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# The Euro Zone Crisis and Differentiation in the European Union: a Threat to the Goals of the EU or an Instrument of Managing the Divergence of National Interests?

This article discusses the institutional evolution of the European Union (EU) in reacting to the euro zone crisis and the new forms of differentiation in the EU. It presents and elaborates several arguments. First, despite calls to complete the creation of the "genuine Economic and Monetary Union" and to make a step towards federal structure of the Union with single currency and single central budget used to react to asymmetric shocks, most decisions actually agreed upon by member states since the start of the crisis can be seen as attempts to avoid exactly such a scenario. Second, although the divide between the "Northern" and "Southern" groups of the EU member states seems attractive in its simplicity, it is a gross simplification of the current situation and hides important differences of member state preferences within each of the groupings. Third, it is also too simplistic to see the membership in the euro zone as the main characteristic defining the state of differentiation in the EU. As it is discussed in the text, both euro zone member states and EU countries outside the euro zone participate in different initiatives of integration and show different national preferences. Finally, the text concludes with a formulation of the main policy dilemmas for Lithuania in terms of ongoing process of complex differentiation and taking into account the prospect of joining the euro zone in 2015.

## Introduction

The euro zone crisis and the renewal of debates about how the European Union (EU) and its member states should react to the crisis, especially the calls to complete the creation of the "genuine Economic and Monetary Union", revived interest in the issue of differentiation in the EU. Recent examples of the new integration initiatives such as the Fiscal Compact, European Stability

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Mechanism, Euro-plus Pact and the Banking Union show that differentiation in the EU is becoming transformed compared to what it used to be a decade or so ago. Previously, as the possibility of differentiation has been formalized in the Maastricht and Amsterdam Treaties, this idea was mostly associated with the possibility to initiate enhanced cooperation initiatives.[1] The debates about differentiation a decade ago were mostly influenced by the ongoing EU enlargement process and the implementation of the EMU project, with enhanced cooperation (or rather the possibility of its use) being seen as one of the possible instruments to manage the two parallel processes of EU widening and deepening.

Currently the situation has changed. Discussions about the cleavage between rich West and poor East have been replaced by the debates about competitive and fiscally sound North and crisis stricken South EU member states. The crisis of public finances, competitiveness or banking sector led to the debates and initiation of new integration projects. However, the public opinion in many EU member states has become increasingly critical of new integrationist projects. Leaders of the EU and its member states, being pressured by the financial markets, motivated to preserve the euro zone and at the same time trying to take into account the changing moods of their voters, adopted a number of decisions leading to growing differentiation in the EU. This process of differentiation has turned out to be different from what it used to be a decade or so ago. It also shows that EU is taking a different route from what many EU leaders and analysts have been calling for in recent years, when they assumed that the euro zone crisis might present a window of opportunity to make a decisive step towards the establishment of federal EU.

This text discusses how the EU has been changing in response to the euro zone crisis and how the process of differentiation has been transformed. It argues that despite the calls to complete the process of creating "a genuine Economic and Monetary Union" and to make a step towards federalizing the EU, which would possess the fiscal capacity, transfer mechanism to be used in the presence of asymmetric shocks in the single currency area, so far most decisions made by the EU and its member states look rather like an effort to avoid such a scenario. It also claims that although the description of the cleavage between the South and the North of the EU might be rather attractive due to its simplicity and political appeal to the policy makers and voters in the North, it is misleading and too great a simplification of the current situation hiding important differences among the countries inside those groups. Finally, it also

[1] See Vilpišauskas R., "Enhaced cooperation in the EU and its implications for Lithuania", *Lithuanian Strategic Annual Review, 2004*, p. 131-147.

argues that it would be too simplistic or at least too early to claim that the main feature of differentiation between EU members states is defined by belonging (or not) to the euro zone. As it will be shown below there are important differences between the member states of the euro zone and those not belonging to the euro zone and some of them might be not just temporary ones.

