2.5 percent. IMF staff consider this target to be too low since the Balassa-Samuelson effect adds about 1-2 percent to the measured price increase (IMF 2003: 18; IMF 2004: 15).¹¹ This would prolong the deflationary pressures that are already present. The NBP's monetary policy committee, however, 'insisted that the target would be consistent with the Maastricht inflation criterion' (IMF 2003: 18). The overfulfillment of the inflation criterion under the pretext of preparing for EMU accession seems to be directed at the fiscal authorities: the monetary policy committee pointed out that it cannot go for larger interest rate cuts as long as the fiscal situation has not markedly improved. The sensible macroeconomic rationale is that if this expansionary stance remains unchecked, the current account situation may worsen even further (IMF, 2003: 16). Yet, IMF advice suggests that it is political economy rather than macroeconomics that accounts for the intransigence of the Polish central bank. It 'encouraged the MPC to avoid excessive caution in assessing inflation pressures and to be responsive to credible improvements in fiscal policy.' (IMF, 2003: 16)

In other words, it is the IMF that warns the central bank not to be overzealous in its use of monetary policy as a disciplinarian device for fiscal policy, thereby locking in a

¹⁰ Nominal convergence of interest rates from 10.7 to 5.9 percent, as seen in table 1, has made inflows of portfolio capital and foreign-currency denominated credit less attractive, however. Both are welcome as they lessen pressures for appreciation of the Zloty and foreign indebtedness, thus the vulnerability to a speculative attack. – A comparison with Turkey highlights that high real interest rates reduce the inflation rate only if the large fiscal deficit is not financed by a dependent central bank. In 2004, Turkey brought down inflation to single digits, with a fiscal surplus of 6% and real interest rates of 15% (IMF Survey 2004). Such figures are typical of a disinflation strategy and cannot be sustained without killing off growth.

¹¹ This effect invokes a kind of structural, non-monetary 'inflation'. It captures the phenomenon of a continuous rise in the measured price level that is caused by catching up of domestic prices and productivity to world market levels.

recession that makes budget consolidation even more difficult. While not a hard proof, this does suggest that the Polish central bank has embraced hegemony as a reform lever of the elitist or technocratic variety in that the bank tries to engineer changes in fiscal policy through the monetary stance. The reconstitution of the Monetary Policy Committee in May 2004 indicated that this is ultimately endorsed by the government. Various administrations have tried to push through fiscal reforms against the odds of what the IMF characterizes as ‘vested interests and fractious politics’ (IMF, 2004: 5, cf. Box 1).

For the assessment of fiscal sovereignty or hegemony, it is interesting to note that in Poland the fiscal debt criterion of 60 percent has got the status of a constitutional limit. Corrective actions must be taken whenever debt exceeds 50 percent of GDP (IMF, 2004: 11). On the other hand, indexation and other automatic, ‘formula-driven’ adjustments of social entitlements are pervasive. They make discretionary budget consolidation hard to achieve. Moreover, adjustments for projected inflation take place only for underprojections but not for overprojections, an asymmetry that creates an upward bias in social expenditure. Now that public debt exceeds the 50 percent threshold, the constitutional limit becomes a binding constraint. The government has indeed proposed an austerity plan in January 2004. Again, abolishing ‘formula-driven’ social transfers which is implicitly mandated by law is politically sold as ‘essential for meeting the Maastricht criteria and restructuring fiscal priorities to ensure adequate funds for co-payments to realize EU grants.’ (IMF, 2003: 13) Any member state that violates the 3 percent deficit criterion under BEPG can be excluded from receiving structural funding, after all the co-financing requirements would make budget consolidation even harder (and the additionality principle means that structural funds must not be used to replace own expenditures). Thus, even non-EMU members face a hard sanction if they do not comply.

