

# NATIONAL PREFERENCES AND BARGAINING OF THE NEW MEMBER STATES SINCE THE ENLARGEMENT OF THE EU: THE BALTIC STATES – STILL POLICY TAKERS?

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## *Abstract*

The article addresses sources of preference formation of the European policy in the Baltic States. More specifically, the article focuses on the key factors Estonia, Latvia and Lithuania relied upon in forming their national preferences since their accession into the EU, the key policy areas where the relevant institutions of these countries have been the most active, and finally, the factors that can account for the varying degree of influence and success with which the Baltic States have been able to upload their national policy preferences onto the EU agenda. The main argument is that the effectiveness of European policies of small countries, such as the Baltic States, largely depends on the consistency of their domestic policy and efforts at implementing it both “at home” and in the neighborhood, as well as European policy demands. The inconsistency of domestic policies originating from policy-makers wary of popular attitudes and, in particular, of activities of interest groups rather than asymmetric bargaining power has prevented the governments of these countries from convincing their EU partners. Importantly, the inconsistency is not so much an outcome of the lack of administrative capacities or political party disagreements on policy priorities; rather, it originates from a tension created by the dependency on third countries and corresponding activities of economic interest groups which have a stake in these relations (for example, energy supplies from Russia) as well as the efforts of political elites to reduce these dependencies and reorient economic links to the EU member states. Additionally, what the comparative analysis of the three countries suggests is that the population’s trust in the government and stronger consensus on domestic policies among elites also reinforce the consistency of domestic and European policies by reducing policy changes caused by election cycles.

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## **Introduction**

Since the beginning of scholarly debates on integration of Central and Eastern European countries into the European Union (EU), the dominant approach was a top-down perspective of EU impact on policies, politics and polities of the countries in question. This tendency has reflected both the nature of the relationship between the EU and candidate countries, with the latter adjusting to the conditions of the former in order to join the Union, and the growing popularity of europeanization debates within the field of European studies.

The accession of Central and Eastern European countries into the EU in two waves in 2004 and in 2007 has brought to the attention the issue of European policies of the newly acceded countries, reviving the debates on the sources of national preferences, main actors and outcomes of representing national interests in the EU. In other words, the early experience of participating in the EU decision-making process has provided a fruitful field for a bottom-up analysis of the European policy of the new EU members. Besides, seven years after their accession, one could expect changes in the behavior of these countries as policy takers and 'good Europeans', which previously was the prevailing stance, in particular, during the accession negotiations, toward more proactive European policy efforts at uploading national preferences onto the EU agenda, at least in the priority policy fields.

This paper addresses sources of preference formation of the European policy in the Baltic States. More specifically, the article focuses on the key factors Estonia, Latvia and Lithuania relied upon in forming their national preferences since their accession into the EU, the key policy areas where the relevant institutions of these countries have been the most active, and finally, the factors that can account for the varying degree of influence and success with which the Baltic States have been able to upload their national policy preferences onto the EU agenda.

In order to set a background for the presentation of the arguments regarding preference formation in the Baltic States, the analysis starts with a brief overview of the relevant literature. In this part arguments regarding the sources of national preferences are formulated and factors which have influenced their transmission onto the EU agenda are established. The analysis then identifies areas in the European policy where the three Baltic States have been

increasingly active both domestically and on the EU arena, and discusses factors which seem to be at play in determining the varying degree of success in uploading the countries' national preferences onto the EU agenda. The article concludes with observations which can be made at this stage, taking into account the limited time frame of the countries' participation in the EU policy-making process.

### **1. The analytical framework**

The participation of the new member states in the EU policy process can be analyzed through the lenses of national preference formation and uploading their preferences onto the EU agenda (interstate bargaining). For the purposes of this analysis one needs to address questions regarding the sources of national preference formation on particular European policy issues and factors that determine the outcomes of interstate bargaining at the EU level. These issues may be analyzed by employing the liberal intergovernmental approach, which sees national preference formation as a process of domestic (usually economic) societal groups interacting with national leaders (usually executive governments), while interstate bargaining depends on relative bargaining power, which, in turn, is conditioned by the degree and nature of economic interdependence.<sup>1</sup> This approach, however, seems to be of limited use when it comes to institutional security issues, which do not have direct impact on the competitive position of economic interest groups in the country. Moreover, in the case of the new EU member states, its application is very limited due to the emphasis on economic interdependence as a source of bargaining power, since most of these countries (except for Poland) are small and open economies, and for the time being, net receivers of EU funds. Therefore, they are asymmetrically dependent on the EU and, by definition, are doomed to be policy-takers in the EU without any prospects of exerting bargaining power in the Council negotiations and feeding their national preferences into the EU agenda. The relative number of votes in the Council as compared to the number of votes of the large countries only reinforces this argument.

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<sup>1</sup> Moravcsik, A., *The Choice for Europe*. Ithaca, NY: Cornell University Press, 1998.

Nevertheless, this article is based on the assumption that, despite the nature of asymmetric dependence with the rest of the EU, it is useful to analyze the preference formation and bargaining behavior of countries, such as the Baltic States. Naturally, liberal intergovernmentalism can explain the process of EU accession negotiations as an asymmetric adjustment of the acceding countries<sup>2</sup>; it can also provide an account of decision-making in the enlarged EU and the relative influence of different EU member states depending on their bargaining power. Besides, as A. Moravcsik has pointed out, the logic of liberal intergovernmentalism is most visible in cases when societal interests behind specific policy issues are well-defined and institutionally represented<sup>3</sup> – conditions which have often been absent in countries undergoing transition and integration reforms. The more uncertainty about the outcomes of particular policy decisions there is, the less predictable is the process of preference formation according to the logic of interaction between the interest groups and policy makers and, more importantly, other factors, such as ideology. In addition, it could be argued that the degree of uncertainty about national preferences towards the EU is proportionate to the behavior of the government following the logic of being “a good European”, rather than calculation of national interests and hard bargaining. The analysis of Lithuania’s accession negotiations shows that uncertainty and lack of information is a more important constraint for small domestic companies, while large transnational enterprises, including energy companies, are better informed about EU norms and, therefore, are more successful in conveying their preferences to the national government.<sup>4</sup> A liberal intergovernmentalism approach can be useful in providing a structure for analysis and an initial set of variables. However, one needs more nuanced lenses to analyze the preference formation and bargaining behavior of small and mid-size EU members, which are asymmetrically dependent in terms of trade and in terms of being net receivers from the EU budget.