The processes taking place in the EU since the start of the euro zone crisis could be best characterized by the term "complex differentiation", which refers to integration among members of formally different groupings inside the EU (the euro zone members, non-euro zone members and different combinations of both), different legal formats of integration (enhanced cooperation or intergovernmental agreements in addition to the usual "community method"), and different directions of the process (calls for further integration or disintegration, for example, repatriation of powers from the EU back to member states or trying to preserve the status quo). The term of differentiation is used in this text with reference to the diversity of the forms of institutionalization of integration processes and the divergence of agreements among EU member states (supranational ones when powers are delegated to the EU institutions, and intergovernmental when member states preserve their dominant role in the decision making process). Differentiation results from the diversity of national preferences of member states, which implies that larger degree of divergence of national preference at the present time might be an indication of possible institutionalized differentiation in the future.

The text is structured on the basis of the above presented arguments. First, the reactions of the EU to the euro zone crisis and the main decisions are presented by focusing on the trends of institutionalized differentiation. Afterwards the causes of this "complex differentiation" and its further possible developments are discussed. Finally, the ongoing process of differentiation is discussed from the point of view of Lithuanian national interests and the key policy dilemmas are formulated taking into account the close prospect of Lithuania becoming a member state of the euro zone and the political incentives to participate in the further initiatives of integration of "the core member states" of the EU.

## 1. The EU's Response to the Crisis

The EU and its member states went through several stages of the financial and economic crisis. First, it was "the real estate bust" in the US in 2007 and the following financial crisis which was soon felt in Europe and its financial sector because of its interdependence to the US. The "freezing" of the inter-banking lending and distrust of the markets soon affected the EU economy which in 2009 experienced a decline. Initially the leaders of the EU and some of its member states reacted to the Great Recession by increasing public spending and attempting in such a way to increase the aggregate demand. However, such measures further worsened the state of public finances. Soon after the real state of Greece's public finances was publicized the new stage of the crisis started in 2010. Financial assistance was provided to Greece, Ireland, Portugal and Spain. However, the pressure from financial markets and extreme uncertainty continued until mid-2012 when the Head of the European Central Bank (ECB) Mario Draghi declared that ECB would do whatever it takes to save the euro. This marked the start of the declining sense of crisis and decreasing urgency to adopt new measures of integration.

The beginning of the euro zone crisis was accompanied with the renewed debates about the need to "complete" the Economic and Monetary Union and the institutional architecture of the EMU. Such proposals were provided by some analysts of European integration, representatives of financial institutions, who often discussed the alternative scenarios of disintegration of the euro zone, and also institutions of the EU, in particular, the European Commission. [2] The underlying idea behind these proposals was the need to pool financial resources of the EU in the euro zone in a form of centralized budget (sometimes called fiscal capacity or transfer mechanism) in order to be able to use it for reacting to the asymmetric shocks in the euro zone and provide support to those euro zone members which experience economic and financial difficulties and are not able to borrow on the market. Although the concrete proposals varied, ranging from the introduction of the Eurobonds or pooling the debt of the euro zone members to the establishment of the euro zone treasury and the Minister of Finance, they all had one element in common – to increase the redistribution of resources through the newly created euro zone budget. These proposals have been particularly elaborated in 2012 when four institutions of the EU presented their ideas and an action plan which had to lead to the gradual creation of the banking, fiscal, economic and political union in such a way completing "the

[2] See: Vilpišauskas R. "Eurozone crisis and European integration: functional spillover, political spillback?", *Journal of European Integration*, vol. 35, no. 3, April 2013, p. 361-373.

incomplete EMU".[3] Importantly, many of the proposed measures of integration were aimed at the euro zone members and other EU members willing join the former rather than all EU member states. The head of the euro zone Jean Claude Juncker was often present together with the presidents of the European Commission, ECB and European Council. This was a signal meaning that the euro zone rather than the EU might become a platform for further integration and institutional reforms if some EU member states (for example, the United Kingdom) continue to resist further deepening of integration.