In other words, while the domestic political economy still resists fiscal policy in line with EU conditionality, the constitutional limit is used to implement reforms in order to comply with EU conditionality. This may be called conspicuous subordination to fiscal hegemony which, however, empowers the government at the same time in its politics of reform. The political backlash against European integration that this external

empowerment strategy may induce is (hoped to be) contained by the prospect of receiving EU structural funds.¹²

The monetary and fiscal authorities in Poland thus try, in anticipation of EMU, to immunise certain policy choices against partisan or democratic contestation. These choices are specifically:

- The macroeconomic policy mix that stabilises demand: Given the high real interest rate strategy of the central bank to discipline fiscal policy, a dynamic of the domestic economy led by public and private investment is unlikely to emerge. This implies that any increase in competitiveness, which shows up in low or relatively decreasing unit labour costs, will mostly rely on moderation of nominal wage claims because the technological progress, ie. rising labour productivity, that comes with buoyant investment will not figure prominently. Even if nominal wage rises are so moderate that they stay below (moderate) productivity increases, this will only lead to lower unit labour costs if commodity prices do not fall in line with lower unit labour costs. This is the case if production is for exports since world market prices are typically given for Polish firms. In short, the monetary accession strategy of the NBP leaves exports as the only source of demand to stimulate growth which is highly dependent on demand conditions in the EU.
- The mix of fiscal consolidation and welfare state reform: Given the constitutional limit on public debt, the government must break the momentum as quickly as possible. This imperative favours cuts in social expenditure: *expenditure*, because measures that make for more effective tax collection typically take more time to materialise in higher revenues; *social*, because automatic adjustments of welfare benefits like pensions are a driving force of the debt dynamic in Poland. While sensible in macroeconomic terms¹³, de-indexation and improved targeting imply that

¹² Even so, the IMF expects *net* EU-related spending to be 0.5-1 percent of Polish GDP per year in 2004-06 (IMF 2003: 15).

¹³ De-indexation is economically sensible because it breaks an inflationary as well as a deflationary momentum and relieves the central bank from using the blunt instrument of interest rate hikes as the sole instrument of price stabilisation. Almost half of the planned savings in the Hausner plan, meant to reduce the public deficit-GDP ratio by 2 percent, stems from cuts in social spending (IMF, 2004: 11).

low- and middle-income beneficiaries will be affected and that poverty relief becomes less effective as an in-built stabilizer of (real) demand.

How suitable or problematic is this institutionalisation of systematically different policy preferences for a political economy like Poland? In other words, is the disenfranchisement that comes with commitment more contentious or stifling in a transition country like Poland? To me, the answer is yes for both choices.

The macroeconomic mix, favouring a mercantilist export-led strategy with nominal wages bearing the brunt of adjustment, is harder to accomplish because the institutional and economic preconditions are not fulfilled. The institutional precondition for such a strategy to be successful is some form of coordinated wage bargain or social pact (Hassel, 2003, Soskice and Hancké 2002). Otherwise it is rather likely to get wage increases that are either too high, resulting in unemployment and unsustainable current account deficits, or too low, resulting in deflationary pressures and subsequent unemployment. Economically, a mercantilist catching-up strategy depends on the main trading partners. They must show sustained and robust demand for Polish imports. Obviously, neither German growth prospects are exactly encouraging nor is it easy for a country with little wage coordination to shadow the German wage bargain. To make things worse, real labour unit costs in Germany are in decline, absolutely and relative to other EMU member states (Directorate-General, 2004).

The mix of fiscal consolidation and welfare state reform, calling for de-indexation of social transfers with immediate regressive effects, is likely to be more contentious than in the incumbent EMU member states. The sheer number of welfare beneficiaries involved make this strategy of fiscal consolidation both very effective and highly contentious. About 20 percent of the workforce are registered as unemployed. At the same time, 70% of all poor do have work, ie. employment does not protect against poverty and makes a considerable share of working households eligible for social transfers, in particular child benefits since families with three and more children have the highest poverty risk. By contrast, pensioners (12 percent of the population) so far have a lower poverty rate than the population at large (in 2000, 5.1 percent of old-age pensioners compared to 8.1 percent of the population) although this is expected to change dramatically due to recent

changes in the pension system (Deutsche Gesellschaft fuer Versicherungswissenschaft und –gestaltung 2002).