For this reason the present article also draws on other publications which discuss variables affecting national European policies of EU members. For

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<sup>2</sup> Moravcsik, A., Vachudova, M., „National interests, state power, and EU enlargement“, *East European Politics and Society*, 17 (1), 2003, p. 42-57.

<sup>3</sup> Moravcsik, A. p. 36.

<sup>4</sup> Maniakas, K., Vilpišauskas, R., Žeruolis, D., eds., *Lithuania’s Road to the European Union. Unification of Europe and Lithuania’s EU Accession Negotiations*. Vilnius: Eugrimas, 2005.

example, in addition to the variables stressed by liberal intergovernmentalism, intensity of trade relations, net receipts from the EU – some authors have also included factors, such as ideology (left- and right-wing attitudes), history (experience of World War II) and public opinion to test the causes of government support for European integration.<sup>5</sup> Other authors inquiring into the extent the variables used to explain European integration preferences in the old EU member states can also be used to analyze national preferences of the new EU members, have argued that “there is no silver bullet which provides explanations both for all countries and all policy areas”.<sup>6</sup> They hypothesized that national preferences are policy-specific, with general support for European integration and liberalization dependent on ideology, support for redistributive policy - on whether a country is a net recipient or contributor, while foreign policy depends on history and size, and, finally, preferences towards EU enlargement are conditioned by geography and attitudes towards deeper integration. The relative importance of these factors depends on the specific policy fields where a particular member state is seen as most vulnerable, or, as the authors put it, “state will prioritize those particular areas of European policy that are perceived to compensate for their particular shortcomings”.<sup>7</sup>

In addition to assessing the variables behind the preference formation, the present article also uses relevant literature on interstate bargaining and uploading of national preferences onto the EU agenda to assess how effective the representation of national preferences during the process of EU decision making has been. Although liberal intergovernmentalism tends to assume that small asymmetrically dependent countries, such as Estonia, Latvia and Lithuania are likely to be policy-takers without any major chances to feed their national preferences into the EU decisions, some authors have drawn attention to policy variables which allow one to expect differentiated outcomes. A possible explanation of differences in effectiveness of forming and representing national position has to do with the institutional structure of policy coordination. Some authors have argued that the institutional structure of coordination

<sup>5</sup> Aspinwall, M., “Government Preferences on European Integration: An Empirical Test of Five Theories”, *British Journal of Political Science*, 37, 2006, p. 89-114.

<sup>6</sup> Copsey, N., Houghton, T., “The Choices for Europe: National Preferences in New and Old Member States”, *Journal of Common Market Studies*, 47 (2), 2009, p. 263-286.

<sup>7</sup> Copsey, N., Houghton, T., p. 273.

can account for the varying degree of effectiveness of European policy of EU member states.<sup>8</sup> In general, however, the evidence regarding the link between the institutional structure and policy effectiveness remains inconclusive.

Another approach maintains that the possibilities to exercise power and influence in the EU depend on a number of resources, such as political and economic weight, political, social and economic practice, persuasive ideas, compelling demands, credibility and consistency.<sup>9</sup> Thus, while, in accordance with the dominant view, this approach acknowledges the importance of variables, such as political and economic weight, its arguments regarding the importance of factors which could be exploited by small EU member states, such as persuasive ideas, credibility and consistency, have already been used to explain instances of influencing major EU decisions by small EU countries, like Belgium and the Netherlands.<sup>10</sup> This offers a potentially fruitful venue for the research of the new EU member states, linking their bargaining behavior with sources of national preference formation as well as domestic policies and practices which can have an effect on European policies and the potential for influencing the EU decision-making process.

The analysis of this paper rests upon several arguments. The aspirations of the Baltic States to join the EU have been based on a number of economic, political and security benefits. The broad party and expert consensus was behind the objective of a rapid conclusion of accession negotiations to be part of the first wave of the EU enlargement into Central and Eastern Europe (in the case of Latvia and Lithuania – to catch up with Estonia, which was invited to start accession negotiations together with the first wave of candidates). The consensus of the parliamentary parties as well as a general positive public attitude towards EU membership, though stronger in Lithuania than in the other two countries and with Estonian public opinion growing more positive after the accession,

<sup>8</sup> Metcalfe, L., „International Policy Coordination and Public Management Reform“, *International Review of Administrative Sciences*, 60 (2), 1994, p. 271–290; Laffan, B., *Managing Europe from home. Impact of the EU on executive government: a comparative analysis. OEUE Occasional Paper No. 1.* – 09.03, Dublin: European Institute. 2003, available at <http://www.oeye.net/papers.asp>; Zubek, R. 2008. *Core Executive and Europeanization in Central Europe*, New York: Palgrave Macmillan, 2008.

<sup>9</sup> Wallace, H., „Exercising Power and Influence in the European Union“ in: S. Bulmer, Lequesne, eds. *The Member States of the European Union*. Oxford: Oxford University Press, 2005, p. 25–44.

<sup>10</sup> Maes, I., Verdun, A., „Small States and the Creation of EMU: Belgium and the Netherlands, Pace-Setters and Gate-keepers“, *Journal of Common Market Studies*, 43 (2), 2005, p. 327–348.

have provided a background against which specific European policy decisions have been elaborated by senior civil servants at the executive government.