However, if we assess in more detail what has been proposed in public and the concrete measures the EU member states have agreed to implement, and actually started enforcing them, we will see a significant gap between proposals and actual decisions being implemented. Significant share of the decisions actually adopted such as the "six pack", Fiscal Compact (Treaty on stability, coordination and governance) and "two pack" were mostly aimed at improving the enforcement of already existing rules, especially, the rules of sound fiscal policy. To be sure, the untraditional monetary policy measures adopted by the ECB, such as purchasing bonds on the secondary market, creation of the European Stability Mechanism (ESM) and the decisions on the creation of the banking union, including the creation of the Single Resolution Fund, are indeed unprecedented and could be regarded as the new steps in the process of financial integration. However, some of them have been hotly contested on legal grounds and in Germany cases were brought to the Constitutional Court regarding the legality of some of them. Besides, their actual impact on the level of the redistribution of resources in the EU remains either very limited or simply still unclear (as in the case of the ECB decisions). It should also be noted that the ESM functions not as a typical mechanism of redistribution among the euro zone members, but as a source of lending.

## 2. The EU's Turn to the Complex Differentiation

Arguably the most important characteristic of the decisions adopted in the EU since the start of the euro zone crisis is that in their legal form and political

[3] See European Council, „Towards a Genuine Economic and Monetary Union". Report by President of the European Council Herman Van Rompuy, EUCO 120/12, Brussels, June 26, 2012; European Commission, "A blueprint for a deep and genuine economic and monetary union. Launching a European debate". Communication from the Commission, COM (2012) 777 final, Brussels, 28.11.2012; President of the European Council Herman Van Rompuy, "Towards a Genuine Economic and Monetary Union", 5 December 2012, available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf

process they are not typical decisions based on the “Community method”. Some of the important agreements which attracted most attention, such as the Fiscal Compact and the part of the banking union, negotiated during the Lithuanian EU Council Presidency, were concluded outside the institutional structure of the EU. They are intergovernmental agreements implying that the role of the EU institutions in monitoring their implementation is limited (though less so in the case of the Fiscal Compact). It is exactly because of the proliferation of such type of intergovernmental agreements that some analysts declared that “silent revolution” is taking place in the EU. It is characterized by the growing differentiation between the euro zone members, on the one hand, and non-euro zone EU members, on the other hand, with the former developing new integration initiatives on the basis of intergovernmental agreements.[4] These intergovernmental agreements complement already existing other forms of EU institutional differentiation such as permanent “opt-outs”, applied in the areas such as the EMU or Home and Justice Affairs, also the instrument of enhanced cooperation which has recently been adopted in the cases of law regulating divorces and EU patent.[5]

Although the argument about the new intergovernmentalism of the EU seems empirically sound, the other part of the argument regarding the growing differentiation between the euro zone members and non-euro zone EU member states could be contested. To be sure, since the adoption of the Treaty of Maastricht the euro zone has been regarded as the institutional and political basis for the potential deepening of integration. Some analysts who discuss the possibilities for the federalization of the EU currently also see the euro zone as the group which could move forward in creating its own separate budget and economic government.[6] Besides, the Fiscal Compact has further strengthened differentiation between those countries which belong to the euro zone and those which do not, for example, by formalizing the euro zone summits, although foreseeing the possibility for the leaders of non-members to join them. But the important point is that growing divergence of member states’ national preferences and the resulting process of institutional differentiation is characterized by a surprising diversity, exceeding just one cleavage defined by the membership in the euro zone.

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[4] Buras, P. “The EU‘s silent revolution”, *Policy Brief ECFR 87*, European Council on Foreign Relations, September 2013.

[5] Blockmans S., ed., *Differentiated Integration in the EU. From the Inside Looking Out*, Brussels: Centre for European Policy Studies, 2014.

[6] See: Piris J. – C., *The Future if Europe. Towards a Two-Speed EU*, Cambridge: Cambridge University Press, 2012. Leaders of the Notre Europe discuss similar scenario – see Delors, J. „Fear not, we will get there!“, Notre Europe, 27 June 2013.

In other words, there is a growing differentiation both inside the "core" and inside the "non-euro zone" EU member states groupings. The idea to initiate the procedure of enhanced cooperation among the eleven members of the euro zone aimed at introducing the financial transactions tax is one interesting example of such differentiation inside the euro zone. If this initiative is actually implemented among the eleven member states it would become the first example of the institutionalized differentiation inside the euro zone. It should also be noted that there are analysts (often representing institutions in France and expressing a nostalgic feeling to those times when the European Community consisted of a small group of member states) who suggest moving ahead with the creation of the federation among six or seven member states, which along most founding members of the EU could include also Spain or maybe Poland.[7] It is evident that for the proponents of the federal scenario for the EU even the euro zone group has become too large and too heterogeneous in terms of national preferences to be able to find a consensus regarding the introduction of the federal level taxation and centralized federal institutions.