Present debates on the reform of the SGP are unlikely to take these concerns of acceding transition economies into account (Coricelli and Ercolani 2002: 1; Schelkle 2004). The entry criteria of inflation and nominal interest convergence – independent of the real interest rate convergence – are not under scrutiny. The budget deficit criterion has been changed to a structural indicator but this is of little comfort to Poland with its high persistent mismatch between spending and revenue over the business cycle. EU accession will add to the deficit rather than provide relief any time soon. In that sense, Poland is about to join a hegemonic club to which it cannot upload its preferences that are bound to remain different from those of the incumbent member states (Grabbe, 2002).

But why is this a dilemma? Or, put differently, is it only an elitist obsession with the ‘return to Europe’ that drives the attempt to enter EMU as well? The electorate at large seems to be generally in favour of European integration but is quite uncertain – and increasingly sceptical – about the specific benefits (Eurobarometer 2004; Szczerbiak 2002, Falkowski 2003).¹⁴ There is no agreement on rapid accession to the euro area even among policymakers (IMF, 2004: 9). Ex ante, this amounts to a political economy tradeoff that policymakers perceive. The biases in domestic policy choices, introduced by the anticipation of EMU entry, create political costs of disenfranchisement. They are potentially and to an unknown extent compensated by manifest economic advantages that monetary union would bring about for a transition economy like Poland.¹⁵ The visible change that EMU membership will bring about is a lowering of real interest rates which arguably has longterm, if less visible benefits in its wake:

- The currency risk premium on interest rates would be eliminated. There are two main reasons for this. First, all Euro-denominated debt would become domestic debt, reducing external vulnerability to that extent. Second, even huge current account

¹⁴ Support for EU membership has decreased by 10% since the last survey and the expectations of benefits from EU membership declined by 6% although 50% still expect some (Eurobarometer 2004: C52; C61).

¹⁵ Rostowski (2003) has a complementary argument, namely that candidate countries outside EMU face severe macroeconomic instability.

deficits with EMU members can no longer trigger a currency crises with widespread default of domestic enterprises and banks that individually may have been solvent before a massive devaluation revalues their foreign debt to an unsustainable level.

- Inflation that is driven by monetary conditions would converge downward or upward (as is now more relevant for Poland though rarely mentioned in the literature). Regional price dynamics would reflect sectoral conditions and catching up (Balassa-Samuelson effect), thus sending less distorted signals to restructuring and investing firms.

Lower real interest rates that these two processes would entail facilitate transition and development. Real interest rates are barriers to investment and therefore employment, so that lowering them also lowers these barriers. A decrease in interest rates signals that the pay-off from an investment needs to be less immediate. In general, lower interest rates should therefore lengthen the time horizon of investments which favours technical progress and a less exploitive use of resources. Moreover, interest rates have a direct impact on living standards. Lower interest rates imply that - in equilibrium - a higher share of each unit value added, i.e. of the income generated in a particular production process, goes to wages rather than to interest and profit income. Thus, real wages in the accession countries could and would rise, income distribution become more equitable, without jeopardizing competitiveness and employment.

Thus, there are good reasons to embrace hegemony in line with the commitment view. However, the concerns of the disenfranchisement view cannot be dismissed either. Only the future can tell how steep or flat the economic trade-off and how grave or easy the political dilemma created by (anticipated) EMU accession will be. Alas, the decline in public support that has already been observed in the EU accession process suggests that the perception of this dilemma may change for the worse over time (Szczerbiak 2002). The authorities will then find that there is no short-cut such as splendid technocratic isolation that allows to substitute for the time-consuming and opportunistic business of convincing a majority of reforms deemed necessary for a sustained catching up process.

