10.2478/v10243-012-0025-0

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Financial Crisis and New Solutions in the European Union: the Case of a Small Country

This paper addresses the probable modifications of the economic strategy of Lithuania after the 2008-2009 crisis (the Great Recession) and the changes in macroeconomic environment in the European Union (EU). In Lithuania's case, like that of the other two Baltic states, a certain specificity of a small open economy was revealed and the need for some adjustment of strategy was displayed. Both the rapid economic progress of the Baltic States as well as their extreme economic depression during the crisis in the largest part was the result of the integration of those national economies into the European and world markets. The crisis has not only halted the economic progress of the EU and other countries of the world for a few years, not only induced attempts to review some weakened postulates of economic theory, but also asked for major adjustments in the economic policy of the EU and member states. Based on the texts drafted by the European Commission it has already agreed on tougher requirements in the Stability and Growth Pact, signed and ratified the Treaty on stability, coordination and governance in the economic and monetary union, and the European semester began operating procedures. EU Member States' economic policies have become inserted into a rigid frame, and the process of content aggregation of national economic policies will continue. Based on theoretical conclusions of single currency area and the practical requirements of the common monetary policy in the euro area integration processes are underway and will proceed rather fast. By the decisions of European Council the euro area should become a nucleus of economic integration of the EU member states, leading to full economic union. EU's political leaders, in conformity with the theory of European integration, raise already an issue of political union into the agenda. The article provides an analysis of the changes and draws a couple of conclusions. First, the process of economic integration should be separated stricter than ever before from process of political integration. Second, economic integration modifies the sovereignty of the states (increasingly moving to the principles of unified economic policy and economic decision-aggregation), which is not to be equated with the loss of sovereignty, but requires a new approach in the assessment of factors and motives of a national economic policy and its role in securing country's sovereignty.

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Third, the economic strategy of small states has to continue to rely on the active involvement of European economic integration, giving priority to real economic convergence (reduction of development gap) and real participation in decision making concerning the issues of the integrated economy of the EU. The conclusion is made that on the basis of these provisions it would be possible to distinguish inexorable, rationality-based process of the EU economic integration from the alleged imperative of political union of European countries.

Introduction

The increasing pace of technological advancement and dissemination not only enabled the world's national economies to increase productivity and improve well-being, but also pushed towards more intensive economic exchange and the increasing interdependence. Problems of international cooperation, globalization and regional integration problems inevitably take up more and more prominent place on the agendas of politicians and research projects of scientists.

These changes are by no means merely nominal. They gradually transform national economies into regional and global economic structures, tied up by trade and capital flows and co-operative production networks. Continental economic complexes relentlessly destroy the relative autonomy of national economies, thereby denying traditionally understood economic sovereignty and demanding a new approach to national economic policy. The current de facto continuing crisis - not throughout the whole world, but in the most developed part of it - shows that the hitherto used means of economic policy arsenal needs to be updated, and the update direction - greater orientation to external economic factors and international cooperation in the economic policy. Some analysts even offer a rethinking of substantive issues of economic theory.

An intellectual dispute between economists of the two camps and a face-off of the United States and the European Union (EU) policies, to be used for an exit from the crisis, is especially relevant for small open national economies. The reason here is that the two alternative strategies to address the crisis caused by economic depression are presented as equivalent, while in fact this is true only for large national economies which are less dependent on external trade and capital markets than small national economies.

Supposed equivalence of these strategies—either to boost demand by deficit financing in anticipation of subsequently balancing public finances when economy recovers, or to eliminate public finance deficit as the necessary condition for investment rebound—threatens small nations with much greater destabilization of the national economies than large ones, because having chosen the first strategy they would receive much more powerful inflationary impulse than the great powers and would be pushed into a long-term inflationary spiral, destabilizing the economy.

Thus, the current financial and economic crisis requires a new look at the specificity of economic policy of a small nation. The analysis here will offer new insights for further discussion about what economic strategy is recommended for small national economies during the rapid regional and global economic integration.

Principal provisions of an economic policy require ensuring the state's economic security. Economic security is directly linked to economic independence (sovereignty). Each state, in search for security and benefits, binds itself to the proliferating international commitments, among them, to the commitments in economic policy (by joining the intergovernmental organizations such as the WTO, IMF, WB, ILO, signing multilateral and bilateral trade, investment protection, and the like agreements with other states). This intertwining with commitments will continue to increase, it is sufficient merely to mention climate change, non-recoverable mineral resource exhaustion problems. All this changes the content of economic sovereignty.

The main threat to national economic security is the asymmetric situation of a country in the global markets of commodities and raw materials, dependence, in its external economic relations (suppliers, markets, creditors and others) on one or a few partners. As each threat, the dependence also offers means neutralization of its harmful effects, but until there is no unambiguous identification of threats, there is no consensus on measures to threats to economic security should be mitigated and eliminated.

The article is based on the theory of economic integration, developed by the works of B. Balassa, F. Machlup, J. Viner, mainly devoted to international trade, and the theory of optimal currency area, first elaborated by R. Mundell to address a higher, monetary, level of economic integration. In this article economic integration is studied within the EU, i.e. without examination of its impact on the EU's economic relations with the outside (the problem of trade diversion and impact of the euro on international currency system are left aside).

The article consists of two sections. The first section gives a brief overview of specificity of small states economic policy, describes the current financial and economic crisis and post-crisis period, and identifies changes in the economic environment of the EU small member states. The second section focuses on the crisis in the euro zone and the debate on its resolution – in the authors' view, the discussion about causes, progress and solutions of the euro zone crisis enables the discovery of new phenomena in the problems of economic policy of small states and, by delving deeper into them, grasping the guidelines for adjustment and revision of their economic strategy.

1. The Specificity of a Small National Economy and Changes in Its Macroeconomic Policy, Boosted by the Crisis in the EU.

1.1. Impact of globalization on a small state's economic policy.

The strategic goal of economic policy is to ensure the country's economic security. Economic security treatment is homogeneous neither in theory, nor in practice; it has options. In our view, one of the most accurate definitions is given by Artūras Grebliauskas, who emphasizes the essential importance of sustainable economic equilibrium: "... the economic security of a country has to be understood as the ability of state and national [economic] actors the ability to sustain economic entities and systems in state of equilibrium in response to external environmental conditions[1]."

Equilibrium in the economic systems of the big states is, to a large extent, a matter of their domestic economic policies, while for the small states this equilibrium is the result of their external economic relations and the issue of their external economic policy. The guarantee of success for small national economies is their participation in international trade and capital markets in most rational way. International trade allows for specialization and economy of scale even for small countries, capital markets provide funds for investment and technological progress. Along with that a small country becomes dependent on those markets, and to a much greater extent than the great powers. Although the national interests of small states is not something special (as compared with the interests of the great powers), such states, as Gediminas Vitkus notes, are forced to act in specific, less favourable conditions.[2] The crisis is a strong shock for such equilibrium; it raises serious issues for economic strategy of small states.

