The management of economic interdependencies of a small state: assessing the effectiveness of Lithuania's European policy since joining the EU

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By

Ramunas Vilpišauskas

Institute of International Relations and Political Science, Vilnius University

Centre for Small State Studies
Institute of International Affairs
MMXII

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Preface

One of the chief preoccupations of small state studies today is the relationship of small states with multilateral organizations, both at global and (where available) regional level. Such groupings can offer explicit or existential security protection for small states; provide markets where they can exploit their comparative advantages; and give them new opportunities for self-expression and influence. Small states, however, pay a complex price themselves for these benefits, and whether they secure a net 'profit' in all relevant spheres depends also on how they play their own hand in each institutional context.

These issues have been explored by researchers notably with regard to the European Union, an organization with elements of uniquely deep integration where members have an unusual amount both to gain and lose. Few such studies, however, have yet been devoted to the newer small member states from Central Europe that joined the Union in 2004. The present paper by Ramunas Vilpišauskas, Director of the Institute of International Relations and Political Science at Vilnius University, helps to fill the gap with a theoretically advanced and politically realistic survey of Lithuania's experiences as an applicant and full member state over the last fifteen years. Like other analysts, he finds that the EU framework offers unprecedented openings for such a small actor to 'upload national policy preferences' into collective strategy. However, he stresses that success in this depends as much on domestic-political unity and consistency as on good coordination and negotiation.

Such unity can be hard to preserve when a small European state not only has major dependencies on a non-EU neighbour (in this case, Russia), but houses varying views on how to deal with that challenge. Combined with the lack of a common front among all three Baltic States on issues like budgetary policy and energy, this has not only blunted Lithuania's impact on EU policy, but slowed down the application in Lithuania of core EU instruments including the Euro.

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Introduction

This paper analyzes Lithuania's economic situation and its policies aimed at managing external dependencies which arise from being a small and relatively open European country.[1] Since the start of transition reforms in the early 1990s, Lithuania's economic policies have been reoriented from a closed East-oriented planned economy to a relatively open and increasingly diversified market economy. Accession to the European Union (EU) became the key instrument for managing external dependencies, with other regional economic agreements such as the Baltic free trade area providing stepping-stones in the process of EU accession. While from the economic point of view, the complete liberalization of external economic relations could be seen as the first-best option (and was indeed the means chosen by Estonia from the early 1990s until 2004), for a number of reasons accession into the EU became a dominant strategy. The need to Europeanize bilateral economic relations with Russia, in particular in the field of energy – where the aim was to reduce asymmetric dependence of supplies on Russian supplies – was among the national interests at stake.

The main focus of the paper is on the way Lithuania's policies have sought through EU membership to reduce certain external dependencies and diversify external economic links, and now seek to integrate further by attempting to join the Economic and

1 This paper is a modified version of an article by the author 'National preferences and barging of the new member states since the enlargement of the EU: the Baltic States - still policy takers?', *Lithuanian foreign policy review.* No. 25, 2011, p. 9-32.

Monetary Union (EMU) and using other instruments available to EU members. These issues are closely linked to broader academic debates on the national preference formation of EU member states and the (limits of) influence of small EU countries in particular. More concretely, the paper asks what have been the key factors in forming the national preferences of Lithuania (and other two Baltic states) since their accession into the EU; what have been the key policy areas where their institutions have been most active in managing economic dependencies; and finally, what factors can account for the varying degree of influence and success with which these countries have been able to upload their national policy preferences onto the EU agenda. Although the focus is on Lithuania, the paper also often refers to Latvia and Estonia to allow for comparative analysis and observations.

The analysis starts with a brief overview of relevant literature covering the national preference formation of EU member states, to set a background for the presentation of the arguments regarding the preference formation in Lithuania. It formulates arguments regarding the sources of national preferences and the factors that influence their transmission onto the EU agenda. It then discusses the European policy areas where all three Baltic States have been increasingly active, both domestically and in the EU arena, and explores the factors that seem to be at play in determining the varying degree of success achieved in uploading national preferences onto the EU agenda. In other words, it focuses on factors which allow using the EU membership to manage external interdependencies of small member states. It concludes with such observations as can safely be made at this stage, taking into account the limited time-frame of the Baltic states' participation in EU policy making processes.

1. The analytical framework

The participation of new member states in the EU policy process can be analyzed through the lenses of national preference formation and uploading of their preferences onto the EU agenda (interstate bargaining). Such an analysis requires addressing the questions of what are the sources of national preference formation on particular European policy issues, and what determines the outcomes of interstate bargaining at the EU level. One way to analyze these issues is by using the liberal intergovernmental approach, which sees national preference formation as the outcome of domestic (usually economic) societal groups interacting with the national leaders (usually executive governments), while the outcome of interstate bargaining depends on the states' relative bargaining power – in turn related to the degree and nature of economic interdependence.[2] Accordingly, large countries which usually have less intense economic relations with other members of the EU have stronger bargaining power, while small countries - given their openness and more intense trade relations with other members - stand to gain more from economic integration (market opening), and therefore have less bargaining power. Besides, rela-

2 Moravcsik, A., *The Choice for Europe*. Ithaca, NY: Cornell University Press, 1998.

tively less wealthy countries can be motivated to agree to the intergovernmental bargains by offering them EU funds.

However, this approach has a very limited application in the case of new EU member states due to its emphasis on economic *inter*dependence as a source of bargaining power. Most of these countries (with the exception of Poland) are small and open economies, and in the near term net receivers of EU funds. The Baltic States are among the smallest (though not necessarily most open) economies of all the Central and Eastern European countries that joined the EU in 2004 and 2007[3]. Therefore they are asymmetrically dependent on the EU and by definition are doomed to be "policy takers" in the EU, without any prospects of exerting bargaining power in the Council negotiations and feeding their national preferences into the EU agenda. The relative numbers of votes for weighted majority voting in the Council where large countries have more votes only reinforce this argument. The Baltic States are among those 19 countries that have a smaller number of national votes in the Council than the EU average.

