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EURO ZONE CRISIS: CAUSES AND CONSEQUENCES FOR THE EURO-ATLATNIC REGION

Report for the Commission of the Euro-Atlantic Security Initiative (EASI), July 2010

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This report analyzes the causes and consequences of the 2010 crisis in the euro zone. It has been prepared by IMEMO RAN experts for the Commission of the Euro-Atlantic Security Initiative (EASI). The EASI project, launched by the Carnegie Endowment for International Peace, is implemented by the group of prominent politicians and experts from Russia, the USA and Europe with the goal to elaborate proposals on the new Euro-Atlantic security structure. IMEMO is the key partner of the project in Russia. All participants in the project see the solution of problems not through the prism of Russian-Western relations, but in the context of common threats to security. Such an approach effectively promotes the Russian vision of all-European security. The President of the Russian Federation and the Ministry of Foreign Affairs recognized as expedient the EASI project and Russia’s active participation in it.

The report gives an insight into the structural, systemic, institutional, fiscal and debt specifics of the euro zone crisis and the credibility gap on the part of financial institutions. It examines the effectiveness of the proposed anti-crisis measures and the political opportunity to carry them out in problem euro zone states, and identifies new impulses to intensify European integration as the crisis slows down the euro zone enlargement. The authors also estimate the consequences of this crisis for Russia, its economic ties with the EU, as well as post-Soviet integration dynamics.

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1. Causes of the 2010 crisis in the euro zone

The downfall of the euro exchange rate against the dollar by more than 15 percent compared with the beginning of the year – amidst the ongoing global financial and economic crisis -- provoked a series of unjustified panicky prognoses about the approaching collapse of the single European currency and a new spiral of the world crisis. Indeed, one of the euro zone members – Greece – was on the brink of default in the spring on 2010, and it was only outside assistance that bailed it out. Meanwhile, the euro continued its downfall, dipping below the 1.20 dollar benchmark in early summer. It should be borne in mind however, that the euro rate actually returned to the 2003 level after several years of "an expensive euro." In 1999, the euro traded at 1.17 dollars whereas in October, it posted the historical low of 0.82 versus the U.S. currency. By July 2010, the recovering euro climbed past the 1.25-dollar benchmark which largely fits into the long-term trend of the single European currency.

Four key features of the euro zone crisis

The opinion that the euro zone crisis if the follow-up of the global crisis or its new wave which started this time from Europe, not the USA, has no serious arguments in its favor. Furthermore, many reasons of the current euro zone crisis stem from the specifics of EU integration.

In the first place, the current crisis is structural. The presence of the countries in the euro zone and the EU with considerable differences by the level of development hampers the efforts to effectively pursue a harmonized economy policy, not mentioning a complete unification of some of its guidelines. It is not just about a considerable gap between EU countries in terms of per capita GDP. Whereas the purchasing power parity indicator for 16 euro zone countries made up 108 percent of the 27-nation European Union's average, it was just 72 percent in Slovakia, 78 percent in Portugal and Malta, 86 percent in Slovenia, and 95 percent in Greece. What is more important is the fact that not all euro zone states are successfully embracing the innovative development model, which guarantees that European states might still retain a competitive edge.

Some countries, in the first place in Southern Europe, are unable to transform their backward and uncompetitive economies in the conditions of globalization. They often view the EU and euro zone membership as the opportunity to directly improve the standard of living of their citizens, for example, within the framework of the supranational regional policy, not by exploiting some synergic effects (such as national companies' access to new sales markets or the development of cross-border production cooperation).

International statistics formally puts several problem states in the group of developed nations, just because they are EU members. In terms of labor productivity, they are far behind the leading European countries. The low quality of education, characteristic for Southern Europe, is also indicative of a low level of human capital, and the population's slow assimilation of the information revolution's achievements. On top of that, there are

large areas in Southern and Eastern Europe which are almost completely shut out from the modern "Knowledge Economy." The least developed EU countries almost have no R & D, with private business showing particularly low involvement, which reduces the opportunities for the backward countries to catch up with Europe's leaders even in the future. (see Table 1)

Table 1

Contrasts by economic indicators between EU countries

Country	Per capita GDP by PPP, % of EU-27 (2009)	Share of high-tech in exports, % (2006)	R & D spending, % of GDP (2007)	Share of business in R & D spending, % (2007)	Households with Internet access, % of (2009)	Permanent Internet users, % (2009)	Use of electronic government's services at least once in 3 months by citizens aged 16 to 74, % (2009)
EU-27	100	16,6	1,9	55	65	48	30
Euro zone-16	108	…	1,9	57	…	48	…
Slovakia	72	5,8	0,5	36	62	49	31
Portugal	78	7,0	1,2	47	48	33	21
Malta	78	53,8	0,6	52	64	45	24
Slovenia	86	4,7	1,5	58	64	47	32
Greece	95	5,7	0,6	~ 31	38	27	12
Cyprus	98	21,3	0,4	16	53	34	22
Italy	102	6,4	1,2	42	53	40	17
Spain	104	4,9	1,3	46	54	39	30
France	107	17,9	2,0	52	63	50	39
Finland	110	18,1	3,5	68	78	68	53
Belgium	115	6,7	1,9	61	67	56	31
Germany	116	14,1	2,5	68	79	55	37
Austria	124	11,2	2,5	49	70	48	39
Netherlands	130	18,3	1,7	~ 51	90	73	55
Ireland	131	29,0	1,3	50	67	40	28
Luxembourg	268	40,7	1,6	76	87	71	54
Bulgaria	~ 43	3,3	0,5	34	30	31	10
Romania	~ 48	3,8	0,5	27	38	19	6
Latvia	49	4,2	0,6	36	58	47	23