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[1] Grebliauskas A., „Analysis of Threats for Economic Security of Lithuania", *Lithuanian Annual Strategic Review 2002*, p. 277.

[2] Vitkus G., „Mažosios valstybės ir jų nacionaliniai interesai", *Lietuvos nacionaliniai interesai ir jos politinė sistema. Konferencijos medžiaga, Vilnius, 1994 gruodžio 16-17d.,* Vilnius: Pradai, 16 p.

In 2010. U.S. export volume amounted to 12.6 per cent of its GDP[3], import - 16.1 percent.[4] Meanwhile, Lithuania's export in 2011 amounted to 69.6 billion. LTL, i.e., 65.4 percent of GDP, import - 78.7 billion (74 per cent of GDP)[5]. This means that the Lithuanian economy is totally dependent on communication with the exterior, while for the U.S. economy this linkage is relatively less important (if to dissociate from the vital importance of such links to individual sectors of the economy). If, say, the price imports of the United States and Lithuania in some year would increase by 10 percent, the price level in the U.S. would rise (we distance ourselves from the structural changes taking place afterwards) by 1.6 per cent, and in Lithuania – by 7.4 percent.

Due to the relatively lesser economic openness major powers can afford, in times of depression, the increase of the money supply not only by making borrowing less expensive or buying up securities in the secondary market, but also by "printing" money, that is – by the decisions of central bank, the country's monopolistic issuer of money, financing the deficit state spending, undertaken to increase aggregate demand and thus pulling up the productive activity. Small countries cannot do this. The demand of their households and corporations is satisfied, for a large (or even largest) part by imports, which means that by boosting money supply state may only increase the growth of the trade balance deficit and pose a risk to the stability of the domestic currency (thereby, after the currency depreciation or its devaluation shall trigger fast inflation, to create a risk for country's export competitiveness).

The importance of external economic relations (both for the provision of energy resources, raw materials, capital goods and the production realization as well) shows the dependence on the choice of suppliers and buyers; it also suggests solution: open economies should strive as much as possible to diversify their foreign partners in supply and demand relations and to achieve the mutual liberalization of the relations on the principles of free market. Only under such conditions is the equilibrium of domestic entities, sectors and the

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[3] The value of exports and imports in statistics is calculated according to their full value, while GDP expresses only the value, created (added to what has already been left for productive use from previous years) in that particular year. Therefore, we can not state that the US imports represented 16 per cent of the country's GDP; just two different economic indicators are compared among themselves. The whole value of goods and services produced in a country in particular year has to be counted by adding the value created in previous years and transferred to the value of goods and services produced in the current year to the value created in the current year. Accordingly, the total value of the produce of the country in a particular year is larger than its GDP and, consequently, the value of exports and imports would be less by a few percentage points. This insignificant difference allows to treat relation of export and import to the GDP as an approximate measure of export's and import's relative weight in the country's yearly production.

[4] Statistics Pocket Book, European Central Bank, January 2012, p. 7.

[5] Lietuvos Statistikos departamentas, *Lietuvos statistikos metraštis*, 2012, p. 375.

whole economic system relatively sustainable and dynamic. In the economic sphere that relatively much higher dependence on external factors requires specifics in the economic policy of small states. The issue of economic integration is much more relevant and pressing for them.

Economic integration greatly facilitates the access of production of small countries to markets, and thereby fosters greater economic cooperation in general. The integration also facilitates mitigation of the impact of negative external economic factors. Thus, both with a view to economic benefits and the economic security economic integration for small countries' economies is to be assessed positively. However, participation in a multilateral economic structure with the inevitable domination of the great powers in its institutions requires a change in the content of national economic policy: strengthening its adaptive function and prioritize further regional (in global scale - local) integration.

Such trends – the overlapping of internal and external policies and intensification of regional cooperation - are common to all public policy areas. However, the specificity should be noticed – in the economic activity these trends are much stronger than in other fields of activities of nation states, therefore national political agendas now contain and implement economic integration items, while in other areas of public policy such integration is still a subject of academic interest only. Therefore, in the current phase of economic globalization economic policy has a tendency to branch out from other sovereign state policies. What this policy detachment mean for the politics of small states is a large and complex issue.

1.2. Economic Crisis in the World and in Lithuania

Although after the Second World War the economy retained its cyclicality, its swings softened dramatically. When at the end of the twentieth century more serious economic problems emerged (Mexico's "Tequila Crisis" in 1992, the crisis in Southeast Asian countries in 1997 ant that in Russia and Argentina in 1998), it was considered a global economic phenomenon on the peripheries. In 2007, the economic crisis hit the most developed countries in the world. The scale of the crisis shattered the world economy. For the first time since World War II, the planet's economy shrunk - in 2009, the global GDP fell by 0.6 percent, among other the EU economy declined by 4.2 percent, United States - 3.5 percent.[6]

[6] IMF, World Economic Outlook, April 2012, p. 190.

It was a systemic crisis. The inherent “genetic” failures of market mechanism broke the regulation of national and fragmentary work of international trade and financial institutions, used channels of free movement of capital, and finally organized a “Valkyrie feast”. As N. Roubini and S. Mihm rightly point out, it is wrong to consider the U.S. subprime loans crisis as the cause of the crisis which rolled over the global economy. This could be just the catalyst. In most other countries the financial and then economic crisis blew up due to the analogical excessive expansion of mortgage loans and construction sector as well as the rise of financial investments for which those economies needed just a slight jab to being placed in the inevitable hole already inevitable.[7]

The global financial crisis was caused by too liberal order in world financial system – the uncontrolled commotion in real estate and credit markets, fueled by unlimited private interest to make use of ever heating conjuncture drove it out of equilibrium. The global financial system, says N. Roubini and S. Mihm, “…rotted from the inside out.”[8]

It is the private capital markets which are to be identified as the fireplace of the crisis, now called the Great Recession. Multiannual and excessive public sector deficit was only in Greece; other euro area and non-euro EU countries before the credit crisis were characterized by the expansion of the private sector, which later caused problems and deficits in national budgets. Since the introduction of the euro in 1999 up till the financial crisis in the EU in 2008 the bank loans and private debt grew by an incredible pace.[9] Only in the public sector (euro zone countries) debt not only failed to increase but even decreased - from 72 to 68 percent GDP. Public finances have become deficient after the beginning of the financial crisis because, first, states had to rescue ailing banks and, second, to take on the costs of increasing functioning of automatic stabilizers, when the crisis halting economic development its revenues decreased and expenses increased.[10] . “As we saw during the crisis,” write the authors of a study, “private commitments may very soon become public debt.”[11].