Nevertheless, this paper postulates that it is useful to analyze the preference formation and bargaining behaviour of countries such as the Baltic States in spite of their asymmetric dependence with

3 The main economic indicators of economic openness include the share of foreign trade in relation to country's GDP, as well as indexes such as the KOF globalization index that include not only economic data but also economic policy indicators. In 2010, according to the respective national institutions of statistics, Lithuania's share of foreign trade equalled around 120 percent of its GDP, Latvia's external trade was around 88 percent of GDP, and Estonia's foreign trade constituted around 128 percent of GDP (calculations by the author). In the KOF globalization ranking in 2011 Lithuania ranked 36th, Latvia 41st and Estonia 24th. Interestingly, an economic globalization ranking in 2011 puts Lithuania in the 34th place with Latvia being 29th and Estonia as high as 8th among 156 countries assessed.

the rest of the EU. Liberal intergovernmentalism can explain the process of EU accession negotiations as an asymmetric adjustment by the acceding countries[4]; it can also provide an account of decision making in the enlarged EU and the relative influence of different EU member states depending on their bargaining power. As Moravcsik has pointed out, however, the logic of liberal intergovernmentalism is most visible in cases when the societal interests behind specific policy issues are well defined and institutionally represented[5] – conditions that have often been absent in countries undergoing transition and integration reforms. The more uncertainty there is regarding the outcomes of particular policy decisions, the less predictable is the process of preference formation based on the logic of interaction between the interest groups and policy makers, and the more important other factors such as ideology might become. In addition, it could be argued that the more uncertainty there is regarding national preferences towards the EU, the more likely the government's behaviour is to follow the logic of being "a good European", rather than calculation of national interests and hard bargaining. The analysis of Lithuania's accession negotiations shows that uncertainty and lack of information is a more important constraint for small domestic companies, while large transnational enterprises, including energy companies, are better informed about EU norms and therefore are more successful in transmitting their preferences to the national government.[6] In sum, liberal

4 Moravcsik, A., Vachudova, M., 'National interests, state power, and EU enlargement', *East European Politics and Society*, 17 (1), 2003, p. 42-57.

5 Moravcsik, A. p. 36.

6 Maniokas, K., Vilpišauskas, R. Žeruolis, D., eds., *Lithuania's Road to the European Union. Unification of Europe and Lithuania's EU Accession Negotiations.* Vilnius: Eugrimas, 2005.

intergovernmentalism can be useful in providing a structure of analysis and a set of variables to start from; but one needs more nuanced lenses to analyze the preference formation and bargaining behaviour of small EU members that are asymmetrically dependent in terms of trade and in the position of net receivers from the EU budget.

Accordingly, this paper also draws on other works that discuss variables affecting national European policies of EU members. For example, in addition to the variables stressed by liberal intergovernmentalism – intensity of trade relations, net receipts from the EU – some authors have also used factors such as ideology (left and right wing attitudes), history (experience of the Second World War), and public opinion to test the causes of government support for European integration.[7] Other authors, asking to what extent the variables used to explain European integration preferences in the old EU member states can also be used to analyze the national preferences of new EU members, have argued that "there is no silver bullet which provides explanations both for all countries and all policy areas".[8] They hypothesize that national preferences are policy-specific, with general support for European integration and liberalization being dependent upon ideology, support for redistributive policy depending on whether a country is a net recipient or contributor, foreign policy being affected by history and size, and, finally, preferences towards EU enlargement resting upon geography and attitudes regarding deeper integration. The

7 Aspinwall, M., 'Government Preferences on European Integration: An Empirical Test of Five Theories', *British Journal of Political Science,* 37, 2006, p. 89-114.

8 Copsey, N., Haughton, T., 'The Choices for Europe: National Preferences in New and Old Member States', *Journal of Common Market Studies*, 47 (2), 2009, p. 263-286.

relative importance of these factors depends on the concrete policy fields where a particular member state is seen as most vulnerable, or, as the authors put it, "states will prioritize those particular areas of European policy that are perceived to compensate for their particular shortcomings".[9]

In addition to assessing the variables behind preference formation, this paper also uses the literature on interstate bargaining and uploading of national preferences onto the EU agenda to assess how effective has been the representation of national preferences during the process of EU decision making. Although liberal intergovernmentalism tends to assume that small asymmetrically dependent countries such as Estonia, Latvia and Lithuania are likely to be policy takers with no major chances to feed their national preferences into EU decisions, some authors have drawn attention to policy variables that allow differentiated outcomes to be foreseen. One of the possible explanations of differences in the effectiveness of forming and representing national positions has to do with the institutional structure of policy coordination. Some authors have argued that the institutional structure of coordination can account for the different degrees of effectiveness of the European policy of EU member states.[10] However, in general the evidence regarding the link between institutional structure and policy effectiveness remains inconclusive.

Another approach maintains that the possibilities of exercising

9 Copsey, N., Haughton, T., p. 273.

10 Metcalfe, L., 'International Policy Coordination and Public Management Reform', *International Review of Administrative Sciences*, 60 (2), 1994, p. 271–290; Laffan, B., 'Managing Europe from home. Impact of the EU on executive government: a comparative analysis', *OEUE Occasional Paper No. 1.* – 09.03, Dublin: European Institute. 2003, available at http://www.oeue.net/papers.asp; Zubek, R. *Core Executive and Europeanization in Central Europe*, New York: Palgrave Macmillan, 2008.

power and influence in the EU depend on a number of resources such as political and economic weight, political, social and economic practice, persuasive ideas, compelling demands, credibility and consistency.[11] It is in line with the dominant view in acknowledging the importance of such variables as political and economic weight; but its arguments regarding the importance of factors that could be exploited by small EU member states - such as persuasive ideas, credibility and consistency - have already been used to explain instances of influencing major EU decisions by small EU countries such as Belgium and Netherlands.[12] Similarly, arguments have been advanced about argumentative power as well as moral and institutional power (for example, when holding the rotating Presidency).[13] This offers a potentially fruitful venue for research on new EU member states, linking their bargaining behaviour with sources of national preference formation as well as with domestic policies and practices that can have an effect on European policies and the potential for influencing the EU decision making process.

The main argument of this paper is that *the effectiveness of European policies of such small countries like the Baltic States depends to a significant degree on the consistency of their domestic policy and their efforts to implement the corresponding measures "at home" and in the neighbourhood, as well as European policy demands.* Inconsistency in domestic policies

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11 Wallace, H., 'Exercising Power and Influence in the European Union' in: S. Bulmer, Lequesne, eds. *The Member States of the European Union*. Oxford: Oxford University Press, 2005, p. 25-44.

12 Maes, I., Verdun, A., 'Small States and the Creation of EMU: Belgium and the Netherlands, Pace-Setters and Gate-keepers', *Journal of Common Market Studies*, 43 (2), 2005, p. 327-348.

13 See Panke, D., 'The influence of small states in the EU: structural disadvantages and counterstrategies', Dublin European Institute, DEI Working paper No. 2008-3.

as a result of policy makers being wary of popular attitudes and, in particular, of interest groups' activities--rather than asymmetric bargaining power--prevented the governments of these countries from convincing their EU partners. Importantly, *such inconsistency is not so much an outcome of the lack of administrative capacities or political party disagreements regarding policy priorities, but rather originates from a tension created by the facts of dependency on third countries and corresponding activities by economic interest groups with a stake in these relations--for example, energy supplies from Russia--set against the efforts of political elites to reduce these dependencies and reorient economic links towards the EU member states.* To put it differently, existing patterns of dependence, especially dependence on non-EU suppliers, impact on the effectiveness of countries' European policies by complicating the attempts to re-orient economic integration into the EU and agree on common regional projects. Additionally, the comparative analysis of the three countries suggests that *trust by the population in the government and a stronger consensus among elites regarding the domestic policies also reinforces the consistency of domestic and European policies, by reducing policy changes caused by election cycles.* Estonia's fiscal policy, which allowed it to join the Eurozone in 2011 as an exit strategy from the economic crisis of 2008-2009, is a good illustration of this argument.