Lithuania	53	4,7	0,8	25	60	43	19
Poland	~ 58	3,1	0,6	34	59	39	18
Estonia	62	8,0	1,1	42	63	54	44
Hungary	63	20,3	1,0	44	55	46	25
Czech R	80	12,7	1,5	54	54	34	24
UK	116	26,5	1,8	47	77	60	35
Denmark	117	12,8	2,6	61	83	72	67
Sweden	120	13,4	3,6	64	86	73	57

Source: Eurostat

The credit and monetary policy in the euro zone reflects the averaged circumstances in all the countries of the Economic and Monetary Union. However, with typologically different countries, the same anti-cyclic measures can yield entirely different results in various countries. It is not possible to enhance Southern Europe's competitiveness through devaluation, given its euro zone membership, while a decrease in unit labor costs meets with a powerful resistance from trade unions. A number of Southern Europe countries began to live beyond their means as wages largely grew faster than the output per person employed. The budget's failure to keep the established standards in welfare policy, an imperfect social security system, and ineffective administration worsened the social situation.

Attempting to harmonize the national economic policy of the countries with different economic setups is not the only problem in the functioning of the Economic and Monetary Union, as it only regulated the monetary and credit policy at the supranational level, with other economic policy guidelines remaining "disunited." Therefore, the second feature of the current euro zone crisis is its systemic and institutional nature.

Unlike a monetary union, which is the exclusive responsibility of the Community, an economic union is based upon coordination of independent economic policies of the member-states. The Economic and Monetary Union countries handed over to the Community the two most important levers of national economic policy: the rights to set the interests rates and change the national currency exchange rate. Consequently, the nation states which bear the main responsibility in fighting the economic crisis found themselves stripped of the crucial instruments of anti-cyclic regulation.

Launching a single currency and a uniform monetary and credit policy was insufficient to prevent the uneven the development of the national economies. Strictly speaking, the European Central Bank (ECB) coped with its formal task to keep prices stable, cubing inflation at 2 to 2.5 percent a year (also, the exchange rate against the dollar has largely kept within long-term trends). However, in a worsening economic situation, the coordination of other economic policy guidelines regulated at the national level (within the scope of the general economic policy of the Community) turned out to be not quite adequate. An imperfect coordination mechanism decreased the effectiveness of the whole economic policy. From time to time, the ECB had disagreements with national governments regarding the way to resolve the emerging economic problems.

The third key feature of the euro zone crisis is its fiscal nature and liabilities. Long before the crisis, the euro zone states, including their leaders, began to violate the

Maastricht criteria of the Stability and Growth Pact, in particular in budget discipline (the consolidated state budget deficit should not exceed 3 percent of the GDP). These criteria have crucial significance for other EU member-states (although Hungary has never met them), given the plans of a majority of states to convert to the euro (see Table 2). Perhaps, only Great Britain, devoted to the pound, would find it unacceptable to violate the 3-percent target, as it implies an excessive budget deficit. We should also take into consideration the fact that the 2005 reform initiated by France and German practically eliminated the sanctions for breaching the Maastricht criteria.