In small Baltic economies these excesses occurred on a greater scale.

[7] Roubini N., Mihm S., Crisis Economics: A Crash Course in the Future of Finance, New York: The Penguin Press, 2010, p. 127.

[8] Ibidem, p.272.

[9] According to N. Robini ir S. Mihm, the weekly „The Economist“ already in 2005 computed, that in the developed countries the total value of residential properties had dubbled from 2000 to 2005 (rose by 40 trln. dolars). (Roubini N., Mihm S., Crisis Economics: A Crash Course in the Future of Finance, New York: The Penguin Press, 2010, p. 126).

[10] De Grauwe P,. „A Mechanism of Self-destruction of the Eurozone“, Intereconomic, 2010, No.6, p. 344.

[11] Nacarino R.C., De Corte S., Freudenstein R., „Democracy and legitimacy in an European Union“, CES, October 2012, p.4.

Private sector borrowing in Lithuania in 2003-2007 grew by 37 percent annually. Short-term loans' real (nominal minus inflation) interest rates since 2005 became negative and remained such until the year 2008 inclusive, in 2007 and 2008 they were negative also for long-term loans. Housing prices increased on average by 26.5 percent. Public finances have always been deficient – governments were borrowing and pouring money into economy, which was already heating for several years and approaching disaster. Unemployment, as it was to be expected under such borrowing fever, decreased from 16.4 percent in 2000 to 4.3 percent in 2008. Banks' profitability has reached unprecedented heights – in 2006-2007 returns on equity in the banking sector were respectively 21.4 and 27.3 percent. [12] Bank loans, granted to customers, jumped from 8 billion LTL at the end of 2002 to 71 billion LTL at the end of 2008.[13]

All of this led to overheating. According to the assessment of the experts of Lietuvos Bankas, during 2000-2007 the country's economy grew yearly by an average of 8 percent, and it has exceeded its potential; non-inflationary growth could, in their view, be only 5 to 5.5 percent.[14] Such rapid growth was fueled by credit expansion, which, in turn, was made possible when Lithuanian banks started intensively to bring in capital from parent and other foreign banks (which, in turn, became possible when business of Western countries became persuaded by vitality of the new post-communist national economies, split from the former Soviet Union's continental industrial complex and functioning now in new conditions of the EU membership guarantees and conditions of the market mechanism).[15]

Credit expansion has focused mainly in the real estate sector. Thus, the large amount of capital brought from abroad (borrowed there and relent in Lithuania for house purchase) did not directly contribute to the country's productive potential.[16] For some time the economy grew at a fast rate, but it soon

[12] Reiner M., Zauchinger C., „Recent Developments in the Baltics and Southeastern European Countries with Low Nominal Exchange Rate Flexibility", Oesterreichische Nationalbank, Workshops, Proceedings of OeNB Workshops, March 23, 2009, p. 15, 17, 18, 21, 25, 27, 36.

[13] Lietuvos makroekonomikos apžvalga, SEB bankas, 2009 m. kovas, Nr. 35, p. 29.

[14] Kuodis R., Ramanauskas T., „From boom to bust: lessons from Lithuania", *Pinigų studijos*, 2009 birželis, Nr.1, p. 96.

[15] Quite often it is said that huge and excessive loan injection into the Lithuanian economy, which blew a buibble in real estate and construction sectors, is the result of the fact, that the largest Lithuanian banks belong to foreign banks. The ownership of banks did not play here any considerable role. Looking at the experience of other countries (even without using the examples of catastrophies of Ireland and Iceland national banks) one may be sure that expansion of bank loans in such an extraordinary speed would go also with national bank ownership - if such conditions to draw funds in international capital markets wouild exist and decision to provide loans for heavily unindebted households sector was in place.

[16] Kuodis R., Ramanauskas T., „From boom to bust: lessons from Lithuania", Pinigų studijos, 2009 birželis, Nr.1, p. 100.

began to "heat up" – it exceeded its productive potential and still increasing income became a factor of prices increase. In 2005 inflation was 2.7 percent, and 2008 it jumped to 10.9 percent.[17] Labour productivity in Lithuania in 2000-2006 rose on average by 6.6 percent (in 2007 - 4.7 per cent).[18] Nominal wages in the same period rose an average of 10.6 percent annually.[19]

The inadequacy of economic policy also should be noted. The Lithuanian government, even in boom times, planned and implemented exclusively deficit budgets. In 2002 Lithuanian public sector revenue was 17.1 billion LTL, and expenses were 18.1 billion. In 2008 rapidly rising revenue more than doubled, but the governments still "needed" to supplement them with borrowed funds, thus financing the still increasing government spending (it rose up to 41.7 billion LTL in 2008).[20]. Bank of Lithuania (Lietuvos Bankas) remained passive. In the autumn of 2006 Bank of Estonia raised the mandatory reserve ratio from 13 to 15 percent, and the Bank of Latvia in 2007 raised it from 3 to 8 percent.[21] The Bank of Lithuania continued without using this possibility.

However, one may partially agree with the excuse of the representatives of the Bank of Lithuania: "The global financial bubble and its regional repercussions, accompanied with rosy EU related expectations, short-sighted economic interests and neglect of risks were simply the too powerful element to counteract effectively."[22]

As has been shown by the example of Estonia (during 2001-2007 the budget was in surplus except in 2001, when the deficit was 0.1 percent GDP),[23] government short-sightedness or, conversely, foresight had very little meaning for the rise and course of crises in the small Baltic countries; the economy in all three countries shrank most in Europe (along with Ukraine). Estonia's economy shrank even more deeply than the rest of the Baltic States: it decreased already in 2008 by 3.7 percent and continued to decline in 2009 by another 14.3 percent. [24] Thus, the overall decline since 2007 was even 17.5 percent. But national economic policy is not meaningless. Estonia's foresight shall reveal itself

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[17] Lietuva skaičiais, Lietuvos Statistikos departamentas, 2011, p. 30.

[18] Mackevičius J., Molienė O., „Bendrojo vidaus produkto vienam gyventojui analizės metodika", Pinigų studijos, 2009 birželis, Nr. 1, p.34.

[19] Statistical Annex of European Economy, European Commission, Autumn 2012, p.209.

[20] Valdžios sektoriaus pajamos ir išlaidos, Lietuvos Statistikos departamentas, http://www.stat.gov.lt/lt/pages/view/?id=2266.