The completion of integration into the EMU and Schengen area as well as support for the common EU energy policy and active Eastern neighbourhood policy have been the priorities of Lithuania's and other Baltic States European policies since accession into the EU. These priorities can be explained by the perceived need to manage existing interdependencies with the EU and to restructure dependence on the third (non-EU) countries. In most other European policy areas the Baltic States have remained passive policy takers, with some temporary exceptions. One example of strong initial support by all three Baltic States, at least at the level of rhetoric, was the original version of the Services Directive.[14] The Lithuanian and to some extent the Latvian authorities have been also supportive of the EU's protectionist external policy measures: a case where the competitive position of domestic economic interest groups, interacting with executive government, provides the main explanatory variable behind national preferences apparently at odds with the usual policies of open and small economies[15]. In the area of external trade policy, Estonia stands out as different from the other two with its policy of consistently supporting trade openness, thus representing a continuation of its liberal pre-accession regime. During the negotiations on the Financial Perspective for 2007-2013 and preparation of national positions on the EU budget review during 2007-2008, support for the status quo seems to have been the dominant logic in Baltic states' stances, explained by the net recipient position of these countries, although Estonia stands out as a supporter of Common Agricultural Policy reform.[16] The following

14 Akule, D., *Latvia. The EU new member states as agenda setters in the enlarged European Union*, Sofia, Open Society Institute, 2009, available at http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport_OSI-Sofia_EuPI_April2009_.pdf; Veebel, V., *Estonia. The EU new member states as agenda setters in the enlarged European Union*, Sofia, Open Society Institute, 2009, available at http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport_OSI-Sofia_EuPI_April2009_.pdf; Kolyta, S. Žeruolis, D., 'An overview of Lithuania's five years membership in the internal market of the European Union: pre-accession efforts, impact and current trends', *Annual Review of Lithuanian Political Science 2008*, Vilnius: Institute of International Relations and Political Science, 2009, p. 101-155.

15 Elsig, M., 'European Union trade policy after enlargement: larger crowds, shifting priorities and informal decision making', *Journal of European Public Policy*, 17 (6), September 2010, p. 781-798.

16 Lessenski, M., *Not your grandfather's Eastern bloc. The EU new member states as agenda*

sections, first, present the main European policy priorities of Lithuania (and other Baltic countries) since their accession into the EU; and then discuss the record of these policies and the successes and failures of Baltic states' efforts to upload their policy priorities into the EU agenda. The paper concludes by suggesting some preliminary observations regarding the logic of preference formation and participation in the EU decision making process.

setters in the enlarged European Union, Sofia, Open Society Institute, 2009, available at http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport_OSI-Sofia_EuPI_April2009_.pdf.

2.
Achievements and limits of active European policy: "accession leftovers"

Already before their actual accession to the EU, the governments of the Baltic States started the process of formulating national preferences and priorities for these countries' European policy. There have been several instances of active European policy efforts originating from the current EU agenda. These were the cases of the draft Services Directive, negotiations on the Financial Perspective of 2007-2013, and the preparation of positions on the new EU budget review. Although these cases of bargaining present probably the most important examples of negotiations in the enlarged EU on regulatory and redistributive issues, this paper focuses on two other categories of European policy priorities that have been stressed by the Baltic States' authorities since their accession to the EU and which are directly linked to the effort to manage external interdependencies. One category includes what could be called "leftovers" from the accession process, namely joining the Eurozone and the Schengen area. Another category includes energy policy and Eastern Neighbourhood Policy, where all three countries have been actively trying to upload their preferences onto the EU agenda, and to achieve their objectives by Europeanizing (EUizing) their domestic policy problems or reducing vulnerabilities in bilateral relations with EU neighbours. These European policy priorities have been regularly stressed by Baltic policy makers in their speeches and in the main strategic policy documents initiated by foreign ministries since the completion of accession negotiations.[17]

However, progress in achieving the main objectives defined in these European policy areas has been mixed. All three Baltic States have been members of the Exchange Rate Mechanism II (ERM II) since June 2004. While Lithuania failed to introduce euro in 2007 as planned, Estonia dropped its target date of 2007 at an early stage but later managed to meet convergence criteria for joining the euro zone in 2011. All three Baltic States joined the Schengen area by the end of 2007. The progress in Europeanizing energy policy issues and neighbourhood policy agenda has been more complicated, with some initiatives in these areas being adopted on the EU level while others have been ignored by EU partners, delayed, or reversed in the domestic arena. Although the process of learning and adapting to the EU routines could still be seen during this period as an important limiting factor, it is argued that failures to achieve key European policy objectives were chiefly due to the inconsistency and low credibility of Lithuanian and Latvian policies linked to the achievement of these objectives, resulting from the divergence of interests between countries' European policy makers (first of all, senior bureaucrats) and economic interest groups, and militating against the consistent adoption of policies and projects characterized by long-term implementation periods. Estonia presents a different case in this respect with a much higher consensus among political elites and the general public, greater coherence between its domestic and

17 Valionis, A., 'Konvento eigos ir rezultat vertinimas' [,Assessment of the work of the Convention and its results] in: *Konventas, Konstitucija ir Europos S jungos Ateitis 2002-2003*. Vilnius: Firidas, 2004, p. 82-83.

European policies, and consistency of policies over longer time periods without reversals linked to political cycles.[18]

In this connection, probably the biggest failure of Lithuania's European policy as perceived in the country was its failure to join the Economic and Monetary Union (EMU) in 2007. This resulted from domestic fiscal and regulatory policies inconsistent with the goal of rapid Euro introduction. Accession to the Eurozone had been seen as a part of the broader process of joining the EU and managing the nation's external financial dependencies, and, according to the Accession Treaty, Lithuania committed itself to introduce the euro as soon as the relevant convergence criteria were met. It should be noted that in 1994 Lithuania adopted a currency board arrangement that was based on several pillars including a fixed exchange rate in relation to an anchor currency. Although the US dollar was initially chosen as an anchor due to its importance for the country's economy, in 2002 it was replaced by the euro.

The currency board regime with the national currency's fixed peg to the euro became a cornerstone of the strategy for euro adoption. Lithuania's formal accession to the ERM II in June 2004, less than two months after joining the EU, formed the basis for monitoring how the country stood with respect to nominal convergence criteria. It should be noted that at the time of joining the ERM II, Lithuania committed itself "to secure a balanced budget over the medium term", as well as to undertake structural reforms aimed at further enhancing economy's flexibility and adaptability "in a

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18 Kuokštis, V., Vilpišauskas, R. '*Economic adjustment to the crisis in the Baltic States in comparative perspective*', paper prepared for the 7th Pan-European International Relations Conference, September 5-7, 2010, Stockholm.

timely fashion".[19] However, these aims were not achieved during the years of high economic growth, despite the fact that European Commission and the local expert community routinely criticised the government for its pro-cyclical fiscal policy, inability to balance the budget, failure to accumulate a surplus for times of economic decline, and the lack of structural reforms. Similar recommendations were made by the IMF analysts who, after analyzing economic trends in Lithuania and other countries with currency boards, came to the conclusion that the currency board arrangement could satisfy all the requirements of a regime leading towards accession to the EMU and could be the optimum policy for these countries.[20] Importantly, it was noted that if countries wished to preserve the viability of their currency board arrangement during preparations for the introduction of the euro, they had to maintain fiscal policy discipline and preserve flexible labour markets: something that was proved to be essential during the economic crisis in 2008-2009 and the resulting downward adjustment that some countries made in domestic wages and prices, while preserving fixed exchange rates for their currencies (a process of internal devaluation, as it is sometimes called).