Table 2

Budget deficits in EU countries, % of GDP

Country	2003	2004	2005	2006	2007	2008	2009
EU-27	-3,1	-2,8	-2,5	-1,4	-0,8	-2,3	-6,8
euro zone-16	-3,1	-2,9	-2,5	-1,3	-0,6	-2,0	-6,3
Ireland	+0,4	+1,4	+1,6	+3,0	+0,1	-7,3	-14,3
Greece	-5,6	-7,4	-5,1	-3,6	-5,1	-7,7	-13,6
Spain	-0,2	-0,3	+1,0	+2,0	+1,9	-4,1	-11,2
Portugal	-2,9	-3,4	-6,1	-3,9	-2,6	-2,8	-9,4
France	-4,1	-3,6	-2,9	-2,3	-2,7	-3,3	-7,5
Slovakia*	-2,7	-2,4	-2,8	-3,5	-1,9	-2,3	-6,8
Cyrpus**	-6,5	-4,1	-2,4	-1,2	+3,4	+0,9	-6,1
Belgium	0,0	0,0	-2,3	+0,3	-0,2	-1,2	-6,0
Slovenia***	-2,7	-2,3	-1,5	-1,3	0,0	-1,7	-5,5
Italy	-3,5	-3,5	-4,2	-3,3	-1,5	-2,7	-5,3
Netherlands	-3,1	-1,7	-0,3	+0,5	+0,2	+0,7	-5,3
Malta**	-9,9	-4,6	-3,0	-2,6	-2,2	-4,5	-3,8
Austria	-1,6	-3,7	-1,5	-1,5	-0,4	-0,4	-3,4
Germany	-4,0	-3,8	-3,4	-1,6	+0,2	0,0	-3,3
Finland	+2,5	+2,4	+2,9	+4,0	+5,2	+4,2	-2,2
Luxembourg	+0,5	-1,2	-0,1	+1,4	+3,6	+2,9	-0,7
UK	-3,3	-3,4	-3,4	-2,7	-2,8	-4,9	-11,5
Latvia****	-1,6	-1,0	-0,4	-0,5	-0,3	-4,1	-9,0
Lithuania****	-1,3	-1,5	-0,5	-0,4	-1,0	-3,3	-8,9
Romania*****	-1,5	-1,2	-1,2	-2,2	-2,5	-5,4	-8,3
Poland****	-6,3	-5,7	-4,3	-3,6	-1,9	-3,7	-7,1
Czech R****	-6,6	-3,0	-3,6	-2,6	-0,7	-2,7	-5,9

Hungary****	-7,2	-6,5	-7,8	-9,3	-5,0	-3,8	-4,0
Bulgaria*****	0,0	+1,4	+1,8	+3,0	+0,1	+1,8	-3,9
Denmark	-0,1	+1,9	+5,0	+5,2	+4,8	+3,4	-2,7
Estonia****	+1,8	+1,6	+1,8	+2,5	+2,6	-2,7	-1,7
Sweden	-0,9	+0,8	+2,2	+2,5	+3,8	+2,5	-0,5

Source: Eurostat

legend

+ budget surplus

** EU member since 2004, euro zone member since 2009*

*** EU member since 2004, euro zone member since 2008*

**** EU member since 2004, euro zone member since 2007*

***** EU member since 2004, outside euro zone*

****** EU member since 2007, outside euro zone*

In the conditions of the global financial and economic crisis, a majority of European countries launched large programs to reanimate the economic situation and save jobs. Moreover, some states expedited the plans to begin structural changes with the view of developing infrastructure, retooling the economy, and enhancing its resource- and energy effectiveness. But the increased state expenditure with diminishing or stable budget revenue inevitably had budget deficits bloated by an order of magnitude. In the euro zone, government spending increased from 46 percent of the GDP in 2007 to 50.7 percent of the GDP in 2009, while budget revenue decreased from 45.4 percent to 44.4 percent within two years, which resulted in an average deficit of 6.3 percent.

The euro zone's debt problem occurred not just because of increased government borrowings to patch larger budget holes. The trend toward an unjustified growth in borrowings was seen practically at all levels. For example, in the pre-crisis period, there was a surge in the debts of households (both mortgage and consumer debts). In 2007, the loan debt of households in the euro zone made up 99 percent of the GDP on the average (in Spain, it reached 125 percent). It was a significant indicator, though not as high as in the United States (where these debts reached 134 % of the GDP).

The euro zone banks' liability, especially their foreign debts, increased as well. At present, the financial leverage co-efficient which shows a firm's dependence on foreign loans, reaches 12 to 17 for U.S. banks, versus 21 to 49 for European banks. As integration in banking stepped up, banks posted a larger share of cross-border bank operations in the euro zone, which makes banks of certain countries more vulnerable to the risks from bank operations in other euro zone countries. Banks are therefore involved in operations across the whole euro zone, although each bank is subordinate to the regulator in the country that has licensed it.

The situation in the euro zone can be regarded not only from the standpoint of Southern Europe countries' excessive debt, but also from the point of view of leading EU banks, in the first place German and French, that bought some two trillion euros of government bonds in problem countries. This points out to the fourth key feature of the euro zone crisis – the credibility gap, on the part of financial institutions, in the problem states and

the EU supranational governance. To a certain extent, it worsened due to the difficulties in stepping up European integration that have emerged in the recent years, against the background of ineffective anti-crisis measures by a number of states. Consequently, many players on the financial markets began to doubt the EU capability to resolve problems of its individual members.

Differences in crisis severity in individual euro zone states

In reviewing the severity of the crisis in individual euro zone states, we should take care not to take out the provision on government finance form the broader context of overcoming structural problems. The EU specifics are such that the global financial-economic crisis has revealed the latent problems in member-states, with each facing a predicament of its own. In 2009, the export-oriented countries posted the largest decrease in the GDP. In Germany, which now plays the role of Southern Europe's saviour, production decrease exceeded that in Greece, Portugal or Spain. It is another matter that the most problem countries would not see an economic upturn even in 2010. Unemployment has been growing at a fast rate in several EU states: for example, it grew by more than two-fold in Spain in Ireland in two years (unlike Germany which largely coped with the job rescue problem). A higher unemployment puts an additional strain on national budgets, and creates a breeding ground for social protests that hamper the launching of necessary anti-crisis measures (see Table 3).

