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The Euro as a Tool to Increase the Security Level of Lithuania

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Lithuania, as a result of restrictive monetary policy and an austerity approach to public finances, has received final approval from the Council of the European Union on the introduction of the euro in January 2015. Lithuania will be the last among the Baltic States to adopt the common currency. This will increase not only the level of economic security, but also strengthen the position of Lithuania as a trading partner, especially in the face of increasing confrontation between the EU and Russia. The Ukrainian–Russian conflict, which has changed the conditions of economic cooperation in the region, has forced Lithuania to rethink its unstable cooperation with Russia, and therefore Russia's aggression has persuaded the previously eurozone-sceptic centre-left government in Vilnius to implement the euro rapidly.

Ready Again, so What Now? Lithuania has fulfilled the convergence criteria required to enter the eurozone with a low inflation rate of 0.6% (the limit is 1.7%) and by maintaining public debt below 40% of GDP (the maximum is 60%) and keeping the budget deficit clearly under 2% (the limit is 3%). In 2006, it could not introduce the euro because inflation was too high, albeit by less than 0.1%. However, it must be added that, under the circumstances in which the Lithuanian authorities managed the country's finances fulfilling the relevant criteria in the economic crisis was much more difficult and required greater determination. The global recession and the financial crisis in the EU, including the need to reform fiscal policy, removed Lithuania's prospects of joining the eurozone. It also had a negative influence on the Lithuanian ruling authorities and caused scepticism among the greater part of Lithuanian society. Moreover, when Andrius Kubilius lost power to the left-wing populists in the 2012 election, Lithuania's prospects of joining the eurozone diminished. This was mainly due to the demands of a society clearly tired of the crisis and of austerity measures, and easily swayed by populist promises.

Meanwhile, Lithuania, along with other Baltic States, quickly pegged its currency, and entered ERM II. This resulted in a fixed exchange rate being set for the Lithuanian currency, but also in limitation of the central bank's ability to manage monetary policy, preventing, for example, the use of the mechanism of interest rates. The litas, in practice pegged to the euro strongly associated Lithuania with the eurozone, but costs resulting from charges for bank transfers or conversion were still incurred.

At the same time, the economic crisis required restrictive financing. This was associated with the need to cut spending and reduce taxes (including approximately 20–40% lower wages in public administration, and reduced pensions and social benefits). Then, Lithuania lost a number of strategic investors (mainly in the banking, real estate and construction sectors), which was associated with the outflow of foreign capital and a clear reduction in the purchasing power of domestic consumers. The economic downturn has affected the banking sector in Lithuania, which is largely dominated by Scandinavian subsidiaries, and additionally weakened by the impact of corruption at Snoras—one of the largest commercial banks and one in which Russian capital dominates.

The Enthusiasm of the Authorities vs. the Concerns of Lithuanian Society. The optimism of the Lithuanian authorities, though by no means unanimous (the leaders of the coalition parties in the European Parliament, Waldemar Tomaszewski (Electoral Action of Poles in Lithuania) and Rolandas Paksas (Order and Justice), voted against introducing the euro to Lithuania) does not reflect the enthusiasm of Lithuanian society. More than half of the population of Lithuania (52%) remain opposed to the introduction of the euro, although Lithuanians have reacted more calmly to it than Latvians or Estonians as there is relative calm in the real estate market and clearly less willingness in Lithuania to invest in gold and other precious metals. This also reflects the lower level of wealth in Lithuanian society, and their investment opportunities in general.

The greatest concerns of the average citizen are associated with the expected increase in prices, and further order fluctuations resulting from changing currency loans, wages, and social benefits, particularly pensions. Although the relevant institutions in Lithuania will retain control of companies and direct sellers of goods and services with regard to the conversion of the litas to the euro, the experience of other countries that have recently adopted the euro suggests that higher prices for basic goods (on average, 5% per annum) should be expected in the initial period. There are indicators that current prices will rise, even a few months before the introduction of the euro, and before sellers are obliged to inform the public about the price in both currencies (August 2014.).