It seemed in 2005-2006 that there was a window of opportunity for Lithuania and Estonia to swiftly join the Eurozone together with Slovenia in 2007 (Latvia was already exceeding the convergence

19 European Commission, *Commission assesses the state of convergence in Lithuania. – IP/06/622*, Brussels, European Union Communique, 27 June 2004. 16 May 2006, available at <http://ec.europa.eu/economy_finance/publications/publication6170_en.pdf>,12 20 2009.

20 Gulde, A. M., Kahkonen, J., Keller, P., 'Pros and Cons of Currency Board Arrangements in the Lead-up to EU Accession and Participation in the Eurozone', *IMF Discussion Paper* 1, 2000.

criteria). Lithuania and Estonia met all nominal criteria at that time, although as the time of formal application and the evaluation of countries' compliance with the Maastricht criteria approached, inflation started picking up. However, differently from Estonia which decided to withdraw its application to be evaluated for readiness to introduce the euro in 2007, Lithuanian policy makers maintained their determination to introduce the euro. In March 2006, Lithuania applied to be evaluated accordingly.

However, despite the official willingness to be assessed and the apparent certainty that the country was ready to join the Eurozone, there was a lack of well articulated political consensus regarding this goal. Although it was laid down in strategic programmes and strongly supported by the Central Bank and the MFA (and senior bureaucrats in the Ministry of Finance), as well as the community of analysts, some key actors in the Government remained reluctant to advocate the introduction of the euro both at home and when talking with the EU institutions. To some extent, this was a reflection of a rather reluctant public which was less supportive of Eurozone membership, compared with its relatively strong enthusiasm for membership in the EU. The main concern for the public, judging from the public surveys, had to do with a fear of price increases expected to follow the introduction of the euro.[21] Interestingly, the share of population favouring the adoption of the Euro increased after the failure to introduce it in 2007, although it remained below 50 percent.

It should further be noted that the reluctance of some political

21 Eurobarometer Surveys available at <http://ec.europa.eu/public_opinion/euro_en.htm>, 12 20 2009.

leaders in Lithuania to publicly support the goal of joining the Eurozone was also reflected in a lack of consistency and viability in official euro-oriented policies. The lack of budgetary discipline and expansionary policy as well as certain decisions in the area of regulated prices (energy, transport) contributed to the acceleration of inflation during the period from 2005-2008. Although global market trends, in particular the rise of energy and food prices, and the one-off effects of joining the EU customs union impacted on price increases in Lithuania, domestic demand pressures have also been shown to contribute to this inflationary trend. For example, IMF analysts emphasized the importance of the inflation in non-tradeables, which pointed to the importance of regulated price increase and growing domestic demand, and at the time advised the adoption of a conservative fiscal stance in order to contain future inflationary pressures in Lithuania.[22] The decision to allow the indexation of assets owned by energy companies in 2004, which increased the room for regulated prices to be raised, as well as the regulatory policy measures allowing for the increase in public transport prices, also added to the inflationary pressures that took effect in 2005 and later.

Thus, while Lithuania's monetary policy was clearly targeted towards the adoption of the euro as soon as the country's two years of membership in the ERM II were completed, other economic policies - in particular, budgetary policy and certain regulatory decisions - were inconsistent with this goal. The contradictory public statements made at the time by some ministers of the

22 Ohnsorge, F., Igan, D., Lugaresi, S., 'Republic of Lithuania, Selected Issues', *IMF Country Report* 06/163, 2006.

government illustrate the hesitancy of the political elite, and the gap between the officially declared goal and actual policy efforts.

In spring 2006, Lithuania's compliance with the Maastricht criteria was evaluated by the European Commission and the European Central Bank. The conclusion that both institutions reached, and which was in June 2006 submitted to the European Council, was that "Lithuania meets all the convergence criteria except the one on inflation. The average rate of inflation has been slightly higher above the reference rate value since April 2005 and is expected to rise gradually until the end of the year".[23] The recommendation was that there should be no change in Lithuania's status as an EU member state with a derogation from EMU. Although Lithuania's leaders attempted to convince the heads of other EU Member States at the June 2006 Summit that this was not an obstacle for the adoption of the Euro in 2007, since the difference was less than 0.1 percent (the average inflation rate in Lithuania was 2.7 percent while the reference value was 2.6 percent), the conclusions of the Summit approved the negative opinion of the EU institutions.

While subsequently the goal was voiced of joining the euro zone in 2010, with accelerating inflation the prospects of euro adoption grew more distant and the target was abandoned for a more flexible formula of "as soon as the country meets the convergence criteria". It should be noted that the Law of Fiscal Discipline which had been advocated for years by some analysts was finally adopted in November 2007, with a view to facilitating the achievement of the cyclically balanced budget and introduction of the euro. But it was a step taken too late, and when the time came for it to be tested (the

23 European Commission, *Commission assesses the state of convergence in Lithuania. – IP/06/622*, Brussels, 16 05 2006.

intention was to have a balanced budget in 2009), the start of the economic decline made this law largely obsolete due to its emphasis on restricting expenditure growth. With the economic decline starting in the end of 2008 and accelerating in 2009, budgetary revenues dropped significantly while official expenditure, which had been raised before the parliamentary elections of 2008, was not cut proportionately--though it was substantially adjusted downwards several times in the course of 2009. By the end of 2008 Lithuania, for the first time since it joined the EU, exceeded the budget deficit criterion of 3 percent of GDP, reaching 9.5 percent in 2009. The state debt grew rapidly and attained 38 percent of GDP in 2010 from just around 16 percent in 2008.[24] This rapid increase in the fiscal deficit rendered any prospect of introducing the euro quite remote. Although in 2009-2010 the Lithuanian government managed to contain further worsening of the fiscal deficit, and set itself a target of bringing it down to 3.0 percent in 2012--which could allow for joining the Eurozone in 2014--this is still an uncertain prospect, not least because of the parliamentary elections set for 2012.