It is also important to remember the coalitions of EU member states which were formed in 2011-2013 during the negotiations of the new Multiannual Financial Framework for 2014-2020. They partly overlapped with the currently existing divide between the North (net payers to the EU budget) and South (net receivers from the EU budget). To be sure, such issue based temporary coalitions form quite often during the process of negotiations in the EU and they are not institutionalized. However, what these particular negotiations indicate is that not only the leaders of the United Kingdom, but also the leaders of Germany, Netherlands and Finland showed reluctance to increase the level of redistribution in the EU. This is an important illustration of the potential limits of further deepening of integration.

A similar divide was observed during the negotiations on the banking union, when national positions of Germany and France diverged significantly. It should also be noted that an interesting domestic political debate on possible exhausted limits of European integration has been taking place recently in the Netherlands, i.e. another founding member of the EU which traditionally has been included into the "core" of EU member states supportive of an ever deeper integration. As it was stated in the report produced by the Government of the Netherlands "the times of ever closer union are behind us", and therefore the EU

[7] See Godino R., Verdier, F. „Heading towards a European Federation. Europe's Last Chance". *Policy Paper No. 105*, Notre Europe, 11 February 2014.

should stay out of such areas as criminal law, direct taxation or social protection.[8] Such provisions seem to indicate an important shift in the national preferences and European policy of the Netherlands.

National preferences and positions regarding concrete issues on the EU agenda also diverged among the EU member states which do not belong to the euro zone since the start of the crisis. Fiscal Compact was signed by 25 EU member states (after accession into the EU Croatia also joined it). After the change of President and the Government in the Czech Republic, debate started about joining the Compact. A number of non-euro zone member states signed up to the euro-plus pact agreed among 23 EU member states. Differences of national preferences among EU member states not belonging to the euro zone are well illustrated by the examples of the United Kingdom, Sweden and Poland. In the United Kingdom there is an intense domestic political debate going on regarding the repatriation of powers from Brussels back to national level and the renegotiation of the country's membership in the EU or even leaving the EU.[9] In Sweden, which differently from the UK and Denmark does not have a permanent "opt-out" from the participation in the EMU, after the accession into the euro zone was rejected in the consultative referendum, the accession into the euro zone was postponed for indefinite period of time and the country's Government also prefers to stay out of the banking union.[10] In Poland, current political leaders are actively positioning their country as one of the leading country's in the EU (as part of the "Weimer triangle" or in other formats) and support actively further deepening of EU integration, but at the same time do not rush into the EMU.

Another important and related question – whether this growing diversity of institutional agreements and national preferences (complex differentiation) during the period of the euro zone crisis is just a temporary phenomenon caused by the crisis, or does it mark a new stage of European integration? It should be noted that, for example, the Fiscal Compact has a provision allowing other EU member states to join it; also the banking union is open to other EU

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[8] Ministerie van Buitenlandse Zaken, „NL ‚subsidiarity review' explanatory note", *Policy Note*, 21.06.2013, available at http://www.government.nl/documents-and-publications/notes/2013/06/21/nl-subsidiarity-review-explanatory-note.html

[9] The review of the EU competences initiated by the Government of the United Kingdom provides an interesting assessment of country's membership in the EU. It can be found in this web page https://www.gov.uk/review-of-the-balance-of-competences .

[10] It should be noted that in the midst of the debates about the EU should react to the crisis, on September 15th, 2011, two ministers of Sweden (Foreign Afairs and Finance) warned about the „dangers of two-speed Europe" in a joint article in the *Franfurter Algemeine Zeitung* (the translation of the article was kindly provided to the author by the Swedish Ministry of Foreign Affairs).

member states that preferred to stay out of it but might decide to join later. However, whether the non-members will decide to join these initiatives later will most likely depend on those factors that caused greater divergence of national preferences and strengthened tendencies of differentiation. Domestic politics of EU member states, in particular attitudes of voters regarding further European integration, as well as external pressure might be mentioned as such important factors (in addition to traditional interaction of interest groups and national governments). As the example of the Czech Republic shows, domestic political changes in the ruling coalition might cause rethinking of country's European policy and participation in the ongoing projects of integration. As the public statements of the policy makers in Poland illustrate, the aggravating security situation in the Eastern neighborhood and Russia's aggression against Ukraine might accelerate the process of country's accession into the euro zone.[11] However, the prospects of Poland's accession into the euro zone will also depend on domestic politics due to the need to amend country's Constitution in order to introduce the euro, which requires the support of 3/5 of members of the Parliament.