[21] „Recent Developments in the Baltic Countries – What Are the Lessons for Southeastern Europe?", Oesterreichische Nationalbank, Workshops, Proceedings of OeNB Workshops, March 23, 2009, p.87, 93.

[22] Kuodis R., Ramanauskas T., „From boom to bust: lessons from Lithuania", *Pinigų studijos*, 2009 birželis, Nr.1, p. 103.

[23] Statistical Annex of European Economy, European Commission, Autumn 2012, p.188.

[24] Statistics Pocket Book, ECB, January 2012, p. 39

positively in the near future, having stepped into crisis without extrabudgetary reserve, and, unlike Estonia, becoming deeply indebted, both Lithuania and Latvia in the next decade shall have to devote a significant part of their revenue to service national debt.

1.3. The Crisis and Changes in the EU Macroeconomic Policy

On the EU level, the threat created by the insufficient regulation of financial markets was highlighted when the monetary union was created. The monetary union encourages its sovereign participants to the sovereign, national governments, for wider use of the deficit financing, because borrowing becomes much cheaper, and when finally, if the majority of union members abuse it, real interest rates increase, and the burden falls not only on the countries with improper budgeting policy , but is divided among all the states in the monetary union. Of course, the indebted country risk premium increases in their interest payments, but it is not enough to avoid a financial disaster. Common rules and adequate mechanism is needed to ensure fiscal moderation.[25]

The Stability and Growth Pact (SGP), adopted in 1997, established requirements also for fiscal discipline: the medium-term budget had to be balanced or in surplus, and its deviation into deficit could not exceed 3 percent of GDP. Not just the excessive deficit monitoring and warning procedures were set, but also penalties. However, when in 2003 several large euro area countries violated the requirements of the Pact, the "non-interference" approach, as the ECB stated in one of its reports, was won in the Council and penalties are not applied. Further, in 2005 the Pact fiscal discipline was relaxed and its effectiveness was undermined[26].

As we see it, the main reason for the serious damage to the SGP was that the euro-zone member countries failed to come to terms with the sudden transformation of national economic policy. A full waiver of autonomy in one of the two main parts of the policy - monetary policy, they failed to significantly constrain themselves also in fiscal policy. Their required changes were too rapid and too large.

As early as 1999 the German Council Presidency proposed the start of a macroeconomic dialogue (otherwise - Cologne process), which would ensure

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[25] The relationship between monetary policy and fiscal policies in the euro area, ECB, Monthly Bulletin, February 2003, p.41 -42.
[26] Fiscal Integration in Europe, ECB, April 2012, p. 89.

better interaction between monetary, budgetary and fiscal policy and wage policy in the EU. After some time it was realized into periodically adopted Broad Economic Policy Guidelines, but their execution member states, as some authors argue, treated it as more than an optional.[27]

In spring 2008, in commemoration of the first decade of the European Council's decision to create the Economic and Monetary Union (EMU), the European Commission was already well aware of the risks of the single currency area. We clearly recognize, said Commissionaire Joaquín Almunia on this occasion, that interdependence of the EU economies has never been so strong, so that the EU and each member state have a strong interest to go towards a genuine economic policy coordination.[28] The Commissionaire acknowledged that national budgetary surveillance under the Stability and Growth Pact in the public finance stability criteria must be supplemented by macro-economic aspects which go beyond purely budgetary matters.[29]

Such a move still had to wait. Only in the autumn of 2011, the Council and the European Parliament adopted the so-called six-pack, which reinforces the Stability and Growth Pact operation, introducing new macroeconomic imbalance monitoring procedures and tightening sanctions for euro-zone countries.[30] In other words, the six-pack moved beyond the requirements of tightening budgetary discipline – it agreed on a deeper control of reasons in national economies, destroying budgetary equilibrium.[31]

A more consistent monitoring procedure—the so-called European Semester—was also introduced. In the first half of every year the EU member states will submit the Annual Growth Surveys, which will be assessed at the Council and the European Parliament, discussed by the member states, and the recommendations, given to the countries, will be in their National Reform Programmes and Stability (for the euro-area members), or Convergence (for the rest of the EU countries) reports, submitted to the Commission. These will also be evaluated, discussed and will receive the

[27] Howarth D., Loedel P., *The European Central Bank. The New Leviathan?*, London: Palgrave Macmillan, 2005, p.104.

[28] Almunia J., „EMU @ 10: Successes and challenges of 10 years of Economic and Monetary Union", European Parliament. Plenary Session, Brussels, May 7, 2008.

[29] Ibidem.

[30] Financial Integration in Europe, ECB, April 2012, p.97.

[31] Macroeconomic imbalances procedure scoreboard uses 10 indicators, according to which the Alert Mechanism Report is prepared. Among those indicators are the three-year rolling average of current account balance, a country's export's relative weight in world exports change during 5 years, housing price index, compared with the consumer price index change, and so on.

Council recommendations, which will be considered at the end of the year, during the preparation of new national budgets. Owing to such procedures the risk of financial imbalance will be alerted earlier and may facilitate problem solution.

The most important national obligations in the field of macroeconomic governance turned out to be legal acts of the EMU by the Treaty on stability, coordination and governance in the Economic and Monetary Union (sometimes called a Fiscal stability treaty). It was joined by the non-euro Member States, except the United Kingdom and the Czech Republic. It is expected to come into effect, depending on the progress of ratification, in 2013. Its requirements will be transposed into national law by 1 January, 2014.

To monitor stability of the EU financial sphere and provide early warnings the relevant authorities were formed (or reformed). The first is the European Systemic Risk Board, to act on the macroeconomic level, and three European financial supervisory authorities, observing the relevant financial areas - the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).[32]

In managing public finances there are only two alternatives in a monetary union to determine stability and reliability of common currency; either the union states are prohibited from infringing on the equilibrium of national public finance or they retain their sovereign budgetary policy, but the monetary union has the necessary mechanisms and funds to assist countries as they get bogged down in the excessive indebtedness. In both cases, there is no reason to talk about absolutely sovereign fiscal policy of a monetary union member state—it is impossible there.

So far, the EMU has not had it. Article 126 of the EU Treaty states: "Member States shall avoid Excessive government deficits,"[33] but the Stability and Growth Pact providing details on how it will be implemented has not been carried out. More strictly regulated fiscal discipline and a strengthened analysis of the deeper reasons that threaten the public finance equilibrium, as well as the analysis of performance in accordance with the general rules and conducted under the supervision of the European Commission is expected to strengthen sustainability and competitiveness of national economies. Individual EMU member states (and the candidates) will be confronted by reduced

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[32] Commission adopts legislative proposals to strengthen financial supervision in Europe. Brussels, IP/09/1347, 23/09/2009, http://europa.eu/rapid/press-release_IP-09-1347_en.htm, 2012-11-27.