It should be noted, though, that despite the failure to introduce the Euro in 2007 or to accumulate reserves from the budget surplus during the years of rapid economic growth in 2000-2008 (when growth averaged 7-8 percent of GDP), the Lithuanian government formed after the Parliamentary elections at the end of 2008 did manage to maintain fiscal stability. The package of measures adopted at the end of 2008 and developed through a couple of budgetary revisions during 2009 included significant cuts in public expenditure programmes (retirement pensions, maternity leave

24 European Commission, *European economic forecasts Spring 2011*, available at http://ec.europa.eu/economy_finance/eu/forecasts/2011_spring/lt_en.pdf , 13 05 2011.

benefits, investment programmes, wages for public sector employees, etc.) and increases in taxes (VAT from 18 to 21 percent, profit tax, and excise taxes). The size of this adjustment has been estimated at around 8 percent of the country's GDP. The private sector also adjusted through wage decreases and downsizing, resulting in increased unemployment and negative economic growth of almost 15 percent of GDP in 2009. However, economic recovery resumed already in 2010, and in 2010-2011Lithuania and the other two Baltic states were among the fastest growing countries in the EU. According to the most recent European Commission forecasts, Lithuania is expected to be the fastest growing EU economy in 2012 with 3.4 percent GDP growth and 3.8 percent growth in 2013[25]. Still, with the current uncertainty in the Eurozone and worsening economic prospects in Europe, the introduction of the euro is regarded with growing scepticism in the country and the date of its introduction remains uncertain (though 2014 might still be feasible).

On the other hand, the Estonian example shows how the consistency of domestic fiscal policy can contribute to the effectiveness of European policy. The country constantly ran budgetary surpluses during the times of high economic growth following accession to the EU, while Lithuania and Latvia did not manage to balance their budgets. This has been an important factor in easing the pressure on Estonia's public finances since the start of

25 European Commission, *European economic forecasts Autumn 2011*, available at http://ec.europa.eu/economy_finance/eu/forecasts/2011_autumn_forecast_en.htm, 09 11 2011.

the economic crisis in 2008, thus allowing the country to meet the convergence criteria and join the Eurozone in 2011.[26]

The case of Lithuania's attempt to adopt the euro in 2006-2007 has probably been one of the most debated cases in the history of Eurozone enlargement. The rejection of its application by the European Commission and the European Central Bank on the basis of missing the inflation criterion was criticized by analysts and policy makers, leading to more general debates about the nature of convergence and the meaning of the Maastricht criteria as applied to new member states. Criticisms were made of the methodology of calculating inflation criteria, and of the inconsistent way convergence criteria were applied as between Eurozone members and candidate countries.[27] The very strict interpretation of convergence criteria for the new member states - compared with the way a number of the founding Eurozone members were seen as having breached the criteria at the time of the creation of the EMU, and with the relaxation of the Stability and Growth Pact - provoked claims about the application of double standards[28]. The evidence of Greece having provided false data about meeting convergence criteria that

26 Kuokštis, V., Vilpišauskas, R.

27 Vilpišauskas, R., 'The Political Economy of Eurozone Enlargement: the Motives, Prospects and Implications for the EU and its Member States', in: Roy, J., Gomis-Porqueras, P., eds., *The Euro and the Dollar in a Globalized Economy*, Aldershot : Ashgate, 2007, p. 149-162; Vilpišauskas, R., 'Economic and political challenges of Lithuania acceding to the Euro area', in a comparative volume *Economic and political challenges of acceding to the euro area in the post-Lehman Brother's world*. Country Report. Sofia: OSI, 2009.

28 Willem Buiter has been among the most vocal critics of the strict interpretation of the Maastricht criteria by the ECB and the European Commission in case of Lithuania (see his blog <http://blogs.ft.com/maverecon/> accessed 04 18 2009). For a similar criticisms see Begg, I., *Economic Governance in an Enlarged Euro Area*, European Economy, Economic Papers 11, March 2008; De Grauwe, P., *The politics of the Maastricht convergence criteria*, available at <http://www.voxeu.org> 04 20 2009.

emerged when the true state of its public finances was publicized in 2009-2010 further strengthened these criticisms. However, what is important for this analysis is that it was inconsistent and non-credible fiscal and regulatory policies, ignoring the recommendations of the European Commission and the IMF that lay behind the failure to convince EU leaders that Lithuania was ready to join the EMU in 2007. Intense diplomatic efforts and even the broad support of the European expert community did not help to compensate for these domestic political inconsistencies.

Although the failure to introduce the euro did not result in political resignations, it had an important effect on Lithuanian policy makers. It is quite possible that a fear of a similar failure with regard to the country's joining the Schengen area of free movement of people lay behind the intensified efforts to prepare the country and convince the EU to enlarge the Schengen area in the end of 2007. The framework of accession to the Schengen area is very different from EMU accession in terms of the conditions a country has to meet. Instead of broad economic trends in the case of EMU, the main focus in the criteria for joining the Schengen area is on border infrastructure and information sharing systems, which are more directly under the control of state institutions. Besides, in the latter case it was delays on part of the EU institutions and some incumbent EU members that threatened the initial plans adopted in 2006 for Schengen enlargement. In the event, Lithuania and Slovenia took the initiative to support a proposal by Portugal (the so called SISone4All project) to overcome the possible postponing of a new information system (SIS II), which had been threatening the timely enlargement of the Schengen area.

It is true that in the early stages of infrastructure preparation there was some criticism of the Lithuanian authorities by the European Commission, and some questions were raised regarding the use of resources for the enhancement of border protection facilities; but the Lithuanian institutions were quick to respond to these criticisms. This opened the way for Lithuania and eight other EU members to join the Schengen area in December 2007 as regards controls on travel by land, and in March 2008 for travel control in airports. This had important symbolic meaning because it made visible the benefits of an enlarged and united Europe for the citizens of its member states. In this respect accession into the Schengen area has been politically less controversial than accession into the EMU since free movement of people has become probably the most visible expression of EU's enlargement.

The enlargement of Schengen area is also an example of managing external interdependencies, in particular, the flows of people from the outside of the EU. The difficulties faced by Bulgaria and Romania with their accession into the Schengen area are largely linked to the lack of trust on behalf of some EU member states in their ability to effectively manage their external borders. It is quite possible that if the window of opportunity for joining the Schengen area in 2007-2008 has not been used by mobilizing efforts at both domestic and European levels, the resolution of this "accession left-over" would have been far from certain.

3. Achievements and limits of an active European policy: small states as selective policy initiators

It is more difficult to assess the achievements of Baltic States' European policy in the areas of energy and neighbourhood policies. Compared to the accession "leftovers" which had concrete target dates with concrete measures to be implemented, the goals of energy policy and Eastern neighbourhood policy are more diffused. Besides, they require the consensus of all other EU member states. For example, in the energy field, the main goals of the Baltic countries could be formulated as follows: integration of the EU internal electricity and natural gas market, thus reducing the present dependence on supplies from Russia (100 percent dependence for all three Baltic states in the case of natural gas) and achieving a diversity of sources of supply; forging a common position of the EU vis-à-vis external suppliers; and increasing the security of supply at competitive prices. This implies the integration of Baltic electricity and natural gas markets into European networks, thus increasing the local sources of supply; allocating EU funds for the major infrastructure projects required (electricity links with Sweden and Poland, new nuclear power plant); and forging a common EU position vis-à-vis Russia on the issues such as the closure of the Druzhba ('Friendship') pipeline in 2006.