Therefore it is rather complicated to forecast how institutional differentiation might develop further in the EU. It is clear that amending the Treaty of the EU would be politically a very complicated process, although it seems that recently this idea has been publicly voiced by Germany's leaders. Much more complicated is the implementation of the grand visions of integration and such ideas as "a decisive deal for Europe" proposed to the European Parliament in the State of the Union address by the President of the European Commission.[12] The record of the actual decision-making and implementation of decisions in the EU during the crisis years shows that it is taking place not according to the visions formulated by the EU institutions and analysts, but during the process of forging compromises between EU member states, whose leaders not only interact with the interest groups but increasingly take into account the attitudes of their countries' voters.

[11] The need to review Poland's plans related to euro introduction was publicly raised by the Governor of the Polish Central Bank M. Belka, who linked this to the crisis in Ukraine. See Bloomberg, „Ukraine crisis means Poland needs to reconsider euro, Belka says", March 3, 2014, http://www.bloomberg.com/news/2014-03-03/ukraine-crisis-means-poland-needs-to-reconsider-euro-belka-says.html

[12] This deal included the creation of all four unions (banking, fiscal, economic and political). See Barroso, J. M. „State of the Union 2012 Address", Plenary Session of the European Parliament, Speech 12/596, Strasbourg, 12 September, 2012, available at http://ec.europa.eu/soteu2012/index_en.htm

## 3. Domestic Politics as the Cause of Growing Differentiation

Some authors call the EU itself a system of differentiated integration, arguing that differentiation – vertical (among different levels of governance, in other words, in terms of centralization), functional (among different areas of public policy) and horizontal (among different geographical entities) – is a permanent feature of European integration.[13] The main cause of differentiation is found in EU member states' domestic politics and their preferences generated by their actors. This observation is far from novel. However, what seems to be a relatively new phenomenon is the increase of public interest in the EU and especially euro zone affairs. For about half a century the process of European integration was a matter of political elites with society expressing little interest in it. The absolute majority of EU decisions were related to the functioning of the common market and were too technical for society to be interested in, so elites were operating under the conditions of "permissive public consensus".[14] The EU was involved mostly with regulatory policy issues which created only indirect redistributive consequences and therefore were not noticed by the member states' societies, with the notable exception of common agricultural policy.

During the euro zone crisis, however, the debates on the redistributive policy among euro zone countries have intensified. Although the ESM functions as a mechanism which lends money rather than redistributes from one country to the other, in many public debates and media commentaries financial assistance to countries like Greece and others is perceived as an outright redistribution.[15] It was mostly due to the changing nature of EU politics and the growing attention dedicated to the issues of redistribution that voters in many euro zone countries became more interested in European and euro zone affairs and the positions of their governments.[16] Domestic politics, including the role of the Constitutional Court might provide the explanation of the national preferences of German leaders on the issues such as the Eurobonds, pooling of national debts or common deposit insurance fund. As popular opinion surveys of German

[13] Leuffen D., Rittberger B., Schimmelfennig, F., *Differentiated Integration. Explaining Variation in the European Union*, Hampshire: Palgrave Macmillan, 2013.
[14] This description was used among others by the author of neofunctionalism E. Haas. See Haas, E. B. *The Uniting of Europe*. Stanford: Stanford University Press, 1968, p. xii.
[15] This was witnessed by the public debates in euro zone member states which took place during the ratification of the ESM Treaty, for example, in Estonia in 2012.
[16] See Vilpišauskas R., "Eurozone crisis and European integration: functional spillover, political spillback?", *Journal of European Integration*, vol. 35, no. 3, April 2013, pp. 361-373.