5. Conclusions

In this paper, I presented two views of hegemony that are useful to understand both the motivation for and the problématique of EMU accession. On the one hand, political Economy with capital E provides a rationale why sovereign governments may subordinate themselves and future administrations to the hegemonic policy paradigm of EMU and even find popular support for it. Supposedly, subordination enhances the credibility of the commitment to sound macroeconomic policy. On the other, Political economy with capital P points out that subordination clashes with democratic contestation over vital economic policies. It amounts to disenfranchisement of the electorate by delegating policymaking to non-majoritarian institutions like the ECB or to majoritarian institutions like the Council that are not accountable to domestic voters.

Hegemony seen as a device of *both* commitment and disenfranchisement entails a paradox. Delegation is meant to make up for the imperfect contracting that a democratic transfer of political property rights inadvertently means – administrations are bound to change and entitled to revise decisions of their predecessors. After the fact, delegation is likely to raise the awareness of a democratic deficit that calls for majoritarian accountability of the independent delegate. This, however, would create exactly the same credibility problem for the delegate that it was supposed to amend. The theoretical paradox translates into a practical dilemma for policy-making (Rodrik and Zeckhauser, 1988).

The dilemma has been illustrated by the case of Poland: Until now, the monetary and fiscal authorities have not managed to get the policy mix right. Monetary austerity combined with large structural budget deficits make for high real interest rates, rising public debt and deflationary pressures that depress investment. Fragile parliamentary majorities and volatile popular support for any Polish government can be interpreted as suggesting that the fiscal authorities are in desperate need of a commitment device to reduce the structural deficit. The Polish central bank follows this line and justifies its tough policy stance already as preparation for EMU accession, more specifically as a signal to discipline the government. However, the IMF country report of 2003 portrays this central bank strategy as not very constructive. Rebalancing of the unfavourable policy mix under the hegemony of EU economic governance will favour welfare state

reforms that are highly contentious. Even if they would ultimately be called for irrespective of EMU, such as getting rid of pervasive automatism in upward adjustment of entitlements, the median voter could be forgiven if he or she perceives this as a diktat from Brussels or Frankfurt. This would be unfortunate, to say the least, as it would give Polish voters the impression that after fifteen years of political transition they have just come full circle.

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Özet

Güvenli Bir Reform Siyasal Hegemonyaya Boyun Eğerek mi Yapılmalı? Avrupa Birliği Genişlemesinin Siyasal Ekonomisi

Avrupa Birliği'ne girmeyi hedefleyen Doğu ve Merkez Avrupa ülkelerinin pek çoğunun hükümetleri, Birliğe kabul edildikten kısa bir süre sonra Euro'ya geçmek konusunda büyük bir ilgi göstermektedir. Bu ilginin kökeninde, her şeyden önce, Avrupa ile bütünleşmenin artık geri dönülemez bir süreç olduğu olgusunun politik olarak gösterilmesi vurgusu yer almaktadır. Bu ilgiye neden olan bir diğer etken de, ülke içinde ücret pazarlıklarında ve maliye politikalarında bağlayıcı bir sınırlamayı öngören güvenli bir reform arayışıdır. Avrupa Birliği Kulübü (EMU)'nün kuralları oluşturulurken, Merkez ve Doğu Avrupa ülkelerinin olası üyelikleri göz önünde bulundurulmamış olmasına rağmen, söz konusu ülkelerde yukarıda belirtilen Euro'ya geçmeye yönelik ilgi bir olgu halinde kendini göstermektedir. Bu yazı, hegemonyayı politik mülkiyet haklarının spesifik bir transferi olarak kavramlaştırmaktadır. Bu ise hem temsil heyetinin (delegasyon) bir uzlaşma aracı olarak kullanımını, hem de bu durumun zorunlu bir sonucu olarak ortaya çıkan yurttaşlık haklarından mahrum etme sorunsalını kapsamaktadır. Merkez ve Orta Avrupa ülkelerinin bir hegemonik kulübe üye olmalarının ikilemi, en büyük aday ülke olan ve geçmişinde makroekonomik sorunlar yaşamış bulunan Polonya referans alınarak incelenmiştir.