It has been maintained that Lithuania started out with favourable structural conditions to influence the EU's energy policy. The latter was in the process of being seriously debated just at the time of enlargement in 2004, while in view of its high energy vulnerability Lithuania had strong incentives to actively upload its national preferences onto the EU agenda and seek to use EU policy instruments to further its national goals.[29] However, on closer examination one can state that the record of achievement has been mixed. On the one hand, Lithuania--like Estonia and Latvia--has consistently emphasized the issue of its isolation, the existence of the Baltic states as an "energy island in the EU", and its dependence on supplies from Russia; and these issues have been recognized by the EU in a number of its documents. For example, the Baltic States were mentioned as an isolated "energy island" separated from the rest of the EU in the Green Book on a Sustainable, Competitive and Secure EU Energy Strategy issued by the European Commission in 2006. Also, a provision on the importance of infrastructure projects ensuring security of energy supplies was included in the Lisbon Treaty.

The Lithuanian authorities also used the opportunity of the EU debate on climate change in 2007-2008 to link this issue (in particular the allocation of emissions) to the closure of the Ignalina nuclear power plant and the need for additional compensation from the EU for Lithuania. Eventually the EU decided to give Lithuania additional rights to emission quotas (depending on the actual need) and allocated financial support for the electricity bridge from Lithuania to Sweden as part of its Economic Recovery

29 Vai i nas, Ž., 'Europos S jungos bendros energetikos politikos formavimasis ir Lietuvos interesai' [,Formation of European Union common energy policy and the interests of Lithuania'], *Politologija*, 55 (3), 2009, p. 89-120.

Plan adopted in December 2008. Most importantly, in June 2009, the EU adopted a Baltic Energy Market Interconnection Plan (BEMIP) which provides a basis for the implementation of electricity links and integration of the Baltic States into the EU energy market. The European Commission also raised the issue of the Druzhba pipeline at EU-Russia summits. Most recently, the February 2011 EU Council Conclusions stated that 'The EU needs a fully functioning, interconnected and integrated internal energy market' and the deadline of 2014 was set for gas and electricity 'to flow freely'.[30]

On the other hand, at the start of 2010 when the Ignalina nuclear power plant was finally closed due to accession commitments, the reality was that Lithuania's dependence on supplies from Russia (natural gas used for the electricity generation and electricity imports) had actually increased compared to pre-accession years, while energy integration with the EU has been absent (aside from the old Soviet links with Latvia and Estonia where the latter is linked by electricity cable to Finland). It is the inconsistency of domestic energy policy that provides the main reason behind the lack of progress in implementing the electricity power bridge and new nuclear power plant projects, whose deadlines are constantly being postponed. This inconsistency is a result of the mismatch between the rhetoric of policy makers, in particular diplomats, which supports integration projects and the creation of European market--thus reducing asymmetric dependence on Russian supplies--and the economic interest groups that stand to lose from these projects or have different interests, mostly in maintaining

30 European Council Conclusions, EUCO 2/11, Brussels, 4 February, 2011.

the current links to Russia.[31] It seems there has been a lack of powerful economic interest groups (industrial users of electricity, for example) that would be interested in lobbying for the projects integrating Lithuania's electricity and natural gas market into the EU networks, while there have been a number of groups interested in preserving existing links with Russia. Thus, while the lack of interdependence with the rest of the EU has acted as an incentive for policy makers to push for the Europeanization of the energy policy of Lithuania and other Baltic countries and for integration into the EU market, the existing dependence on Russia acts as an incentive for economic interest groups such as industrial producers using imported gas and the importers of natural gas and electricity to preserve these links. The influence of domestic producers, especially industrialists and farmers, on policy makers has been the key reason for a rather inconsistent Lithuanian external trade policy in which rhetoric about external openness has often been contradicted by a protectionist stance in the EU talks on particular external trade issues. Actually, if it were not for EU membership and WTO commitments, Lithuania would probably have reverted to more protectionist measures--especially during the time of economic decline.

The credibility of Lithuania in the field of energy policy has been particularly damaged by the lack of progress in implementing the projects that have been politically agreed and declared in several National Energy Strategies. For example, the Strategy adopted in 1999

31 See Smith, K. C. *Lack of Transparency in Russian Energy Trade. The Risks to Europe*. Center for Strategic and International Studies, Washington, D.C., July 2010; Vilpišauskas, R. 'Wider energy perspectives for Baltic countries', in The Riga Conference Papers, Riga: LATO, 2011.

stated that generation facilities (including possibly a new nuclear reactor) designed to replace the RBMK-type Ignalina nuclear power plant reactors would have to be built by 2009. However, by 2009--and even later, in 2011--despite the completion of several feasibility studies, the debate on whether Lithuania needs a new nuclear power plant was still going on and the new co-generation facilities were just starting to be constructed. A renewed Strategy adopted by the Parliament in 2002 stated that Lithuania's energy systems had to be fully integrated into the EU in 10 years--a target which will definitely be missed. The attempts made to compensate for these delays by trying to convince the European Commission to reopen the issue of closing the second reactor of the Ignalina nuclear power plant, and to postpone it further, damaged Lithuania's credibility and risked giving it an image as a country that does not honour its obligations. There have been a number of instances of inconsistent and contradictory policies, reflecting repeated course changes after elections or switches in the Cabinet of Ministers, as well as the lobbying efforts of certain interest groups. Examples are the splitting up of the national electricity company into several separate entities, followed later by the creation of the controversial national champion Lithuanian Energy Organization modelled on the Czech Republic's national energy company, which was dismantled just about a year later in 2009 to create again an integrated state owned national energy company. Lithuania's ambiguous and changing position on the Third Energy Package is another case in point. --All this prevented the country from successfully Europeanizing its energy issues and using EU financial and political resources to tackle national challenges and reduce domestic vulnerabilities.

Moreover, Latvia and Lithuania have been drawn into mutual disagreements regarding regional energy projects. One example is a dispute that took place in 2008-2009 between Latvia and Lithuania on the issue of to where the electricity power bridge from Sweden to the Baltic States should be constructed. After having delayed the project for more than a year, this was solved mostly as a result of EU involvement and provision of EU funding for the domestic electricity infrastructure in Latvia. Again, Estonia seems to be the most consistent of the Baltic states in aligning domestic efforts with European policy, and is the only one of them that has managed to create an energy connection to Finland. Each of the Baltic States seems to be choosing its own method of implementing the Third Energy Package directives with different options of unbundling, in particular in the natural gas sector, and each of them also plans to build its own LNG terminal. Domestic regulatory differences reflecting lobbying by domestic interest groups not only complicate the coordination of policies among these countries, but also their efforts at uploading their preferences onto the EU agenda.