This consensus towards a fast accession process has allowed these countries to adjust quickly to the EU conditionality (institutional and regulatory reforms with transition periods for the most sensitive issues, such as the closure of the Ignalina nuclear power plant in Lithuania, or sale of agricultural land to foreigners in all three countries, or most costly measures, such as increase in excise duties or investments into environmental protection). The prioritization of the EU accession coupled with the logic of asymmetric adjustment created a pattern of behaving as “a good European” in support of further European integration. This logic of bargaining could be observed during the process of participation in the work of the Convention, drafting of the Constitution for Europe and its ratification in the parliaments, and, finally, negotiating the Lisbon Treaty. High uncertainty and non-familiarity with EU norms also contributed to this logic of behavior.

After joining the EU, the political interest in European policy decreased except for efforts to deal with “accession left-overs”, such as joining the Schengen area and the euro zone, to absorb EU funding, to further infrastructural integration in order to reduce dependency on non-EU suppliers in the field of energy, and to project national interests into the Eastern neighborhood countries. Therefore, the key priorities of European policy were mostly formulated by senior civil servants and were adopted by political parties in power, for example, by signing the cross-party declaration on new Lithuania’s foreign policy priorities in 2004. This process of preference formation was dominated by the executive government and was driven by the motive of europeanizing policy areas where the Baltic States were seen as the most vulnerable due to their geopolitical situation as well as economic interdependence with neighboring non-EU countries. The record of influencing the EU decision-making process, however, has been mixed. While in some cases national preferences have been successfully fed into the EU decisions (in the case of the three countries - accession to the Schengen area, adoption of the Eastern Partnership initiative, in the case of Estonia – adoption of euro in 2011 and some minor initiatives like integrating databases), other policies have been less effective in convincing EU institutions and other member states to adopt their proposals (in the case of Lithuania, to join the eurozone in 2007, to create a common energy policy allowing for a unified stance of the EU vis-à-vis Rus-

sia). On some issues, all three Baltic States seem to favor status quo opposing the new European Commission's initiatives like harmonization of corporate tax base or an initiative regarding the reform of the EU budget.

The main argument of this article is that *the effectiveness of European policies of small countries, such as the Baltic States depends, to a significant degree, on the consistency of their domestic policy and efforts at implementing it "at home" and in the neighborhood as well as European policy demands.* The inconsistency of domestic policies originating from policy makers wary of popular attitudes and, in particular, activities of interest groups rather than asymmetric bargaining power has prevented the governments of these countries from convincing their EU partners. Importantly, *the inconsistency is not so much an outcome of the lack of administrative capacities or political party disagreements on policy priorities; rather, it originates from the tension created by the dependency on third countries and corresponding activities of economic interest groups which have a stake in these relations (for example, energy supplies from Russia) and the efforts of political elites to reduce these dependencies and reorient economic links to the EU member states.* Additionally, what the comparative analysis of the three countries suggests is that *the population's trust in the government and stronger consensus on domestic policies among elites also reinforces the consistency of domestic and European policies by reducing policy changes caused by election cycles.* Estonia's fiscal policy, which allowed the country to join the euro zone in 2011, is a good illustration of this argument.

In most other European policy areas, the Baltic States have remained passive policy-takers, with some temporary exceptions. One example of strong initial support of the three Baltic States, at least in rhetoric, was the case of the original version of Services Directive.<sup>11</sup> Lithuanian and, to some extent, Latvian authorities have also been supportive of the EU's protectionist external policy measures: interacting with the executive government, the competitive position of domestic economic interest groups has been the prevailing

<sup>11</sup> Akule, D., *Latvia. The EU new member states as agenda setters in the enlarged European Union*, Sofia, Open Society Institute, 2009, available at [http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport\\_OSI-Sofia\\_EuPI\\_April2009\\_.pdf](http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport_OSI-Sofia_EuPI_April2009_.pdf); Veebel, V., *Estonia. The EU new member states as agenda setters in the enlarged European Union*, Sofia, Open Society Institute, 2009, available at [http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport\\_OSI-Sofia\\_EuPI\\_April2009\\_.pdf](http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport_OSI-Sofia_EuPI_April2009_.pdf); Kolyta, S. Žeruolis, D., „An overview of Lithuania's five years membership in the internal market of the European Union: pre-accession efforts, impact and current trends”, *Annual Review of Lithuanian Political Science 2008*, Vilnius: Institute of International Relations and Political Science, 2009, p. 101-155.

explanatory variable behind these national preferences, which seem at odds with the usual policies of open and small economies<sup>12</sup>. In the area of external trade policy, Estonia is different from the other two countries, since its policy consistently supports trade openness thus demonstrating a continuation of its liberal pre-accession regime. During the negotiations of financial perspective for 2007-2013 and preparation of national position of the EU budget review during 2007-2008, the support for the status quo seems to have been a dominant logic explained by the net recipient position of these countries, although Estonia stands out as a supporter of the Common Agricultural Policy reform.<sup>13</sup> Only in very few cases have the European policy issues become a matter of domestic party politics. One of them is the closure of the Ignalina nuclear power plant, which, perceived by the Lithuanian public as an unjustified accession obligation, was used as a pre-election issue and manipulated by some parties calling for a referendum on this membership condition. Another instance has been the suggestion to recognize the Stalinist crimes, raised by a country's representative in the EU institutions.

These arguments are elaborated in the following sections. First, the main European policy priorities of the three Baltic countries since their accession into the EU are presented. Then a discussion follows on the record of these policies as well as the successes and failures of the relevant countries in uploading their policy priorities into the EU agenda. The article is concluded by preliminary observations on the logic of preference formation and participation in the EU decision-making process.

## **2. Achievements and limits of active European policy: “accession leftovers”**

Even before the actual accession into the EU, the governments of the Baltic States started the process of formulating national preferences and priorities of their European policy. There have been several instances of active Euro-

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<sup>12</sup> Elsig, M., „European Union trade policy after enlargement: larger crowds, shifting priorities and informal decision making“, *Journal of European Public Policy*, 17 (6), September 2010, p. 781-798.