[33] Consolidated version of the Treaty on the Functioning of the European Union. Official Journal C 83, Volume 53, 30 March 2010, p. 99. http://eur-lex.europa.eu/JOHtml.do?uri=OJ:C:2010:083:SOM:EN:HTML, 2013-01-29

possibilities and attractiveness of taking the risky actions in the macro-economic policy that their loss of sovereignty in this area is about.

It may seem that increasing fiscal discipline and financial stability-building measures are a definite step towards fiscal federalism. Logically the strict limitation of the deficits in national budgets of the monetary union member states is accompanied by a "federal budget". However, the still-to-be-created European Stability Mechanism (ESM) is a fund under the central bank of the monetary union established to provide the loans of last resort, than the federal budget embryo. The Treaty states that "Like the IMF, the ESM will provide stability support to an ESM Member when its regular access to market financing is impaired or is at risk of being impaired."[34]

This fact, just as strenuous debate on the strategy of every new multi-annual EU budget strategy[35] indicates that fiscal federalism, in its classical sense, remains a utopia in the EU. The movement goes not towards "financial (or even macroeconomic) federation" of the member states, but towards creation of a "regulatory union", that is, towards standardization of fiscal governance.

However, the factors pushing to the opposite direction may also be noticed. Consolidation of macroeconomic policies will lead towards political federation not by legislation, limiting sovereignty, but by practical procedures of reporting, reviewing, recommending, reproaching and threatening with sanctions in dealing with a country's public finances. Economic policy sovereignty, in this case, will decrease due to aggregation (pooling) of sovereignty into the EU's macro-economic policy and the commitments to its implementation in the national economies.

There is no doubt that the growth of power of supranational institutions in systemic (macroeconomic) supervision will increase the relative weight of the EU Member States' international obligations, thereby continuing decline of their absolute sovereignty and its rising regulation. Within the EU it may promise to turn into a new quality—the creation of a political union of member states. German Chancellor A. Merkel (followed by the European Commission President J.M.Barroso) has already talked about such a union as the future

[34] Treaty establishing the European Stability Mechanism, http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf , p.7., 2012-11-27.

[35] The ongoing and still unfinished (the discussion in the European Parliament is ahead) discussion on the 2014-2020 budgetary framework witnesses that the maximum volume of the EU budget - 1.24 percent of EU's gross national income, established a few decades ago, not just will not be increased, but shall remain unachieved. A new budget, as expected, will make up about 1 percent. GNP.

of the EU; without such union, they argue, all unification of macroeconomic policy principles and provisions may prove ineffective.[36]

However, a different process is possible: the formation of an economic union for a long time may take place as a relatively autonomous (with regard to the political integration) process. Ideas about the EU economic government and the EU economic federation is not without reason. Sovereign EU Member may stay as such while their national economies function as the units of the unified economy (single EU economy). A national economic policy will remain, but as a means for realization of the single project (similar to the common monetary policy carried out now in the euro area by national central banks of those countries).[37]

The development of an economic and monetary union provides material for monitoring these alternative processes and their perspectives.

2. Features of the European Monetary Union and Its Incomplete Establishment

2.1. Deficiencies in the Construction of EMS and Problems in Establishing a Monetary Union

One of the best-known indices of globalization is the so called Dreher (KOF) Index of Globalization which has the ability to assess the impact of globalization on the country's development and country position in a globalized world. Researchers believe that small countries are more globalized. The analysis of the level of globalization in the Baltic countries confirms that their overall level of globalization is quite high and it is strongly associated with economic development[38].

The understanding of the Monetary Union's untapped potential could substantially change the situation in the future. The failure of functioning of the single currency in the whole EU territory hampers the economic development opportunities for the EU as a whole for competitive swimming in the oceans of global economy. Different power relations have an impact on both

[36] Germany's Chancellor Merkel urges EU political union, http://www.bbc.co.uk/news/world-europe-18350977, 2012-11-30.
[37] This option is best evidenced by the wide resonance of the British Prime Minister David Cameron's speech January 23. 2013, where the economic efficiency of the union and strict rejection of any political integration was emphasized. (http://www.ft.com/cms/s/0/259ef844-653d-11e2-a3db-00144feab49a.html#ixzz2InSXDc3b, 2013-01-24).
[38] Pekarskiene I., Susniene R., „An Assessment of the Level of Globalization in the Baltic States", Engineering Economics, No.22 (1), 2011, p.58-68.

economic literacy and economic awareness. Ideology in economic policy and theoretical foundations are now dictated by the results of the integration, i.e. the EU supranational institutions.

The EU developed countries' "signatory states" integrated slowly, evolving over decades. However, the integration model of strict rules and principles is applied for new Member States. The supranational institutions developed such that, depending on the power of economic interests of an individual Member State, provided new opportunities for some Member States while it applied constraints to the others. During the crisis, different priorities of Member States were even more obvious, and the subject of the EMS collapse is not a taboo any more. A country with a small open economy, having agreed to integrate into the Free Trade Area, opens the borders for circulation of financial flows without limitations. However, a country does not have the right to have full participation in the EMS, and is inevitably faced with a serious problem, i.e. how to ensure economic stability.

Moreover, the first programme of the Government of the Republic Lithuania adopted in October 1990, identified that "involvement in the creation of the European Economic Area" would require to sacrifice some part of sovereignty of each Member State, however, "not all countries are ready for such a step" and "are concerned about the dominance of major Western European Countries in the European Community"[39]. After nearly a decade, quite a few world famous economists warned that the new Member States should not be separated from the EMS development affairs[40]. Previously, the refusal of some certain provisions of national sovereignty was only the tool of negotiations; now it is called "enhanced cooperation" and became a part of the EU Treaty official vocabulary.[41]

Two features lie at the basis of the monetary union: a single currency (or its alternative – national currencies pegged at a fixed rate for an unlimited period) and a single monetary policy. To ensure the EMS functioning quality, there are following significant factors: common interests; focus of institutions on common interests, not only on the euro area interests; free-riding; breaking rules and norms; institutional capacity to respond adequately to "spoiling "of

[39] Lietuvos Respublikos Vyriausybės (LRV) programa, [Action Report of the Government of the Republic of Lithuania], 1990 10 11, http://www.lrv.lt/bylos/vyriausybes/po_1990_1_programa.pdf .
[40] Mundell R. A., „Exchange Rate Arrangements in Central and Eastern Europe" in Arndt S., Handler H., Salvatore D., Eastern Enlargement: the Sooner, the Better?, Vienna: Austrian Federal Ministry of Economic Affairs and Labor, 2002.
[41] Moravscik A., Europos pasirinkimas: socialinis tikslas ir valstybės galia. Nuo Mesinos iki Mastrichto, Margi raštai, Vilnius, 2008.

the EMS as public good; bureau pathology phenomenon closing in the cycle of domestic interests and converting external (global) interests into the implementing measure of internal interests[42].