Table 3

Euro zone GDP dynamics and unemployment

Country	Weight in EU by GDP, %	GDP dynamics, %				Unemployment rate,%			
		2007	2008	2009	2010	2007	2008	2009	2010
Euro zone-16	*76,1*	2,8	0,6	-4,1	1,1	7,5	7,5	9,4	10,2
Germany	*20,4*	2,5	1,3	-4,9	2,1	8,4	7,3	7,5	7,2
France	*16,2*	2,4	0,2	-2,6	1,6	8,3	7,8	9,5	10,2
Italy	*12,9*	1,5	-1,3	-5,0	0,9	6,1	6,8	7,8	9,0
Spain	*8,9*	3,6	0,9	-3,6	-0,6	8,3	11,3	18,0	19,9
Netherlands	*4,8*	3,6	2,0	-4,0	1,5	3,2	2,8	3,4	4,0
Belgium	*2,9*	2,9	1,0	-3,0	1,4	7,5	7,0	7,9	8,3
Austria	*2,3*	3,5	2,0	-3,6	1,5	4,4	3,8	4,8	4,9
Greece	*2,0*	4,5	2,0	-2,0	-5,0	8,3	7,7	9,5	11,8
Finland	*1,4*	4,9	1,2	-7,8	2,1	6,9	6,4	8,2	8,6
Portugal	*1,4*	2,4	0,0	-2,7	1,2	8,1	7,7	9,6	11,1

Ireland	*1,4*	6,0	-3,0	-7,1	-1,0	4,6	6,3	11,9	13,2
Slovakia	*0,5*	10,6	6,2	-4,7	3,5	11,1	9,5	12,0	13,9
Luxembourg	*0,3*	6,5	0,0	-3,4	2,5	4,2	4,9	5,4	5,8
Slovenia	*0,3*	6,8	3,5	-7,8	1,6	4,9	4,4	5,9	6,2
Cyprus	*0,1*	5,1	3,6	-1,7	-0,7	4,0	3,8	5,3	7,1
Malta	*0,0*	3,8	1,7	-1,9	1,0	6,4	5,9	6,9	7,0
EU-27	*100,0*	2,9	0,7	-4,2	1,3	7,1	7,0	9,0	9,8

Sources: Eurostat (2007-2009), Kieler Institute for the World Economics forecast-2010 (Weltkonjunktur im Sommer 2010 – Kieler Diskussionsbeitrag 481/482).

As for government finance, Greece is the only euro zone state where a critical situation has developed. The country's debt soared to almost 300 billion euros (over 100 percent of Greece's GDP), of which it had to pay 53 billion euros in 2010. Greece would have had to announce default without outside assistance. The poor situation with government finance in other euro zone countries and the rapid growth of their national debts caused speculations about the "domino effect"- the collapse of financial and other markets in certain states under the influence of the crisis on the markets in other states (see Table 4). Portugal, Spain and Italy are allegedly the next possible victims, and occasionally Ireland is added to this group, now abbreviated to PIGS or PIIGS.

The possibility of a sweeping "domino effect" in the euro zone is unlikely, even in case of Greece's inability to meet the anti-crisis program targets. There are two key reasons that warrant this conclusion. Firstly, the socio-economic position of Greece is unique for the EU in many ways. Whereas Greece can compare with Ireland by the degree of the government finance problem, the latter by far outpaces all the countries of Southern Europe in terms of science-intensive economy, and the consumers' readiness to create demand for innovations (for example, in the field of information technologies). It was largely the mortgage crisis that toppled its economy (as in Spain, whose government counted too much on the construction sector in combating unemployment, and by now this tactic has worsened the employment situation). Ireland's economic situation worsened as its exports shrank in 2009. Elsewhere in Europe, the scaling down of exports affected the most competitive EU countries, such as Germany.

Table 4

Euro zone national debt dynamics

country	National debt, bln of euros				national debt, % of GDP			
	2000	2007	2008	2009	2000	2007	2008	2009
Euro zone-16	4 694	5 940	6 425	7 063	69,2	66,0	69,4	78,7
Germany	1 232	1 579	1 646	1 762	59,7	65,0	66,0	73,2
France	826	1 209	1 315	1 489	57,3	63,8	67,5	77,6
Italy	1 300	1 600	1 663	1 761	109,2	103,5	106,1	115,8
Spain	374	381	432	560	59,3	36,2	39,7	53,2