<sup>13</sup> Lessenski, M., *Not your grandfather's Eastern bloc. The EU new member states as agenda setters in the enlarged European Union*, Sofia, Open Society Institute, 2009, available at [http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport\\_OSI-Sofia\\_EuPI\\_April2009\\_.pdf](http://eupi.osi.bg/fce/001/0070/files/ComparativePolicyReport_OSI-Sofia_EuPI_April2009_.pdf).

pean policy efforts that originated from the EU agenda. These comprise the Services Directive, negotiations on the Financial Perspective 2007-2013, and preparation of the position on the new EU budget review. In most cases, when the issue was triggered by the EU agenda, the leading role in the process of policy formation was played by senior executives in the line ministry responsible for the relevant issue (frequently the Ministry of Foreign Affairs).

For example, in the case of Services Directive, which was arguably the main EU integration initiative in the field of internal market in the post-accession period, Lithuania's national preferences were based on senior civil servants (former members of the accession negotiations team) driving the preference formation process alongside interacting with the (rather passive) domestic economic interest groups and experts who, on the basis of market access arguments, favored strong support for the original version of the Services Directive.<sup>14</sup> It was one of the few cases when Lithuania's bargaining behavior did not correspond to the logic of a "good European", since Lithuania preferred to abstain from supporting the watered down version of the Directive (interestingly, despite their support for further completion of the internal market, Latvia and especially Estonia did not ally with Lithuania). However, the subsequent preparations for the implementation of the adopted Services Directive were slow and kept lagging behind the schedule, which may be explained by the lack of awareness of businesses and policy elites who were quite passive throughout the entire process of negotiations. The contrast between active support for the initial version of the Services Directive and a very passive approach towards the implementation of its revised version has been assessed as damaging the credibility and image of Lithuania among its EU partners.<sup>15</sup>

Negotiations on the Financial Perspective 2007-2013 were another test of preference formation and bargaining within the enlarged EU. Again, in this case the argument that national preferences were aimed at maximizing the net balance between contributions into the EU and receipts from the Union had been confirmed, and the Baltic States, like most other net receivers, accepted the deal drafted by Great Britain and other major contributors to the EU budget, even though it did not correspond to the initial demands of these

<sup>14</sup> See Kolyta, S., Žeruolis, D.

<sup>15</sup> Kolyta, S., Žeruolis, D.

countries.<sup>16</sup> The Baltic countries were pressing for the structural support to be linked more proportionally to the economic development of each member state and emphasized their specificity requiring an exception from the 4 percent of GDP ceiling rule until the very last night of the negotiations in December 2005. Finally, the new member states agreed to a deal as they stood to benefit from the EU budget anyway. This was exploited by Great Britain, which proposed to reduce the structural support already on the table just weeks before the Summit. After the symbolic proposal of the Presidency to increase funding for the closure of the Ignalina nuclear power plant, Lithuania supported the final deal. In public, it was presented as a major victory of Lithuanian diplomacy.

Although these bargains arguably present the most important cases of negotiations on regulatory and redistributive issues in the enlarged EU, this paper focuses on two other categories of European policy priorities, which have been stressed by the authorities of the Baltic States since the latter's accession into the EU. One category includes what could be referred to as "leftovers" from the accession process, namely joining the euro zone and the Schengen area. The other category includes energy policy and the Eastern Neighborhood Policy, where all three countries have been actively trying to upload their preferences on the EU agenda and to achieve their objectives by Europeanizing (EUizing) their domestic policy problems or bilateral relations with EU neighbors. These European policy priorities have been regularly stressed by Baltic policy makers in their speeches and in the main strategic policy documents initiated by the diplomats since the completion of the accession negotiations.<sup>17</sup>

However, the progress of achieving the main objectives in these European policy areas has been mixed. All three Baltic States have been members of the Exchange Rate Mechanism II (ERM II) since June 2004. While Lithuania failed to introduce the euro in 2007 as had been planned, and the prospects

<sup>16</sup> See Špokevičiūtė, R. Žeruolis, D., „Dovanotam arkliui į dantis nežiūri? Lietuvos derybos dėl Europos Sąjungos 2007-2013 metų biudžeto“ [„Don't look a gift horse in the mounth? Lithuania's negotiations over the European Union financial perspective 2007-2013“], *Politologija*, 2007, 48 (4), p. 23-86.

<sup>17</sup> Valionis, A., „Konvento eigos ir rezultatų vertinimas“ [„Assessment of the work of the Convention and its results“] in: *Konventas, Konstitucija ir Europos Sąjungos Ateitis 2002-2003*. Vilnius: Firidas, 2004, p. 82-83.

of doing so remained quite remote, Latvia and Estonia discarded their plans for 2007 at an early stage, but later managed to meet the convergence criteria for joining the euro zone in 2011. All three Baltic States joined the Schengen area by the end of 2007. Progress in Europeanizing energy policy issues and the neighborhood policy agenda has been slower than expected, with some initiatives in the relevant areas adopted at the EU level, while others ignored by EU partners, delayed or reversed in the domestic arena. Although the process of learning and adapting to the EU routines could still be seen as an important restrictive factor, it is argued that the main failures to achieve the key European policy objectives were due to the inconsistency and low credibility of Lithuanian and Latvian policies linked to the accomplishment of these objectives, divergence of interests of European policy-makers (first of all, senior bureaucrats) and economic interest groups, thereby hindering a consistent adoption of policies and projects characterized by long-term implementation periods. Estonia presents a different case in this respect, with much higher consensus among political elites and general public, coherence among its domestic and European policies, and consistency of policies during longer time periods without reversals linked to political cycles.<sup>18</sup>

Thus, the biggest failure of Lithuania's European policy, as perceived in the country, was arguably the failure to join the Economic and Monetary Union (EMU) in 2007. It resulted from domestic fiscal and regulatory policies inconsistent with the objective of rapid introduction of the euro. The accession into the euro zone had been seen as part of a broader process of joining the EU, since, according to the Accession Treaty, the country committed itself to introduce euro as soon as the relevant convergence criteria had been met. It should be noted that in 1994, Lithuania adopted a currency board arrangement which was based on several pillars including a fixed exchange rate in relation to an anchor currency. Although at the beginning the US dollar was chosen as an anchor due to its importance for the country's economy, in 2002 it was replaced by the euro.