Currently the power held by euro area countries hinders a solution to the dilemma of how the existing euro area inside the EMS could make decisions in accordance with the provisions of the EU Treaty and ensure the spirit of the principle of equal treatment at the same time for all EU Member States (especially the developing countries). The fears can be justified that it is useful for the euro area to reduce the competitiveness of new Member States and attractiveness for investment.

While the EU "plays" with the internal problems and the convergence between the euro area and non-euro area, the euro is becoming increasingly important at the international level. This means greater responsibility and the benefits that could bring the economic policy coordination across the EU. Being outside the euro area for a longer period of time increases the probability that the negative effects of economic shocks will groundlessly remove the new Member States from the euro area participation and will lead to a higher rate of inflation and the current account deficit.

The crisis has forced not only in theory but also in practice the recognition that the benefits of financial integration are not necessarily the same between the states, and that financial system integration directly affects the efficiency of the market, and if it becomes more efficient[43], the assurance of public interests strengthens the whole system[44].

2.2. How "the Correction and Improvement" of the EMS Could Have an Impact on the Small EU Member States.

In the beginning of integration developing countries implemented the policies that complied with EU rules because they strived for EU membership. The only positive is that they had conditions and opportunities to benefit from "the import of experience" of well-functioning EU supranational institutions and other EU member states internal institutions. During the integration period, small countries benefit from the existing structure of institutional

[42] Gylys P., Ekonomika, antiekonomika ir globalizacija [Economics, Anti-economics and Globalisation], Vilniaus universiteto leidykla, Vilnius, 2008.
[43] Hartmann P., Maddaloni A., Manganelli S., „The Euro Area Financial System: Structure, Ingeration and Policy Initiatives", Working Paper Nr.230, ECB, May 2003.
[44] Kropas S., Kropienė R., Europos pinigai, Vilnius, 2005.

framework, development models of rules and procedures. In these circumstances, fewer resources are expended within small countries for institutional or model development. Both new regulation systems and even an ideology is "imported" into small EU Member States through EU Treaties' system. This is a positive thing provided that these systems are tested and efficient, and the ideology helps to improve quality of life.[45]

We should point out that in recent years the decisions taken on the EMS first of all provide a deeper integration among the euro area countries, though the EU Monetary system brought about by the Treaty of Maastricht (1992), in our opinion, was not intended for such a long time and wide geographical spread of the euro currency. Twenty years ago, the euro integration seemed different. Frequently analysts forget that all the EU Member States are formal members of the EMU, with only a temporary exemption on adopting the euro. Though most of the new mechanisms are valid only within the euro area, the non-euro area countries have renounced the possibility of pursuing an independent monetary policy for almost a decade (to the extent that it may violate the Stability and Growth Pact).

Before reviewing EMS management and improvement techniques, we would like to note the following reasons of failure of the previous monetary unions:

- There was no political integration;
- There was insufficient overall budget;
- Rejection of the single monetary policy functioning principle;
- The lack of resistance to the adverse effects of external shocks[46].

Small countries have to balance between the interests of the two concepts; their signs could also be perceived in the evolution of the EU. One of them is grand universalism, or the so-called universality of fair treatment to all states (no matter how big they are) when the domain of the exercise is the self-imposed rules and principles are applicable to all, without any distinction and without any classification according to the size of economies. Another concept is called national particularism (the orientation to the interests of one country) where the domain of the exercise of fairness involves each nation taken separately, and the relations between nations are governed by a supplementary exercise involving regional (global) justice and impartial rules[47].

[45] Kaul J., Grunberg J. and Stern M. (eds), Global Public Goods: International Cooperation in the 21st century, New York, Oxford University Press, 1999.
[46] Kropas S., Kropienė R., Europos pinigai, Vilnius, 2005.
[47] Kaul J., Grunberg J. and Stern M. (eds), Global Public Goods: International Cooperation in the 21st century, New York, Oxford University Press, 1999.

The Report of the Tommaso Padoa-Schioppa Group on the Action Plan for the development of the EU fiscal union provides the following suggestions:

- In order to foster the Single Market, the euro area needs to become a truly integrated economic area, so domestic institutional adjustments are also required. There is the need to move towards a solution by diversifying degrees of integration. This means the need of moving forward by shifting to a new Intergovernmental Treaty and create a new EU17 structure that would be parallel to the EU-27 framework and strongly linked to it;
- A cyclical stabilization insurance fund should be created outside the EU budget and remain under direct control of national parliaments;
- In order to rebalance fiscal rights and fiscal duties, the Report suggests the creation of a European Debt Agency (EDA) that would allow a flexible refinancing possibility to countries. EDA would be less than a fully-fledged finance ministry, but it would be more than a simple European Monetary Fund. It should be headed by a „Euro Area Finance Minister". National parliaments would have to be involved in providing the legislative basis for the decisions taken by EDA. The exact composition of this institution is quite far-reaching political consideration;
- To ensure the banking union within the euro area, the creation of a euro area banking supervision authority with micro-prudential supervision powers is required. In parallel, the creation of an agency administrating a European deposit insurance fund would be required. It could be a delicate issue to achieve the right rules for financial stability in the euro area without endangering the functioning of the single financial market, so it is necessary to hasten the creation of these institutions. Furthermore, a euro area institution would be much more independent of national interest groups than a national supervisor. A euro area banking union can be implemented within the current Treaty framework on the basis of cooperation between the euro area members, either through enhanced cooperation or intergovernmental agreements;
- The suggestions should be implemented as a package, as a whole and at the same time because all Euro area members „share not only a common currency, but also a common destiny" and their governing institutions „have to finally live up to the expectation that economic policies are a matter of common concern".[48]

[48] „Completing the Euro. A road map towards fiscal union in Europe", Report of the "Tommaso Padoa-Schioppa Group", Notre Europe, June, 2012.

In order to avoid a race to the bottom in the competition when the small economies compete strongly for international direct investment flows, there is a need for clear regional (EU) rules on measures to attract foreign investment capital and for advanced rules on environmental and labour standards. Putting emphasis on clear and common rules creates the potential to offset incentives for regulatory competition. Establishing right rules of the game can be particularly important to developing countries, which otherwise can be subject to constant pressure from potential investors for lower standards. Developing countries fear the agreements in the euro area because politically strong protectionist interests of industrial countries could be defended by using "club" decisions, and developing countries will have no possibility for access to their markets[49]. Financial activity of the markets outside the euro area migrates towards euro area countries and concentrates in the largest financial markets of the euro area. Improper response to the crisis in EU developing countries undermines the EU future development and its role as a global market participant[50].