Netherlands	225	259	347	347	53,8	45,5	58,2	60,9
Belgium	272	282	310	327	107,9	84,2	89,8	96,7
Austria	138	161	177	184	66,5	59,5	62,6	66,5
Greece	141	217	237	273	103,4	95,7	99,2	115,1
Finland	58	63	63	75	43,8	35,2	34,2	44,0
Portugal	62	104	110	126	50,5	63,6	66,3	76,8
Ireland	40	47	80	105	37,8	25,0	43,9	64,0
Slovakia	11	18	19	23	50,3	29,3	27,7	35,7
Luxembourg	1	3	5	5	6,2	6,7	13,7	14,5
Slovenia	< 6	8	8	13	< 28,0	23,4	22,6	35,9
Cyprus	5	9	8	10	48,7	58,3	48,4	56,2
Malta	2	3	4	4	55,9	61,9	63,7	69,1
EU-27	5 696	7 265	7 697	8 690	61,9	58,8	61,6	73,6

Source: Eurostat

Secondly, the EU new “Stabilization” Fund is large enough to contain the crisis in the smaller countries with the most unfavorable situation. For example, Ireland and Portugal by far exceeded the Maastricht target, with their national debt at 60 percent of the GDP, but for the euro zone, the crisis in these countries does not pose much threat due to their small size (see Table 4). Of more than 7 trillion euros of aggregate national debt in the euro zone as of late 2009, Ireland’s national debt amounted to 105 billion euros, Portugal’s to 126 billion euros, and Greece’s to 273 billion euros. Spain, despite the increase in its national debt to 560 billion euros in 2008-2009 had kept within the Maastricht criterion of 60 percent of the GDP, which it only met in early 2000s, by reducing the liability in the years of upturn, as did many other euro zone countries. As a result, Spain keeps the A Credit Rating.

Hypothetically, the situation in Italy would pose the greatest danger for the euro zone, as its national debt almost reached 1.8 trillion dollars, or 116 percent of the GDP. But Italy, like Belgium, has lived with this indicator for years (although the Maastricht Treaty committed all the euro zone countries to gradually meet its criteria). The situation in Belgium and Italy shows that it is not the size of national debt that has crucial significance as the investors’ confidence in the stability of the economy of a given country and the efficiency of its government.

2. Adequacy of anti-crisis measures in the euro zone's problem countries

The current euro zone crisis does not appear severe to the extent that in order to pull out of it successfully, the EU would lack the available intellectual resources to secure adequate expert support in implementing the anti-crisis measures. As for the scale of the problem in the euro zone, suffice it to say that the accrued debts of EU states are not that large compared with the liabilities of financial institutions, whose bankruptcy launched the global crisis in 2008. Consequently, a detailed analysis of specific anti-crisis proposals in individual euro-zone countries would appear superfluous from the point of view of security prospects in the Euro-Atlantic space. What is more important is the timely mobilization of European economists and politicians to design and implement effective anti-crisis measures, as well as the political opportunities in the most problem countries to put these measures into practice. In other words, the Irish government's plans to implement the program of phased reduction of budget deficit to less than 3 percent only in 2014 (Spain plans to return to the Maastricht criteria as early as by 2013) would have no critical influence on the Euro-Atlantic region's economic dynamics. Priority should be given to evaluating the chances for success of the measures, announced by euro zone countries in a difficult socio-political situation.

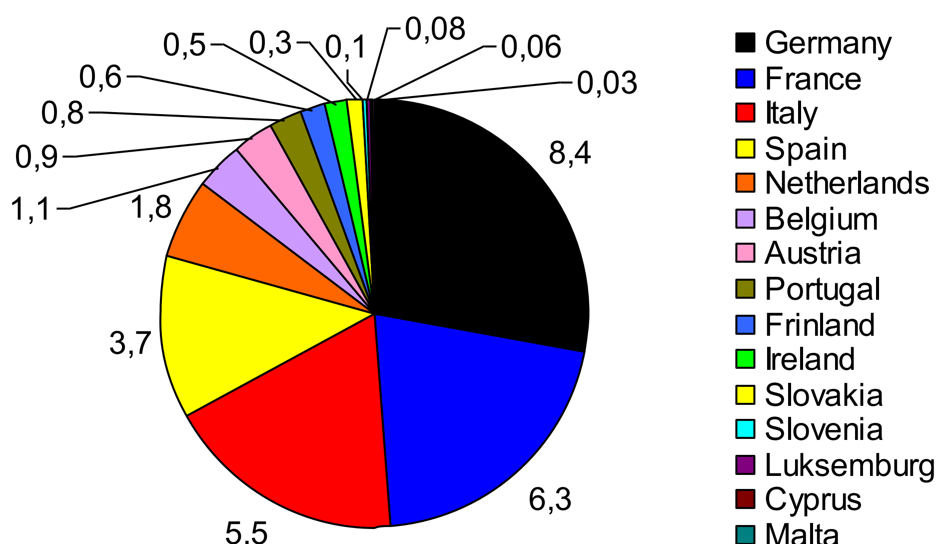
Timeliness and sufficiency of the EU anti-crisis policy

With no detailed multi-stage contingency plan, the euro zone policy has mostly been a series of reactions to concrete events throughout the global financial and economic crisis. Some measures, forged with a trial method, turned out to be quite timely and productive (for example, the use of bonuses to purchase new cars to replace old ones, though a great distortion of competition, supported one of the key branches of the European economy at the right moment). At present, a quick solution of problems that keep emerging in the euro zone (such as possible new banking problems) with adequate, if not the most effective methods, remains the best tactic.