The currency board regime with the national currency's fixed peg to the euro has been a cornerstone of the strategy of adopting the euro. Formal ac-

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

cession into the ERM II on June 28, 2004, less than two months after joining the EU, formed the basis for the monitoring of how the country stood with respect to nominal convergence criteria. It should be noted that, at the time of joining the ERM II, Lithuania sought “to secure a balanced budget over the medium term” as well as to undertake structural reforms aimed at further enhancing economy’s flexibility and adaptability “in a timely fashion”.<sup>19</sup> However, these aims were not achieved in the years of high economic growth, despite the fact that the European Commission and a local expert community routinely criticised the Government because of its pro-cyclical fiscal policy, inability to balance the budget, and lack of structural reforms. Similar recommendations were proposed by IMF analysts who, after conducting an analysis of economic trends of Lithuania alongside other countries with currency boards, came to the conclusion that currency board arrangement could satisfy all the requirements of a regime leading towards the accession into the EMU and could even be the first-best policy for these countries.<sup>20</sup> Importantly, it was noted that, if the countries wished to preserve the viability of their currency board arrangement during while preparing for the introduction of the euro, they were to maintain fiscal policy discipline and preserve flexible labour markets, something which proved to be essential during the economic crisis in 2008-2009.

In 2005-2006, it seemed that there was a window of opportunity for Lithuania and Estonia to swiftly join the euro zone together with Slovenia in 2007 (Latvia had already been exceeding the convergence criteria). Lithuania and Estonia met all nominal criteria at the time, although as the time of formal application and the evaluation of the countries’ compliance with the Maastricht criteria approached, inflation was picking up. However, differently from Estonia, which decided to withdraw its application for the assessment of its readiness to adopt the euro in 2007, Lithuanian policy-makers were determined to proceed. In March 2006, Lithuania applied to be assessed for its readiness to adopt the euro.

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<sup>19</sup> European Commission, Commission assesses the state of convergence in Lithuania. – IP/06/622, Brussels, European Union Communique, 27 June 2004. 16 May 2006, available at <[http://ec.europa.eu/economy\\_finance/publications/publication6170\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication6170_en.pdf)>, 12 20 2009.

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

However, despite the official willingness to undergo the assessment procedure and the apparent certainty that the country was ready to join the euro zone, there was a lack of well-articulated political consensus on this goal. Although it was stated in the strategic programs and strongly supported by the Central Bank and the MFA (also senior bureaucrats in the Ministry of Finance) as well as by the community of analysts, some key actors in the Government were reluctant to advocate the adoption of euro both at home and in their negotiations with EU institutions. To some extent, this was a reflection of a rather reluctant public, which was not as supportive of membership in the euro zone as compared to the relatively strong enthusiasm regarding membership in the EU. Judging from the results of several public opinion polls, the main concern for the public had to do with the fear of prices shooting up following the introduction of the euro.<sup>21</sup> Interestingly, after Lithuania's failure to introduce the euro in 2007, the share of population favoring the adoption of the euro increased, although even then it was still below 50 percent.

It should also be noted that the reluctance of some political leaders in Lithuania to support in public the goal of joining the euro zone was also reflected in the lack of consistency and viability of euro-oriented policies. The lack of budgetary discipline, certain decisions in the area of regulated prices (energy, transport), expansionary policy during the period of fast economic growth and rising wages contributed to the acceleration of inflation throughout 2005-2008 as well as to the rapid growth of budgetary deficit and debt since 2008. Although global market trends, especially the rise in energy and food prices, and the one-off effects of joining the EU customs union had impact on price rise in Lithuania, domestic demand pressures have also been shown to contribute to this inflationary trend. For example, IMF analysts emphasized the importance of the nontradables inflation, which pointed to the importance of increase in regulated prices and growing domestic demand; it was recommended to adopt, for the time being, a conservative fiscal stance in order to contain future inflationary pressures in Lithuania.<sup>22</sup> The decisions to allow for the indexation of the assets owned by energy companies in 2004,

<sup>21</sup> Eurobarometer Surveys are available at <[http://ec.europa.eu/public\\_opinion/euro\\_en.htm](http://ec.europa.eu/public_opinion/euro_en.htm)>, 12 20 2009.

<sup>22</sup> Ohnsorge, F., Igan, D., Lugaesi, S., Republic of Lithuania, Selected Issues, *IMF Country Report* 06/163, 2006.

which increased the room for the regulated prices to be raised, as well as the regulatory policy measures allowing for the increase in public transport prices, also added to the inflationary pressures which came into effect in 2005 and the subsequent years.

Thus, while the monetary policy was clearly targeted towards the adoption of the euro as soon as the two years of membership in the ERM II had elapsed, other economic policies, in particular, budgetary policy and certain regulatory decisions, were inconsistent with this goal. The contradicting public statements of some ministers of the Government illustrate the hesitancy of the political elite and the gap between the officially declared goal and the actual policy efforts.

In spring 2006, Lithuania's compliance with the Maastricht criteria was evaluated by the European Commission and the European Central Bank. The conclusion which both institutions made and which was submitted to the European Council in June 2006 stated that "Lithuania meets all the convergence criteria except the one on inflation. The average rate of inflation has been slightly higher above the reference rate value since April 2005 and is expected to rise gradually until the end of the year".<sup>23</sup> The recommendation was that there should be no change in Lithuania's status as an EU member state with a derogation. Although Lithuania's leaders attempted to convince the heads of other member states at the June 2006 Summit that, since the difference was less than 0,1 percent (the average inflation rate in Lithuania was 2,7 percent while the reference value was 2,6 percent), this was not an obstacle to euro adoption in 2007, the conclusions of the Summit approved the negative opinion of the EU institutions.