voters—conducted during the negotiations on the banking union and in the run up to the Parliamentary elections of 2013—show, the majority of those surveyed did not support the idea of pooling financial resources among the euro zone member states and such initiatives as the Eurobonds.[17]

Interestingly, in 2012 as the crisis seemed at its peak and the issue of the banking sector in Spain was discussed, German leaders agreed to the creation of the banking union which was soon detailed in the proposals of the European Commission. Reluctantly Germany's leaders also agreed to the Single Resolution Mechanism and fund in order to avoid the worsening of crisis and possible break-up of the euro zone. However, the official position of Germany on most other ideas of pooling financial resources among the members of the euro zone remained negative, at least under the current Treaty of the EU. Besides, the Government of Germany maintains that pooling of financial resources should be closely linked with centralization of monitoring of economic policies of EU member states, for example, contracts with each member state foreseeing implementation of concrete measures to improve competitiveness, and stricter control of national economic policies, something which is resisted by authorities of France and other euro zone countries.

To be sure, not only an increase of voters' interest in the EU affairs is important, but also the increase of euroscepticism in many member states. Although more systemic research is needed to assess the change of popular opinion regarding the EU, studies which are undertaken in different EU member states seem to indicate that response to the euro zone crisis and such measures like reduction of fiscal deficits and structural reforms increase popular disapproval of the EU. This is particularly evident in Greece, where popular opinion became more eurosceptical and numerous demonstrations and protests were held during the years of the crisis.[18] It seems that popular opinion also became more eurosceptical in other EU member states.[19] It is likely that these changes will also be reflected in the voting when European Parliament elections take place.

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[17] Peel, Q. „Germans hostile to further transfer of funds to euro zone, says poll", *Financial Times*, September 3, 2013, available at http://www.ft.com/cms/s/0/c5ba1f82-14a8-11e3-b3db-00144feabdc0.html#ixzz2dvNqJ6el. However, it should be noted that other comparative popular opinion surveys show that German population is still among the most supportive of the EU – see Kohut, A. "European Unity on the Rocks. Greeks and Germans at Polar Opposites", Global Attitudes Project, Pew Research Center, May 29, 2012.

[18] See, for example, Mahony, H. „Approval of EU leadership lowest in Greece", *EUObserver*, 08.01.2014, http://euobserver.com/political/122660, Traynor, I. "Crisis for Europe as trust hits record low", *The Guardian*, April 24, 2013, http://www.guardian.co.uk/world/2013/apr/24/trust-eu-falls-record-low.

[19] See Torreblanca J. I., Leonard, M. "The Continent-Wide Rise of Euroscepticism", European Council On Foreign Relations, *ECFR Policy Memo 79*, May 2013, Serricchio, F., Tsakatika, M., Quaglia, L. "Euroscepticism and the Global Financial Crisis", *Journal of Common Market Studies*, 2013, vol. 51, no. 1, pp. 51-64.

It should also be noted that EU decision making processes during the crisis became more intergovernmental, which could be characterized as a general turn of the EU towards more intergovernmentalism. It is illustrated not only by the increasing use of intergovernmental agreements discussed above, but also by the central role of European Council summits and the president of the European Council in reacting to the euro zone crisis or negotiating next multiannual financial perspective.[20] These tendencies could be traced not only to the importance of reacting to the financial crisis but also to the Lisbon Treaty provisions coming into force. At the same time as the importance of intergovernmentalism increased, the role of the supranational institutions, especially the European Commission, seems to be weakened.

## 4. Differentiation and Lithuania

Since Lithuania's accession into the EU, political elites who have been actively interested in European affairs assumed that Lithuania benefits from the use of "Community method", having strong European Commission and other supranational institutions and from being part of the "core" of EU member states. It should be noted that these convictions were not always successfully implemented in practice as the story of unsuccessful attempt to introduce euro in 2007 shows. Also as the slow and complicated transposition of the Services directive illustrates, even when officials state the importance of the common market principles, their actual implementation can be rather difficult.