Meanwhile, Lithuanians are still waiting for compensation for unpaid wages from the period of economic downturn in 2008–2010, and there is public debate on the issue of raising the minimum wage to 1,200 litas (€350) per month. Moreover, objections to the euro rise from the fact that Lithuania will have to bear costs on entering the eurozone. As the EU has adopted the European Stability Mechanism (ESM), when Lithuania joins the eurozone as a member state it must find between €0.8 and €3.6 billion, primarily aimed at strengthening the fiscal and financial support security systems. These obligations have just caused Estonia's public debt to double, from €0.8 to €1.6 billion.

Regional Conditions. Although the adoption of the euro by Lithuania seems to be a logical consequence of its 1990s strategy for European integration, the planned date of introduction of the common currency is a result of geopolitical circumstances. The Ukraine–Russia conflict mobilised the ruling party to withdraw the national currency and to join the eurozone mainly on the grounds that Lithuania defines its security, including in the economic dimension, very broadly. Russia remains an important trading partner, with an average share of over 10% in imports and exports. Furthermore, because of the influence of Russian capital in Lithuania's economy, and particularly if relations between Russia and Lithuania were to deteriorate, Moscow's financial decisions are felt strongly in Lithuania. In such a situation, the ruling Social-Democrats, who generally advocate closer cooperation with their Russian partners, have raised the need to seek alternative markets to ensure greater stability. In 2014 compared to the first five months of 2013, Lithuanian exports of meat products and foodstuffs to Russia decreased by more than 11%, even before Russia imposed its import ban EU countries and others in August this year. At the same time, the Versli Lietuva Lithuanian agency intends to spend 2.5 million litas for the promotion of national exports. Lithuania is also rather sceptical when it comes to possible EU compensation due to Russian sanctions, which may result in a decrease of 0.2% in Lithuanian GDP.

Adopting the euro promises to attract foreign investors, but this could be problematic for Lithuania, given that it is the last of the Baltic States to join the eurozone, and that Estonia has the most transparent market rules of the three. And, while foreign investors treat the Baltic States as one unit, they are not quite right; for Estonia, Latvia and Lithuania are, after all, somewhat diverse markets, especially in terms of business culture. Lithuania had to decide on the introduction of the euro, a difficult decision that required the maintenance of relatively restrictive financial policy in the face of growing public dissatisfaction. In addition, due to Russia's military action in Ukraine, the Lithuanian authorities not only have to compensate for expenses related to the armaments sector and recapitalising the army, but must also increase defence funding to 2% of GDP. Compare this to 2008–2010, when funding for the military was reduced by more than 30% in Lithuania, which currently spends less than 1% of GDP on defence.

Conclusions. The consistent policy of the Lithuanian authorities is logical in view of the goal of EU integration. Although it has slowed due to the economic crisis in the eurozone, it is also a clear result of the Ukrainian–Russian conflict. Lithuania first criticised Russian aggression in Crimea more strongly than the other Baltic States, and demanded greater NATO involvement on the EU's external borders. The euro would increase the level of economic security, especially as Lithuania felt the effects of fluctuations resulting from unstable trade relations with Russia.

The Lithuanian authorities are counting on increasing competitiveness and attracting foreign capital. The euro would help to create new jobs and maintain economic growth in the coming years. Meanwhile, the real implementation of the common currency is a *sine qua non* for the stabilisation of the economy, in order to maintain competitiveness with other Baltic States already prospering in the eurozone. From the Polish perspective, if Lithuania adopts the euro, it may, contribute to increasing stability in the region, due to the regulation of relations in the markets in eastern neighbours. But it may, at the same time, result in fluctuations in the Polish market, especially in the face of Russian sanctions. Poland is an exporter of food products to the Lithuanian market, which is strongly linked to the Russian market; therefore, Polish exporters may lose existing customers both in Russia (due to sanctions), and Lithuania (due to increased competition).