Despite the fact that later on the goal of joining the euro zone in 2010 was voiced, with the inflation accelerating and the prospects of euro adoption becoming more distant, this goal was abandoned in favour of a more flexible formula of "as soon as country meets the convergence criteria". It should be noted that the Law of Fiscal Discipline, which had been advocated by some analysts for a number of years, was finally adopted in November 2007 with a view to facilitating the achievement of the cyclically balanced budget and the introduction of euro. However, this was a step taken too late and when

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

the time came for it to be tested (the intention was to have a balanced budget in 2009), the start of the economic decline made this law largely obsolete due to its emphasis on restricting expenditure growth. With the economic decline starting in the end of 2008 and accelerating in 2009, budgetary revenues declined significantly while expenditures, which had been raised before the Parliamentary elections of 2008, were not reduced correspondingly (even though they were adjusted downwards to a significant degree several times throughout 2009). By the end of 2008 and for the first time since it joined the EU, Lithuania exceeded the budget deficit criteria of 3 percent and reached 9,5 percent of GDP in 2009. The state debt grew rapidly reaching 38 percent of GDP in 2010 from just around 16 percent in 2008.<sup>24</sup> This rapid increase of fiscal deficit made the prospects of introducing euro quite distant. Although in 2009-2010 Lithuanian government managed to contain further worsening of fiscal deficit and set itself a target of bringing it down to 2,8 percent in 2012 (which could allow joining the euro zone in 2014), it is still an uncertain prospect, not least because of the parliamentary elections set for 2012.

On the other hand, the Estonian example shows how the consistency of domestic fiscal policy can contribute to the effectiveness of European policy. The country has been constantly running budgetary surpluses in the times of high economic growth since its accession into the EU (while Lithuania and Latvia did not manage to balance their budgets). This has been an important factor easing the pressure on country's public finances since the beginning of the economic crisis in 2008 thereby allowing the country to meet the convergence criteria and join the euro zone in 2011.<sup>25</sup>

Lithuania's attempt to adopt the euro in 2006-2007 has probably been one of the most debated cases in the history of euro zone enlargement. The rejection of Lithuania's application by the European Commission and the European Central Bank on the basis of missing the inflation criteria has been criticized by analysts and policy makers leading to more general debates about the nature of convergence and the meaning of the Maastricht criteria as applied to new member states. Criticisms regarding the methodology of calculating inflation criteria as well as the inconsistency of applying the convergence

<sup>24</sup> European Commission, European economic forecasts Spring 2011, available at <[http://ec.europa.eu/economy\\_finance/eu/forecasts/2011\\_spring/lt\\_en.pdf](http://ec.europa.eu/economy_finance/eu/forecasts/2011_spring/lt_en.pdf)> , 13 05 2011.

<sup>25</sup> Kuokštis, V., Vilpišauskas, R.

criteria to euro zone members and candidate countries have been raised.<sup>26</sup> A very strict interpretation of convergence criteria applied to the new member states in the context of a number of the founding eurozone members seen as breaching the criteria at the time of the creation of the EMU and the relaxation of Stability and Growth Pact provoked claims about the application of double standards<sup>27</sup>. The evidence of Greece providing false data on meeting the convergence criteria while the true state of its public finances was publicized in 2009-2010 further strengthens these criticisms. However, what is important for the present analysis is that it was inconsistent and non credible fiscal and regulatory policies coupled with disregard for the recommendations of the European Commission and the IMF that stood behind the failure to convince EU leaders that Lithuania was ready to join the EMU. Intense diplomatic efforts and even broad support of European expert community did not help to compensate for the domestic political inconsistencies.

Although the failure to introduce the euro did not result in political resignations, it had an important effect on Lithuanian policy-makers. It is quite possible that the fear of a similar failure with regards to the country's accession to the Schengen area of free movement of people was behind the intensified efforts to prepare the country and convince the EU to enlarge the Schengen area in the end of 2007. To be sure, the framework of accession into the Schengen area is very different from the EMU accession in terms of conditions which a country has to meet. Instead of broad economic trends in the case of EMU, the main focus of joining the Schengen area is on the border infrastructure and information sharing systems, which are more directly influenced by state institutions. Besides, in this case it was the delay on the part of the EU institutions and some incumbent EU members who threatened the initial plans adopted

<sup>26</sup> Vilpišauskas, R., „The Political Economy of Eurozone Enlargement: the Motives, Prospects and Implications for the EU and its Member States“, in: Roy, J., Gomis-Porqueras, P., eds., *The Euro and the Dollar in a Globalized Economy*, Aldershot : Ashgate, 2007, p. 149-162; Vilpišauskas, R., „Economic and political challenges of Lithuania acceding to the Euro area“, in a comparative volume *Economic and political challenges of acceding to the euro area in the post-Lehman Brother's world*. Country Report. Sofia: OSI, 2009.

<sup>27</sup> Willem Buiter has been among the most vocal critics of the strict interpretation of the Maastricht criteria by the ECB and the European Commission in case of Lithuania (see his blog <<http://blogs.ft.com/maverecon/>> accessed 04 18 2009). For a similar criticisms see Begg, I., *Economic Governance in an Enlarged Euro Area*, European Economy, Economic Papers 11, March 2008; De Grauwe, P., *The politics of the Maastricht convergence criteria*, available at <<http://www.voxeu.org/>> 04 20 2009.

in 2006 on enlarging the Schengen area. Lithuania and Slovenia showed initiative by supporting Portugal's proposal (the so-called SISone4All project), which aimed at overcoming the possible postponement of a new information system (SIS II) threatening the timely enlargement of the Schengen area.

Although during the early stages of the preparation of the infrastructure there was some criticism of Lithuanian authorities by the European Commission and some questions regarding the use of resources for the enhancement of border protection facilities were raised, Lithuanian institutions were quick to respond to these criticisms. This allowed Lithuania, alongside eight other EU members, to join the Schengen area in December 2007 for the ground travel controls, and in March 2008, for travel control in airports. This had an important symbolic meaning as it showed visibly the benefits of enlarged and united Europe for the citizens of its member states.