Researchers from the Institute of BRUEGEL also provide a recommendation on the renewed euro area development strategy:

- Analyze the economic indicators in each country separately, taking into account the situation across the EU.
- The convergence criteria have become wholly inappropriate because when applying such criteria, i.e. inflation and deficit, the results are inconsistent.
- Make an economic assessment of the costs and benefits of future euro memberships on the basis of both the immediate benefits of joining and the longer-term sustainability issues.
- Establish in advance at what exchange-rate level potential members should join.
- Despite the status of convergence criteria implementation, the states could be free to choose the date of adopting the euro.
- The criteria for joining the euro should ensure that economic logic prevails over both political and legal logic[51].

We often hear the question whether it is better to be or not to be a member of the euro area during the crisis. In the opinion of Sławomir Skrzypek, each country's answer would be different: "Adjustment in the euro area has to

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[49] Kaul J., Grunberg J. and Stern M. (eds), Global Public Goods: International Cooperation in the 21st century, New York, Oxford University Press, 1999.
[50] Pisani-Ferry J., Posen A.S., „The Euro at Ten: The Next Global Currency?", Bruegel, June 2009.
[51] Sapir A., „Bruegel Memos To The New Commission, Europe's economic priorities 2010-2015", 2009

be achieved through prices, wages and productivity channels, which is more complex than using the exchange rate channel. This also applies to countries which are not in the euro area but have pegged their currencies to the euro. However, if we have to choose between being a member of the euro area and being a member of the EU with the exchange rate pegged to the euro, the answer is simple - it is better to be the euro area member".[52] In reality everything is more difficult. "No single currency regime is right for all countries at all times", writes Jeffrey Frankel.[53] Thus it is not enough to choose only between flexible and fixed exchange rates. The reason is that the euro is already an international currency, so the fluctuating ratio between the euro and the dollar may increase the differences between the EU countries and cause trouble for the countries that peg their currencies to the euro as well as affect the competitiveness of the countries striving to adopt the euro[54].

Controlling opportunism is particularly important for developing countries because international rules and oversight of trade agreements could limit the ability of large firms to exploit monopoly power. Only developed EU countries could take advantage of market imperfections while monopoly in international trade is usually created in developed economies. They have market power not only in regional but also in international trade, so there is no actual competition for their products in developing countries. Developed countries may then be in a position to adopt policies that enhance the market power of their own firms or improve the terms on which they trade[55]. Developing countries, arguing for the need to develop their economies and the ongoing inevitable internationalization outside the EU, should seek to reform the current EMS governance dimensions:

- Developing countries should be better represented at the leadership of supranational institutions.
- The representatives of developing countries should participate in all regional and global forums and formats.
- Avoid solving today's problems at the expense of future generations.
- Strengthen monitoring of monetary integration.

[52] Nowotny E., Mooslechner P., Ritzberger-Grünwald D., „The Euro and Economic Stability. Focus on Central, Eastern and South-Eastern Europe", Oesterreichische Nationalbank, Austria, 2010.
[53] Frankel, J. A., „No Single Currency Regime is Right for All Countries or at All Times", Graham Lecture, Princeton University, 1999.
[54] Nowotny E., Mooslechner P., Ritzberger-Grünwald D., „The Euro and Economic Stability. Focus on Central, Eastern and South-Eastern Europe", Oesterreichische Nationalbank, Austria, 2010.
[55] Kaul J., Grunberg J. and Stern M. (eds), Global Public Goods: International Cooperation in the 21st century, New York, Oxford University Press, 1999.

- New supranational institutions should guarantee proper problem solving and representing of interests[56].

The finances of the EU Member States, particularly the members of the euro area, are more and more closely related. However, the developed countries retain the EU initiative of key decisions. Requirements to impose sanctions on financial discipline witness the development of EMS supranational jurisdiction; it is also a move toward the establishment of the EU economic government[57].

While carrying out internal reforms, developing countries make regional agreements at the EU level and thereby weaken the resistance of various power centers within the country to reforms. However, developing countries face another problem, namely, their weak positions in a multilateral setting, i.e. they do not have sufficient resources to actively participate in meetings of various formats, and to defend their interests in complex and long-lasting negotiations[58]. Such problems could be solved not by operating a spontaneous mechanism but by imposing a programming regime. The application of such a regime could provide a strategy for increasing profit, which would force EU institutions to disclose all the information for developing countries[59].

People expected stability from integration processes, as well as a positive impact on economic growth and markets. Therefore, the three following conditions are necessary for the stability of a monetary union structure: 1) a crisis resolution mechanism in the EU as a whole; 2) a procedure to deal with internal imbalances; 3) a common banking supervisor[60]. There is a need for a coherent framework for crisis management that brings together home and host authorities of key financial institutions as well as the private sector[61].

Integration does not take place mechanically or spontaneously when driven only by market forces. Regimes are used to enhance the process of integration, i.e. programming agreements and actions. EMS, with the non-euro area and the euro area inside, is not a monetary union but simply a fixed exchange rate regime, so the current form of the euro area will fail to survive in the future.[62] We see that the mechanism of legal preconditions gradually

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[56] Kaul J., Grunberg J. and Stern M. (eds), Global Public Goods: International Cooperation in the 21st century, New York, Oxford University Press, 1999.

[57] Čičinskas J., „Euro zona gelbėjasi“, *Balsas.lt*, 2010 03 29.

[58] Kaul J., Grunberg J. and Stern M. (eds), Global Public Goods: International Cooperation in the 21st century, New York, Oxford University Press, 1999.

[59] Tresch R. W., Public Sector Economics, Palgrave Macmillan, 2008.

[60] Münchau W., „Gaps in the euroarea ‘football league’“, The Financial Times, 2010 03 21.

[61] Berglof E., Annenkov A., “Baltic lessons for Europe’s future economic governance”, Europe’s World, No. 12, 2011, p.70–75.

[62] Münchau W., „Gaps in the euroarea ‘football league’“, The Financial Times, 2010 03 21.

leads towards an EU federal state. Economic policy that is solely based on national interests is not useful to human well-being. "The countries of Europe are too small to guarantee their peoples the necessary prosperity and social development", claimed the author of the idea of European integration, Jean Monnet.[63]

The Tommaso Padoa-Schioppa Group maintained that the EMS is incomplete in its current form, and it aims at reaching as much fiscal federalism as necessary for the appropriate functioning of the euro, but as little as possible. The crisis has shown that the old mode of functioning in the EMU can no longer continue. It is not separate Member States but the EU level that should be recognized as an economic policy actor. Common actions mean the recognition that the sum is more important than each separate part. At the EU level it is difficult to find examples of common economic actions (the exception is monetary policy)[64].