Some European experts accuse EU supranational bodies and the governments of the leading member-states, in the first place Germany, in foot-dragging over helping Greece. More likely, the EU underestimated the destabilizing role of excessive budget deficits in all countries in 2009, while the problem of Greece, exacerbated by manipulations with national statistics, took many unawares. The EU political decision to provide help to Greece had to encounter inevitable public resistance in other euro zone states (see Chart 1). The first aid package in early 2009, worth 30 billion dollars, was distributed among all the euro zone states, including problem ones (who were facing the implementation of the unpopular program to cut budget spending). Even in the relatively well-to-do Germany, which eventually initiated this assistance, the ruling coalition lost the regional elections in the key county of North Rhein Westphalia, and, consequently, a majority in the Bundestag in the summer of 2010.

Chart 1

Euro zone states' contribution to the 30-billion-euro Greek aid package



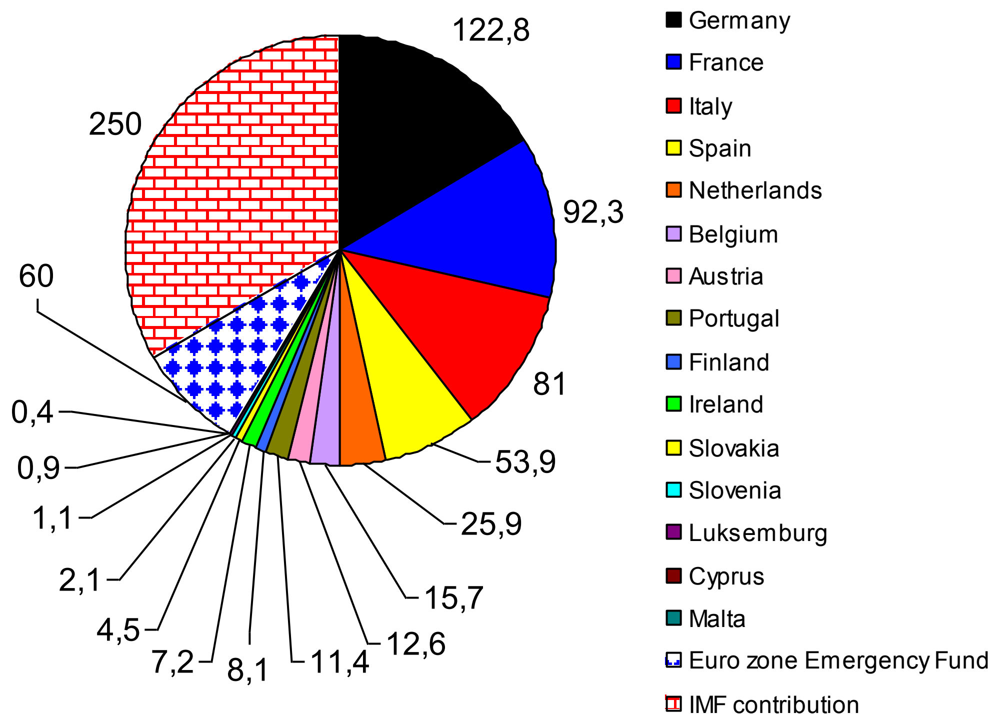
If Greece had acknowledged its acute budget problem on time, it would have been far more simpler to use indirect mechanisms of assistance (after the beginning of the euro zone crisis, Bulgaria, which planned to join the euro zone in a few years, admitted falsifying its statistics in 2009 with the view of concealing the breach of Maastricht criteria). Re-distributing funds within the EU budget, worth approximately 1 percent of the EU consolidated GDP, would be one of the methods to support the crisis-hit problem countries at the present time. For example, in the beginning of the global crisis, the European Commission sanctioned a quick allocation of money within the scope of the supranational regional policy, which accounts for more than one-third of the EU common budget spending. The EU thus funded a majority of regional policy projects as early as 2008, thanks to improved administering of the supranational regional policy, instead of the traditional disbursement of funds by the end of the current 7-year term (2007-2013), that normally involves much bureaucratic coordination to extend the timeframe for the use of funds. By September 30, 2009, the EU disbursed 27 percent of funding (93 billion euros), envisioned for the supranational regional policy until 2013. In Belgium, this indicator reached 61.1 percent, in the Netherlands – 55.8 percent, in Estonia that plans to join the euro zone in 2011 – 52.3 percent, and in Ireland – 51.8 percent. Greece, entitled to over 20 billion euros in allocations in 2007-2013, only disbursed 11.9 percent of funds, the worst EU indicator.