### **3. Achievements and limits of active European policy: becoming selective policy initiators**

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

It has been maintained that Lithuania had favourable structural conditions to influence EU's energy policy – the latter has been in the process of being seriously drafted just at the time of EU's enlargement in 2004, besides, due to its high energy vulnerability, Lithuania had strong incentives to actively upload its national preferences on the EU agenda and to use EU's policy instruments to further its national goals.<sup>28</sup> However, on closer examination, one can state that the record has been mixed. On the one hand, like Estonia and Latvia, Lithuania has consistently emphasized the issue of its isolation, the existence of the Baltic States' "energy island in the EU", and the dependence on supplies from Russia. These issues have been recognized by the EU in a number of its documents. For example, the Baltic States were mentioned as an isolated "energy island" separated from the rest of the EU in the Green book on the Sustainable, Competitive and Secure EU Energy Strategy issued by the European Commission in 2006. A provision on the importance of infrastructure projects ensuring the security of energy supplies was included in the Lisbon Treaty.

Lithuanian authorities also used the opportunity of the climate change debate which took place in the EU in 2007-2008 to link the issue (in particular, the allocation of emissions) to the closure of the Ignalina nuclear power plant and the need for additional compensations from the EU to Lithuania. Eventually, the EU decided to give Lithuania additional rights to emission quotas (depending on the actual need) and allocated financial support for the electricity bridge from Lithuania to Sweden as part of its Economic Recovery Plan adopted in December 2008. Most importantly, in June 2009, the EU adopted a Baltic Energy Market Interconnection Plan (BEMIP), which provided the basis for the implementation of electricity links and integration of the Baltic States into the EU energy market. The European Commission also raised the issue of the Druzhba pipeline in EU-Russia summits. Furthermore, the recent February 2011 EU Council Conclusions have stated that 'The EU needs a fully functioning, interconnected and integrated internal energy market' and the deadline of 2014 was set up for gas and electricity "to flow freely".<sup>29</sup>

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<sup>28</sup> Vaičiūnas, Ž., „Europos Sąjungos bendros energetikos politikos formavimasis ir Lietuvos interesai“ [Formation of European Union common energy policy and the interests of Lithuania], *Politologija*, 55 (3), 2009, p. 89-120.

<sup>29</sup> Conclusions of the European Council, EUCO 2/11, Brussels, 4 February, 2011.

On the other hand, the actual state of affairs in the field of energy in the beginning of 2010, when the Ignalina nuclear power plant was finally closed due to the accession commitments, was that Lithuania's dependence on supplies from Russia (natural gas used for electricity generation and electricity imports) had actually increased compared to the pre-accession years, while integration with the EU was practically non-existent (except for the old Soviet links with Latvia and Estonia with the latter being linked by electricity cable to Finland). It was the inconsistency of domestic energy policy that was the main reason behind the lack of progress in implementing the electricity power bridge and new nuclear power plant projects with their deadlines constantly postponed. This inconsistency was an outcome of the mismatch between the rhetoric of policy-makers, in particular diplomats, who supported integration projects and the creation of a European market, and economic interest groups, which could lose from these projects or had different interests, mostly in maintaining the current links to Russia<sup>30</sup>. It seems that there was a lack of a powerful economic interest group (industrial users of electricity, for example) which would be interested in lobbying projects integrating Lithuania's and Latvia's electricity and natural gas market into the EU networks, while there was a number of groups interested in preserving the existing links with Russia. Therefore, while the lack of interdependence with the rest of the EU was acting as an incentive for policy-makers to push for the Europeanization of the energy policy of Lithuania and other Baltic countries and for the integration into the EU market, the dependence on Russia acted as an incentive for economic interest groups, such as industrial producers using imported gas, importers of natural gas and electricity of to preserve these links.

The credibility of Lithuania was particularly damaged by the lack of progress in implementing projects which had been politically agreed upon and declared in several National Energy Strategies. For example, the Strategy adopted in 1999 stated that generation facilities (possibly including a new nuclear reactor) which were to replace the RBMK-type Ignalina nuclear power plant reactors, would have to be build by 2009. However, in 2009 (and further into 2011), after several feasibility studies had been conducted, the debate on whether

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<sup>30</sup> See Smith, K. C. *Lack of Transparency in Russian Energy Trade. The Risks to Europe*. Center for Strategic and International Studies, Washington, D.C., July 2010; Vilpišauskas, R. „Wider energy perspectives for Baltic countries“, in *The Riga Conference Papers*, Riga: LATO, 2011.

Lithuania needed a new nuclear power plant was still ongoing and the process of constructing new co-generation facilities just began. A renewed Strategy adopted by the Parliament in 2002 stated that, in 10 years, Lithuania's energy systems were to be fully integrated into the EU – a target which will definitely be missed. The attempts to compensate for these delays by trying to convince the European Commission to reopen the issue of and postpone closing the second reactor of the Ignalina nuclear power plant have undermined Lithuania's credibility and risked its image as a country which does not honour its obligations. Finally, the breaking-up of the National electricity company into several separate entities (production, transmission and distribution facilities), some of which were privatized; later, the creation of the controversial National champion Lithuanian Energy Organization modelled on the example of the Czech Republic National energy company, which was dismantled just about one year later in 2009 to create, again, an integrated state-owned national energy company, an ambiguous and changing position on the Third energy package announced by the European Commission in 2007 – all these instances of inconsistent and contradictory policies, which have been regularly modified after the elections or a change in the Cabinet of Ministers alongside lobbying efforts of certain interest groups prevent Lithuania from successfully Europeanizing energy issues and, with the support of EU financial and political resources, from tackling national issues and reducing domestic vulnerabilities. Moreover, Latvia and Lithuania were drawn into mutual disagreements regarding regional energy projects. One example is a dispute which took place between Latvia and Lithuania in 2008-2009 on the issue of where the electricity power bridge from Sweden to the Baltic States should be constructed. After having delayed the project for over a year, the issue was resolved mostly due to EU involvement and provision of EU funding for the domestic electricity infrastructure in Latvia. Again, Estonia seems to be most consistent in aligning domestic efforts with European policy and is the only country which managed to construct connection to Finland. Each of the Baltic States seems to be choosing its own method of implementing the 3<sup>rd</sup> energy package directives with different options of unbundling, in natural gas sector in particular; each of them also plans to build its own LNG terminal. Domestic regulatory differences, which reflect lobbying of domestic interest groups, not only complicate coordination of policies among these countries, but also their efforts at uploading their preferences onto the EU agenda.