In 1989 the Delors Report highlighted that this sort of EMS structure is a mistake: "economic union and monetary union form two integral parts of a single whole and would therefore have to be implemented in parallel ".[65] Prof. Mario Monti suggests looking at the EU single market as a whole, and not only at the euro area. With the increasing number of opponents to integration, the single market needs faster decisions and a holistic vision. The point is not how many different "boards" the EU will have or whether they will be seen as a cohesive entity.[66]

Developing countries often doubt whether it is in the economic and social interests of developing countries to enter into agreements that would require higher standards. It is common for developing countries to point out the existence of a double standard: when the developed countries of today were creating the EMS, they themselves did not adhere to the norms to which they are now requiring others to adhere. Did they strive for the power of rule-making instead of rule-taking? In the future, the internationalization process can change the nature of the dialogue between developing and developed

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[63] Monnet J., „Jean Monnet's thoughts on the future (5 August 1943)", Archives Jean Monnet, Fondation Jean Monnet pour l'Europe, Lausanne, Fonds AME. 33/1/4, translated by the Translation Centre Virtuel de la Connaissance sur l'Europe, Copyright (CVCE), 1943.
[64] „Completing the Euro. A road map towards fiscal union in Europe", Report of the "Tommaso Padoa-Schioppa Group", Notre Europe, June, 2012.
[65] Committee for the Study of Economic and Monetary Union, "Report on economic and monetary union in the European Community", Brussels, 1989.
[66] „Strategies for a post-crisis world: enhancing European growth", Keynote speeches at the Brussels Economic Forum 2010, European Commission, Directorate-General for Economic and Financial Affairs, ECFIN Economic Brief Issue No 9, July 2010.

countries: developing countries may turn from observers to actors and thus get a much better position for asserting their interests[67].

The Tommaso Padoa-Schioppa Group believes that sovereignty should be declined as much as possible so as to ensure the functioning of a single currency: "a stronger economic policy of the EU can emerge only if the actor of the policy is the EU itself and not the assembly of Member States. This implies a significant transfer of sovereignty. The EU level would have to be recognized as full-fledged and autonomous actor in economic policy-making, based on appropriate sources of legitimacy". It is necessary to determine the recognition of the EU level as an independent layer of economic policy-making, yet acknowledging the national origins of budgetary and economic policy choices.[68] The common economic area as a public good cannot exist without a common central bank, monetary policy, public finance and fiscal policy institutions. The EU is clearly confronted with a tension within the system, the infamous dilemma of being a monetary union and not a fully-fledged economic and political union. This tension has been there since the single currency was created but society was unaware of it because of information asymmetry[69].

Sooner or later, in order to survive during the economic globalization, the EU will be forced to change itself and will have to recognize changes in hierarchical market and political power relations. Internationalization affects regular opening of stages of economic development and their subsequent integrated stabilization and closure though at a higher hierarchical level as well as the wider institutional framework.[70] Even the Delors Committee thought the creation of a single currency area will require a greater political union.[71] The EU must be able to cooperate on a global scale and seek for the role of a political coordinator at the global hierarchical level.[72]

[67] Kaul J., Grunberg J. and Stern M. (eds), Global Public Goods: International Cooperation in the 21st century, New York, Oxford University Press, 1999.
[68] „Completing the Euro. A road map towards fiscal union in Europe", Report of the "Tommaso Padoa-Schioppa Group", Notre Europe, June, 2012.
[69] „Strategies for a post-crisis world: enhancing European growth", Keynote speeches at the Brussels Economic Forum 2010, European Commission, Directorate-General for Economic and Financial Affairs, ECFIN Economic Brief Issue No 9, July 2010.
[70] Jeffries S., „A rare interview with Jürgen Habermas", The Financial Times, 2010 04 30.
[71] O'Sullivan J., „Holding Together", The Economist, 2009 06 11, http://www.economist.com/specialreports/displaystory.cfm?story_id=13767371.
[72] Jeffries S., „A rare interview with Jürgen Habermas", The Financial Times, 2010 04 30.

Instead of Conclusions

The economic strategy of Lithuania, a small country, is based on seeking economic security. Therefore, for the Lithuanian state further development of an integrated European economy is crucial.

The crisis hit the Lithuanian economy due to the same reasons and in the same way as in all of Europe, but its power in Lithuania (in the Baltic countries) was much higher than anywhere else. This is the best proof of the relative lack of autonomy (in regard to outside forces) of the Lithuanian economy. Due to the lack of such autonomy the external forces put the country's economy at a higher level than it was realistically able to sustain, and, when crisis came, threw it from that mountain deeper than it would have been in the case of more sustainable development.

Therefore, a small country can secure economic stability only by stepping into the process of economic integration which not only satisfies the search for economic rationality and security needs, but also meets criteria and interests for political alliances and cultural affiliation. The economic integration now proceeds as formation (enlargement) and consolidation of Economic and Monetary Union (EMU).

In the process of EMU creation the principle "one nation (country) - one currency" is being replaced by the principle "one market - one currency." As the economic integration of Europe goes on much faster than the political one, the single EU market coexists with 27 sovereign states. This made the formation of the monetary union a multi-stage process and made its functioning difficult and not without risk.

There is no doubt that economic policy in the euro area must be consolidated and harmonized to the extent necessary for the success of the single monetary policy. The monetary union is to be complemented by a certain fiscal union, which, no doubt, shall develop into an ever closer economic union.

Due to the possible formation of an economic union some state sovereignty dimensions must inevitably change. External economic relations of states are increasingly organized by institutionalized bilateral and multilateral agreements, where in each case states waive themselves of individual opportunities and acquire opportunities (and obligations) to deal with issues in cooperation with other countries. It is obvious that in the economic sphere state sovereignty modifies itself.

In the course of economic integration the stumbling block of national currencies' fluctuations sooner or later have to be removed in the most radical way, namely, by a changeover to a single currency, and therefore to the single monetary policy. The euro zone may change its geographical configuration, but it cannot disappear. Therefore, to be in the EU and not in the EMU means gradually lagging behind European economic integration, and together with that also to incite some threat of political ostracism. As a small country this is contrary to Lithuania's interests, Economic integration, if and when it happens, will inevitably require political integration. However, the political integration is far more difficult and slower. If external forces will not prevent the integration of the economic (rational) world, the gradual formation of a political union in Europe will remain imminent, as well as promoting the creation of a political union in the EU right now is premature.

February 2013