The confidence in the euro fell as problems, similar to Greece's, were exposed in other euro zone countries. This required bailout measures on a larger scale. The EU leaders scrambled to announce a new package of measures on May 9, 2010 (see Chart 2), which envisioned an unprecedented move to draw on IMF funds (earlier, the IMF helped Latvia and Hungary in 2008, and Romania in 2009). The measures included the establishment of a EU Stabilization Fund worth 60 billion euros and a special agency

capable of raising up to 440 billion euros by issuing bonds under euro zone guarantees. The IMF announced a 250-billion-euro support (the sum was dollar-denominated though) with a program of loans for euro zone countries, including loans for individual euro zone countries. The USA supported the program as the Federal Reserve System opened large swap lines (dollars in exchange for national currencies for several months with redemption). The USA approves the ECB policy: like the Federal Reserve System, it intends to buy out government- and corporate bonds with the purpose of regulating the liquidity of euro zone banks.

Chart 2

Breakdown of the 750-billion-euro aid package to the problem euro zone states



The EU should also think about long-term reforms, including the normalization of government finance in the problem countries (PIIGS). This is where it encounters the major difficulties. The most complicated problem is to boost the competitiveness of the economies in Southern Europe’s countries, so that they do not lag that far behind other euro zone states. To resolve this task, the EU needs profound institutional and structural/sectorial changes, otherwise the recurrence of crises, similar to the one it is going through, will be quite possible.

Problem countries' chances to implement anti-crisis measures

PIIGS need to overhaul the principles of the economic policy they have pursued in the past decade, in order to implement the anti-crisis measures towards reducing the budget deficit and carrying out structural changes (in the first place on the labour market and the government's welfare commitments). A considerable experience in conducting these reforms has been accumulated since the 1980s (especially during the international debt crisis of the early 1980s, the market reforms in the post-Socialist countries in the late 1980- early 1990s, and the Asian crisis of 1997-1998), which helps identity the basic political condition for a successful anti-crisis struggle. These conditions can be summed up thus:

1) readiness of the executive and legislative branches of power to adopt anti-crisis solutions within the scope of their competence;

2) a public consensus in favour of the reforms, broad enough to prevent a backtrack during the "pain shock";

3) internal political stability as the guarantee of the normal functioning of the political decision-making system in crisis;

4) support of national anti-crisis efforts by international institutions and foreign states.

Let us review these factors with respect to the PIIGS states.

1. Readiness of the executive and legislative branches of power to adopt anti-crisis solutions within the scope of their competence

This factor is crucial for a quick response to crisis challenges (a short-term aspect). Its main elements are:

a) the authorities' awareness of the nature of the problems;

b) selecting a package of measures adequate to the crisis-related challenges;

c) the opportunity for executive and legislative bodies to take appropriate measures.

Parameter a) is favourable for all the PIIGS states. Ireland leads other states in the group by parameters b) and c) (its government-proposed anti-crisis program sets an example for other PIIGS countries); and the situation is favourable in Italy and Spain on the whole. In Portugal, the principle "to do no worse than the Spaniards" plays a positive role in the traditional Iberian rivalry. Greece is in the worst situation, as the necessary structural reforms directly contradict the policy which the incumbent ruling party has been pursuing for decades (improving the standard of living of low-income residents by creating excessive jobs in the public sector). This implies that Greece is unlikely to come up with an adequate anti-crisis package without pressure from international institutions, while the adoption of proper measures might run into opposition in- and outside the ruling party.

2. A broad public consensus

In a democratic system, the implementation of medium- and long-term anti-crisis policy programs depends on how much public support the government can enlist. In the event of broad public support, even a change of government after the election cycle does not threaten a backtrack from reforms (as Central and Eastern Europe countries showed in the first half of 1990s). Conversely, a lack of public support may prompt the new government to cancel reforms. An alternative option – the so-called "anti-crisis

dictatorship"(as in a number of Latin American countries in the 1980s) looks unrealistic in Europe.

The chances to mobilize the political support of the population depend on

a) political consolidation of the society;

b) the scale of the disproportions to be rectified (the larger the scale, the more painful measures are needed and the more resistance they encounter).

The best chances to secure "an anti-crisis consensus" exist in Ireland due to a powerful support of the "European identity" idea) and Italy (where the budget deficit problem is not too acute, hence the "anti-crisis sacrifice" will be the least). In Spain and Portugal, the governments carry out "an intensive awareness campaign" regarding the need to implement a package of painful but necessary measures, but it is premature to judge if it has been successful. There is a risk that "this pain" (especially in regulating the wage dynamics) will be severe enough to cause public resentment. In Greece, the policy of "partial belt tightening" used to have broad support in the society as it was joining the euro zone (2000-2002), but it would be unrealistic to arrange the same public consensus a second time. There is no "carrot" to show the population that would convince them of the need to suffer hardship. In addition, the scale of disproportions in Greece is the largest in the EU, so any adjustment measures will be quite painful (foreign loans have boosted incomes by 20 percent, and politicians will find it hard to take it back).