In the context of the above mentioned preference for the "Community method" and strong supranational institutions, it is important to assess the national interests of Lithuania in terms of ongoing differentiation in the EU. The first question is related to the growing use of the intergovernmental agreements. Should such a format be preferred to the other instruments and institutions foreseen in the Treaty of the EU? In terms of negotiating power probably there is no major difference since both in the intergovernmental negotiations and when "Community method" is used, the negotiating power of Lithuania is comparatively small. Besides, as some Lithuanian officials learned during the country's EU Council Presidency, European Commission, which is often called the ally of small member states, often pursues its own agenda. From more general point of view, the use of intergovernmental mode of decision making and legal

[20] See Dinan D. "Governance and Institutions: Implementing the Lisbon Treaty in the Shadow of the Euro Crisis", *Journal of Common Market Studies*, 2011, vol. 49, S1 Annual Review, pp. 103-121.

format allows to find consensus among different member states, at the same time maintaining the United Kingdom in the EU, but not allowing it to exploit negotiations on the EU level for its domestic political purposes. It is important, of course, to make sure that such intergovernmental agreements should be open to all other member states, including those which prefer to stay outside of them but might decide to join later, especially allowing all member states to participate when further institutional reforms are discussed and negotiated.

Another important question is linked to Lithuania's accession into the euro zone, where Estonia and Latvia are already participating. There is a strong consensus currently that there are necessary legal and political conditions for Lithuania to introduce euro from 2015 and to become the 19$^{th}$ member state of the euro zone. This step could be seen as the last element of the exit from the economic crisis, which hit country's economy in 2009. It was facilitated significantly by the two decades of existence of the currency board arrangement with national currency litas being pegged to euro since 2002. The timing of the euro introduction was to a large extent determined by meeting the formal convergence criteria, while the willingness of political elites to continue with fiscal consolidation and reduction of the budget deficit after the Parliament elections in 2012 was motivated by a number of economic, political and security reasons.

Thus, although Lithuania has already signed to the Fiscal Compact and euro-plus pact, accession into the euro zone and the reputation of successfully coping with the economic crisis will significantly strengthen the status of Lithuania as a member of the "core" of the EU linking it further with the bonds of the common currency with Germany, France and other members of the euro zone. However, after becoming part of this "core" of the EU the issue of support for further integration will become even more acute – both politically and in terms of the possible impact of concrete new initiatives of integration. Politically incentives to participate in the new projects of economic integration will remain strong, whether the new initiatives are undertaken by all EU member states or only by the euro zone countries. However, in terms of the possible impact, it would be desirable to assess any new initiative in terms of its impact on country's competitiveness and economic development. If we take into account the ongoing debates about the harmonization of the profit tax basis, the need for which is particularly stressed by the leaders of France and Germany, also the initiative to introduce financial transaction tax under the procedure of enhanced cooperation, it is very likely that new initiatives of integration will be in the sphere of tax harmonization. Eventually this could lead to the increase of the level of taxation in Lithuania.

It could be argued that after Lithuania joins the euro zone, two other priorities will be more important than support for new initiatives of deepening integration. First priority is the actual implementation of already adopted EU principles and norms, in particular, enforcement of the common market principles in areas such as services and infrastructure. The existing infrastructural and regulatory fragmentation is costly both economically and politically. In addition to actually following the common market principles it is also important to follow sound fiscal policy rules. This would help to avoid in the future such a situation when no fiscal surplus is accumulated before the start of economic crisis as it happened in 2008-2009 and made reaction to the crisis and the need for fiscal tightening more challenging. It remains to be seen how the new instruments of fiscal governance and strengthening competitiveness adopted by the EU in recent years work in practice. Although officials from the EU institutions often point to the experience of the Baltic States as a good practice example of coping with economic crisis, it is still too early to tell whether this marks a long-term trend of becoming established in the "Northern" bloc of countries characterized by competitive economies and sound public finances. It will become clearer only after a longer term of economic growth and at least one more election cycle.

Another important question – does Lithuania benefit from such a different status of its main regional partners (Latvia, Estonia, Poland, Sweden, Denmark, Finland and Germany) in terms of their participation in the euro zone and other integration initiatives? It seems that such diversity does not prevent cooperation and implementation of common objectives, partly because all these EU countries are members of the common market. The main priority for Lithuania is in establishing a common market in the energy sector. The Baltic energy market interconnection plan (BEMIP) is an example of "soft" differentiation, when a smaller group of EU member states agree among themselves to pursue subregional projects of infrastructural integration which are important only to them, with the involvement of EU institutions in solving collective action problems in implementing these projects. A similar project and format of subregional coordination would be economically justified in integrating services market, but it seems unlikely to be implemented due to rather different economic and social models of Nordic and Baltic countries.