The energy policy issues are closely linked with the Eastern Neighbourhood Policy. Increasing the diversity of sources and routes of energy supplies (electricity and natural gas) has been one of the policy objectives advanced by the Baltic States in relation to the EU Neighbourhood Policy. The intention was voiced at a number of international conferences organized by the authorities in these countries. Lithuania has been particularly active trying to position the country as the centre of the region which included both EU and non-EU neighbouring countries and which resembled, somewhat, the territory of the Grand Duchy of Lithuania of the 15<sup>th</sup> century (later Polish-Lithuanian Kingdom).

Overall, over the first five years of EU membership, Lithuania modelled its role in the neighbourhood policy on the basis of historical references and attempts to reduce energy vulnerabilities, rather than existing economic interdependences. This implied particular emphasis on the partnership with Poland and attention to Southern-Eastern neighbours, such as Ukraine and Moldova reaching to the Caucasus, namely, Georgia. This was manifested primarily in support for democratic and economic reforms in these countries (The Orange revolution in Ukraine and The Rose revolution in Georgia), where Lithuania's and Poland's leaders acted as mediators in domestic reforms linked to their closer relations with the EU. Lithuania, as well as Latvia and Estonia, directed its technical assistance efforts to support reforms in these countries. After Lithuanian Parliamentary elections in 2008 and Presidential elections in 2009, the focus shifted somewhat to reflect more the actual economic interdependences of investments and trade, and emphasis has largely been placed on closer cooperation with the countries of the Baltic Sea Region (a return to Baltic-Nordic cooperation) alongside Belarus and Russia. Actually, all three Baltic States have been active in promoting closer EU ties with Eastern partnership countries. For example, Estonian political leaders have been active in Georgia with former Prime Minister M. Laar advising Georgian President on domestic reforms. However, unlike Lithuania, Estonia kept lower public profile in promoting its role among the Baltic countries in their support to Eastern neighborhood countries and rather positioned itself as a Nordic country.

The active efforts of the Baltic States to promote EU's relations with its Eastern neighbors seem to be an outcome of the EU enlargement shifting the boundaries of the Union to the East, and a consequence of being border countries of the Union with relatively intense economic links with their Eastern and

Southern neighbors. Efforts to bring these EU neighbors closer to the Union by promoting reforms which allow for closer integration can be explained by both economic interdependence and value-based approaches. It is rather difficult, however, to assess the effectiveness of these efforts to influence the EU Eastern Neighborhood Policy (and it is even more challenging to assess the effectiveness of EU policy towards its neighbors). There has been a growing attention of the EU to its Eastern neighbors, which was particularly manifested in the adoption of the Eastern Partnership (initially proposed by Poland and Sweden) in 2009 and the promise of Deep and Comprehensive Free Trade Agreements and Visa Facilitation agreements with these six Eastern Partners.

On the other hand, the actual progress of reforms in these countries has been very different depending on the country and has been influenced by the domestic factors (change in the party in power, as, for example, in Moldova or Ukraine) as well as growing Russia's influence in the region.<sup>31</sup> The prospects for closer relations with the EU in terms of liberalized trade and persons' movement also remain quite distant, even in the cases of Ukraine and Georgia. The slow progress of reforms in most of EU neighbors, the need to reinforce infrastructure projects which should integrate the Baltics into the EU market and other measures to reduce the vulnerabilities of their economy, in particular, in the background of fiscal austerity, might reinforce the tendency to shift attention and focus on home rather than more distant neighboring countries.

## **Conclusions**

Early experience of participating in the EU decision-making process provides some grounds to argue that even small countries like Estonia, Latvia and Lithuania can be heard at the "EU table" given the fact that their preferences are formulated and presented consistently, their policy is credible and coherent with domestic actions as well as consistent in time. This is illustrated by the case of their accession into the Schengen area, by Estonia joining the euro zone and by the adoption of the Baltic Energy Market Interconnection Plan. However, such cases of successful uploading of national preferences onto the EU agenda have been rare. Moreover, even in the cases of priority areas, such as euro adoption,

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<sup>31</sup> Lavenex, S., Schimmelfennig, F., „EU rules beyond EU borders: theorizing external governance in European politics“, *Journal of European Public Policy*, 16 (6), 2009, p. 791-812.

energy market integration or closer relations with Eastern neighbours, the active efforts of senior bureaucrats and diplomats have not been successful.

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

It can be maintained that the logic of being a “good European” and consensus-seeking to achieve a fast agreement, which was dominant during the accession negotiations and the EU Treaty bargains, still prevails in the national European policy. The process of the formation of national preferences is mostly reactive and is driven by the EU agenda. This tendency is likely to remain unchanged in the future thereby reflecting the conventional wisdom concerning the behavior of small and open economies in the EU. However, a possibility to influence EU decision-making, “to be at the table” and not only be heard, but also listened to, has been one of the benefits of EU membership, emphasized by the political elites during the accession process. Moreover, as other studies of EU politics demonstrate, under certain conditions, small member states are indeed able to exert influence extending beyond their formal voting powers in EU institutions. Coherence among the country’s policies and their consistency over time in order to help strengthen the credibility of their demands and to improve opportunities to be heard in Brussels is the key factor stressed in this article. Another challenge for the European policy of the Baltic countries is the question how to improve the effectiveness of implementing priority policies, such as energy policy, where the EU offers a potential of reducing vulnerabilities and solving collective action problems.