It should be noted, though, that recent efforts by the Lithuanian ruling coalition to adopt the complete unbundling option from the Third Energy Package, and to involve the European Commission in the process of restructuring the natural gas sector and in relations with Russian suppliers, seem to be increasingly effective. The active efforts made in the last few years not only to Europeanize energy issues and bilateral relations with Russia, but also to make progress in creating a Baltic electricity exchange by working on electricity connections to Sweden and Poland and some other projects, seem to be making progress.[32] If these efforts are maintained after the

32 While the most recent National Energy Strategy adopted by the Government and submitted to the Parliament for approval in 2011 places the strongest emphasis on “energy

parliamentary elections in 2012, there is a possibility of a significant breakthrough in reducing Baltic energy dependence on one supplier and increasing the diversity of supply, in particular by integrating into the Nordic-Baltic market. Technological progress in making such projects as LNG terminals cheaper and opening up other sources and routes of supply could also contribute to the reduction of asymmetrical dependence and offer a growing choice for consumers.

Energy policy issues in this region are closely linked with the Eastern Neighbourhood Policy. Increasing the diversity of sources and routes of energy supplies (electricity and natural gas) has been one of the policy objectives advanced by the Baltic States in connection with the EU Neighbourhood Policy, as stated at a number of international conferences organized by these countries' authorities. Lithuania has been particularly active in trying to position the country at the centre of a region that embraces EU and non-EU neighbouring countries and which resembles somewhat the territory of the Grand Lithuanian Duchy of the 15th century (later Polish-Lithuanian Kingdom).

Overall, during the first five years of EU membership, Lithuania modelled its role in neighbourhood policy on the basis of historical references and attempts to reduce energy vulnerabilities, rather than on existing economic interdependencies. This implied particular emphasis on the partnership with Poland, and attention to Southern-Eastern neighbours such as Ukraine and Moldova and as far away as

independence", it does not imply the mercantilist understanding of self-sufficiency of energy production, but rather refers to the need to achieve diversity in sources of supply, including the external ones, and the possibility to choose the supplier of electricity (or heating or other products) on the basis of the best price.

the Caucasus (namely, Georgia). Interestingly, the partnership with Poland was meant to allow Lithuania to be an active mediator in relations between the EU and Eastern partners: it highlighted the fact that Lithuania could be trusted by the Eastern partners precisely because it was a small country and thus, unlike Poland, did not aspire to dominate in mutual relations.[33] In other words, Lithuania portrayed itself as an impartial mediator between the EU (and Poland) and the Eastern partners, supporting their closer relations with the EU. This line manifested itself mostly in support for the democratic and economic reforms in the countries concerned (the "Orange revolution" in Ukraine and "Rose revolution" in Georgia), where leaders of Lithuania together with Poland played the mediators' role in domestic reforms linked to their closer relations with the EU. Lithuania as well as Latvia and Estonia directed their technical assistance efforts to support reforms in these countries. After Parliamentary elections in 2008 and Presidential elections in 2009 in Lithuania, the focus shifted somewhat to reflect more closely the country's actual economic interdependences in terms of investments and trade, and the emphasis has been placed more

33 This partnership between Poland and Lithuania, which was quite intense during the years 2004-2008, has not been noticed and researched by outside observers even when they interviewed new EU member states about bilateral and regional cooperation patterns in the EU (see Panke, D. 2008). This gives reason to suppose that in Lithuania the partnership with Poland has not been widely perceived and understood as an instrument for gaining influence in the EU and external relations generally. It should be noted that Lithuania also attempted to play a role of an "impartial broker" between Poland, on the one hand, and Germany (and France), on the other, during the final stage of negotiating the Lisbon Treaty in 2007. Although these mediating efforts were presented to the domestic public in Lithuania as a major achievement of Lithuanian European policy, they went unnoticed by external observers (yet this was presented as the main reason for President V. Adamkus to be awarded the "European of the Year " prize for 2007 by the European Voice).

on closer cooperation with the countries of the Baltic sea region (a return to Baltic-Nordic cooperation), as well as Belarus and Russia.

Actually all three Baltic States have been active in promoting closer EU ties with Eastern partnership countries. For example, Estonian political leaders have been active in Georgia where former Prime Minister M. Laar has been advising the Georgian President on domestic reforms. However, differently from Lithuania, Estonia kept a lower public profile when taking its part among the Baltic states in supporting Eastern neighbourhood countries, and has rather aimed to position itself as a Nordic country.

It should be noted, however, that the experience of economic crisis has exposed quite clearly the high degree of economic interdependence among the three Baltic countries as well as between them and their Nordic neighbours. When the problems of the Parex bank in Latvia brought the issue of financial crisis onto the Baltic agenda and the IMF and European Commission had to come to its assistance, it was a time for extreme concern and coordination not only among the leaders of the three Baltic states but also between them and Sweden, whose banks have been heavily present in the Baltic market. The concern was that if Latvia devalued its currency, the contagion would spread into the other two countries resulting in huge financial losses for their population. Arguably this experience of interdependencies among the Baltic–Nordic economies has led policy makers in the Baltic countries to re-assess Baltic-Nordic cooperation and to re-prioritize it anew.

The active efforts of the Baltic States to promote the EU's relations with its Eastern neighbours are an outcome of EU enlargement shifting the boundaries of the Union to the East, making these states the border countries of the Union, as well as of their relatively intense economic links with their Eastern Southern neighbours. Baltic efforts to bring these EU neighbours closer to the Union by promoting the reforms permitting closer integration can be explained by both economic interdependency and value-based approaches. However, it is rather difficult to assess the effectiveness of these efforts to influence EU Eastern neighbourhood policy--and even more challenging to assess the effectiveness of EU policy towards its neighbours. Growing attention has certainly been given by the EU to its Eastern neighbours, as manifested particularly in the adoption of the Eastern Partnership (initially proposed by Poland and Sweden) in 2009 and the promise of Deep and Comprehensive Free Trade Agreements and Visa Facilitation Agreements with these six Eastern Partners.

On the other hand, the actual progress of reforms in these countries has been very different depending on the country, and much influenced by domestic factors (notably changes in the party in power, as, for example, in Moldova or Ukraine) as well as by Russia's growing influence in the region.[34] The prospects of closer relations with the EU in terms of liberalized trade and people movements also remain quite distant, even in the cases of Ukraine and Georgia. The slow progress of reform in most neighbour countries, coupled with the pressing need to reinforce the infrastructure projects designed to integrate the Baltics into the EU market and other measures to reduce the vulnerabilities of their economies against a background

34 Lavenex, S., Schimmelfennig, F., 'EU rules beyond EU borders: theorizing external governance in European politics', *Journal of European Public Policy*, 16 (6), 2009, p. 791-812.

of fiscal austerity, might strengthen a tendency to shift attention closer to home from more distant neighbouring countries.