Although since the start of the crisis EU member states belonging to the Baltic Sea region have often been characterized as "Northern" countries, they are rather different in many respects, including their status and participation in different initiatives of EU integration. Even three countries – Denmark, Sweden and Poland – will for some time remain outside the euro zone. Another important feature of this subregional group of EU member states is the participation of Germany – the country which is seen as central to the European integration process and reactions of the EU to the euro zone crisis. Although the leaders of Germany have been criticized by analysts for being too cautious in their decisions to solve the crisis, it was the German factor which acted as a stabilizing force during the crisis. If the risk of euro zone disintegration or fragmentation increases again in the future, Lithuania should seek to remain in one currency bloc together with Germany. In such a scenario participation of other Baltic Sea region countries' which are also key trade and investment partners of Lithuania would also be important.

## Conclusions

Since the start of the euro zone crisis there has been an increase in the calls of analysts and EU institutions to strengthen economic governance of the EU and to add to the monetary union economic (banking and fiscal and eventually political) union. Such a scenario is difficult to imagine with the participation of some EU member states which do not belong to the euro zone, in particular the United Kingdom. Therefore debates about the two-speed EU and the deepening of integration and strengthening economic governance by delegating new competences and pooling financial resources among the euro zone members have intensified. Agreements such as the Fiscal Compact, European Stability Mechanism and banking union (Single Supervisory Mechanism and Single Resolution Mechanism) are presented as the steps leading towards the federal structure created by the euro zone member states.

However, it is still too early to tell whether the euro zone will become a political and institutional basis for the establishment of fiscal and especially political union with its own central budget and new economic policy making powers, delegating competences to the central euro zone institutions. At the moment national positions regarding the centralized pooling of financial resources and delegating economic policy monitoring powers are rather different in different euro zone member states, while societies remain largely cautious regarding such a prospect. These factors constrain further deepening of integration among the "core" of EU member states. Besides, those EU member states which do not belong to the euro zone are reluctant to allow further differentiation between the two groups of EU countries on the basis of using single currency and the prospect of two-speed EU.

In the coming years the prospect of complex differentiation seems to be the most likely scenario, possibly with changes in the membership of different groupings within the EU. Some EU members that do not belong to the euro zone will remain outside of the single currency area; others might accelerate the process of accession, especially if the perception of threat from the East changes the calculation of benefits and costs among their voters and elites. It seems that the economic recovery and declining sense of urgency to do something in reaction to the pressure of financial markets reduced the willingness of Germany and other countries' leaders to make further steps of economic integration leading to more federal EU. It seems likely that the greatest attention will be directed to the coordination of economic policy among EU member states, progress in their domestic reforms, fiscal and competitiveness indicators, and possibly implementation of the concept of nation contracts, linked to the use of EU funding. It seems unlikely that consensus will be reached among the EU or euro zone member states regarding the creation of "shock absorption function", suggested by the EU institutions. Meanwhile the review of the EU Treaty suggested by the government of Germany will depend on the composition of newly elected European Parliament, domestic debates on the European integration in EU member states, in particular United Kingdom, and the attitudes of voters.

Most likely the position of Lithuania in the EU will change significantly in 2015 – it will join the euro zone; and, furthermore, in the next couple of years several strategic energy infrastructure projects will finally be completed. These will probably be the most significant changes since Lithuania's accession into the EU a decade ago. During this first decade, Lithuania experienced a period of rapid economic growth, sudden and deep decline and new economic recovery. If political consensus regarding sound fiscal policy and improving competitiveness of the economy is maintained it could help become established as a member of the "Northern" group of still rather diverse countries. It is also in the Lithuania's interest that the United Kingdom remains a member state of the EU and that Germany continues to play a stabilizing role in the euro zone and the EU. The practical enforcement of the common market principles, in particular among the subregion of the Baltic Sea states, and other existing EU norms remains a priority in the coming years. Differentiation extending beyond the simple division between euro zone and non-euro zone members will probably remain an important characteristic of the EU.

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