Conclusions

Early experience of participating in the EU decision-making process provides some grounds to argue that even small countries like Estonia, Latvia and Lithuania can be heard at the "EU table", provided that their preferences are formulated and presented consistently, and that their policy is credible and coherent with domestic actions as well as consistent over time (extending beyond the period of one election cycle). On such a basis, these states can use their membership in the EU effectively to manage their external interdependencies and to benefit from economic integration and globalization. This is illustrated by the case of all three states' accession to the Schengen area, by Estonia's joining the Eurozone, and by the adoption of the Baltic Energy Market Interconnection Plan. However, such cases of successful uploading of national preferences onto the EU agenda have been rare. Moreover, even in the case of priority areas such as euro adoption, energy market integration or closer relations with Eastern neighbours, the active efforts of senior bureaucrats and diplomats have often been unsuccessful when policy makers concerned about support from the interest groups have intervened.

The main factors explaining such European policy failures involve the inconsistency of domestic policies directly linked to the use of EU instruments in achieving national policy goals, which most often had to do with the mismatch between the motivations of EU-oriented diplomats and of national political elites wary of public opinion, or with the demands of economic interest groups. High economic dependence on non-EU neighbouring countries, in particular in energy supply, and the resulting lack of incentives for economic interest groups to lobby for further integration inside the EU, together with frequently changing political ruling coalitions, are the key factors reinforcing this mismatch and perpetuating the inconsistency of domestic policies that has reduced the possibilities for effective European policies. Conversely, domestic consensus among policy elites and the population, coupled with high trust in institutions, seems to facilitate coherence between domestic and European policies and overall consistency of policy as shown by the case of Estonia.

It can be maintained that the logic of being a "good European" and of seeking consensus to achieve a fast agreement, which prevailed during the accession negotiations and the bargaining over new EU treaties, still dominates national European policy on a daily basis in the Baltic states. The process of national preferences formation is mostly reactive and driven by the EU agenda. This tendency is likely to persist in the future, reflecting the conventional wisdom about the behaviour of small and open economies in the EU which benefit more from economic integration than larger member states.

However, the possibility to influence EU decision making, "to be at the table", and not only be heard but also listened to, has been one of the benefits of EU membership as underlined by political elites during the process of accession. As other studies of EU politics show, small member states under certain conditions are indeed able to exert influence extending beyond their formal voting powers in the EU institutions. Coherence among such a country's policies and consistency of its policies over time – which help to strengthen the credibility of demands and improve opportunities to be heard in Brussels – , is the key factor highlighted by this paper's findings.

It also underlines that differently from other studies which focus on economic interdependencies among EU member states and resulting national preferences, in the case of Lithuania and other Baltic States analysts have to be careful not to overlook existing dependencies on third (non-EU) countries which can account to a large extent for the European policy priorities of these countries. It is also this mismatch between actual economic interdependencies and the regional institutions of managing them which creates tensions and risks of policy inconsistencies.

ANNEXES

ANNEX 1 — BALTIC COUNTRIES:
COMPARISON OF KEY ECONOMIC INDICATORS

All figures from 2010 or 2010 estimates, unless otherwise stated.

Sources: European Commission (with *) or CIA World Factbook

INDICATOR	LITHUANIA	LATVIA	ESTONIA
Population	3.3 m	2.2 m	1.3 m
GDP in US$bn.	56.59	32.51	24.69
(PPP)(with world ranking)	89th	106th	113th
GDP per capita, US$	16 000	14 700	19 100
*GDP Growth: 2009	- 14.8%	-17.7%	-14.3%
2010	1.4%	-0.3%	2.3%
2011 est.	6.1%	4.5%	8.0%
2012	3.4%	2.5%	3.2%
*Unemployment	17.8%	18.7%	16.9%
Public debt as % of GDP	38.7%	44.7%	6.6
*Inflation	1.2%	-1.2%	2.7%
Current account balance 667 (US$m)	871	677	
Principal exports	Mineral, products, machinery, equipt., chemicals, textiles, food, plastics.	Food, wood, metals, machinery, equipt., textiles	Machinery, equipt., wood , furniture, metals, vehicles
Top export markets	RU, GER, LV, PL	RU, LT, EST, GER	FIN, SWE,RU, LV, GER, LT
External debt, US$bn	29.88	39.55	22.03

ANNEX 2 — BALTIC COUNTRIES: SUMMARY OF RELATIONS WITH THE EUROPEAN UNION

LITHUANIA	LATVIA	ESTONIA
(NATO since 2004)	(NATO since 2004)	(NATO since 2004)
FTA with EU 1994	FTA with EU 1994	FTA with EU 1994
Association Agreement signed in 1995	Association Agreement signed in 1995	Association Agreement signed in 1995
Membership negotiations with EU in 2000	Membership negotiations with EU in 2000	Membership negotiations with EU in 1998
Joined EU in 2004	Joined EU in 2004	Joined EU in 2004
Joined Schengen in 2007-2008	Joined Schengen in 2007-2008	Joined Schengen in 2007-2008
		Joined EMU in 2011

ANNEX 3: LINKAGES BETWEEN EU POLICY AND INTRA-BALTIC ECONOMIC COOPERATION

EU POLICY TOWARDS BALTIC STATES	POLICY CHARACTERISTICS	BALTIC STATES' INTEGRATION INTO THE EU	INTRA-BALTIC ECONOMIC COOPERATION
Establishment of diplomatic and economic relations; search for policy options (1991-1995)	Group approach; ad hoc support for sub-regional cooperation	Negative market integration (trade and cooperation agreements; free trade agreements) supported by financial assistance (PHARE)	Agreement on free trade in industrial goods
Pre-accession (1995-1998)	Group approach with increasing emphasis on individual developments; strengthened support for sub-regional cooperation	Negative market integration supplemented by unilateral aligning of regulatory policies (Europe agreements, White book), political dialogue and continued financial assistance	Agreement in free trade in agricultural products; agreement on abolishing non-tariff barriers
Accession negotiations (1998-2001)	Differentiation, individual progress and caching-up principles; some support for sub-regional cooperation	Positive integration complemented by continued financial assistance; opening of the accession negotiations with Estonia in 1998, Latvia and Lithuania in 2000, closing them in 2002	Failure to implement customs union and agreements on free movement of production factors; unilateral protectionist measures
Membership and transition periods (2004-2011)	Initial differentiation; formation of issue sub-groups, possibly extending to the whole Baltic sea region, adoption of euro by Estonia in 2011	Positive integration; delegation of authority, participation in decision-making	Coalitions inside the EU on certain policy issues (regional, foreign and security, transport policies, energy, etc.), accession into Schengen area, failures to introduce euro simultaneously, delays in regional infrastructure projects

Source: Vilpišauskas, R. *'Political context of Baltic integration', in Lauristin, M. (ed.) Estonian Human Development Report 2010/2011. Baltic Way(s) of Human Development: Twenty Years on*, Tallinn: Estonian Cooperation Assembly, 2011, pp. 166-172.

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Centre for Small State Studies • Institute of International Affairs
University of Iceland • Gimli, Saemundargata • 101 Reykjavik • Iceland
Tel. +354 525 5262 • E-mail: ams@hi.is • http://www.ams.hi.is