3. Internal political stability

The destabilization of the political situation caused by public discontent with "the necessary, but unpopular measures" can undermine not just the results of the anti-crisis policy (mass disturbances – IMF riots against the implementation of the IMF conditioned loan programs in the period after the 1980-1981 debt crisis), but also the preceding period of economic development (as in Indonesia, following the overthrow of the Suharto regime in 1998). The key risks are found in:

a) a lack of legitimate channels (in the first place electoral ones) of non-violent expression of protest;

b) a lack of violent protest activity traditions.

At present prospects for criterion a) look favourable in all the PIIGS countries, while for criterion b) they are unfavourable for all but Greece. Characteristically, its leftist radicals have been traditionally very active while the population has been quite tolerant of the methods of violent political protests after the 1973-1974 events. The escalation of protests to disturbances can undermine not only the government's capacity to pursue an anti-crisis policy, but also ruin tourism, the only competitive branch of the Greek economy.

4. External support of national anti-crisis efforts

The support on the part of external actors (international institutions and foreign countries) has three key functions in implementing an anti-crisis policy:

a) provision of financial resources to combat the aftermath of the crisis;

b) assistance in working out an adequate package of anti-crisis measures;

c) securing positive expectations in the society ("we're not alone; we'll have help")

Providing unconditional support mostly implies functions a) and c), while conditioned support involves functions a) and b). From the standpoint of function c), its role is

equivocal: on the one hand, it can cause resentment ("we are not getting help, they're making us dance to their flute instead), and, on the other, the government has the opportunity to partially shift the responsibility for the painful measures onto external actors ("the IMF made us do it"). The latter tactic, however, would not work for long, because resentment of "outside dictate" quickly turns against domestic politicians who yield to this "dictate."

The PIIGS states would have a favourable combination of the forms of support. On the one hand, international financial institutions, with U.S. support, provide conditioned support, stimulating the countries to implement an adequate package of anti-crisis measures. On the other hand, EU bodies provide both conditioned and unconditional support (for example, by initiating Estonia's euro zone accession in a demonstrative show of confidence in the future of the euro zone).

Taking all this into account, the influence of the leading external players on the situation in all the PIIGS states would be positive.

An analysis of the political conditions for implementing an anti-crisis policy in PIIGS indicates that Greece is running the highest risks. Due to profound economic disproportions in that country, it needs most radical political moves, but the Greek political system is least fit to the task. Ireland is in a relatively favourable situation (high readiness to carry out an anti-crisis policy, and good changes to build a long-term anti-crisis consensus), as is Italy (where the scale of disproportions does not require dramatic painful measures). The political situation in Spain and Portugal gives no cause for apprehensions at present, but it is crucial that the anti-crisis measures in these countries do not turn out to be longer and more painful than the population expects. The readiness of the population of these countries to carry the costs of the anti-crisis policy can shrink dramatically if they fail to post a steady economic upturn after 2010, what would promise the population an increase in incomes in the foreseeable future.

3. Influence of the crisis on European integration

The crisis might have hit the EU sooner than 2010, if we consider its main causes in the euro zone, reviewed in the first section of the report. However, while clearly showing several serious problems in European integration, the crisis most likely will give new impulses toward intensifying it. It will give a good reason to slow down the increasingly uncontrollable EU and euro zone enlargement. The enlargement, though mostly based on economic integration, has been increasingly politicized since 2000, which weakened the EU integration and even aggravated some security problems in the Euro-Atlantic region. At the same time, the on-going crisis in the euro zone can be used for initiating new institutional changes within the EU in the near future. This will enable the EU to eliminate part of the negative consequences caused by EU countries' compromises in the past few decades, which generally decreased the effectiveness of European integration.

3.1. Overall slowing down of EU and euro zone enlargement

The least the crisis has done was complicate and prolong the process of EU members' joining the euro zone and admitting new countries into the EU. It is a positive factor, from the standpoint of the EU political stability. At the same time, withdrawing from the EU or the euro zone is out of the question (aside from legal obstacles, it will aggravate the economic position of the withdrawing state, as its liability denominated in a sharply devalued national currency will increase dramatically, and irreparably damage the whole European integration process).

Estonia is expected to join the euro zone as early as 2011 – in this case, the demonstrative effect of the continued development of the euro zone is very important, but it should be borne in mind that this small Baltic state fully meets the Maastricht criteria (while its hypothetical problems cannot seriously harm the operation of the euro zone in principle). Further enlargement of the euro zone is not due until 2016-2017, although the Czech Republic in the only state in Central and Eastern Europe that plans to join that late. Taking into account Greece's experience, even after the meeting of the Maastricht targets, the EU will be monitoring the quality changes in the economies of the new EU members for several years before qualifying them as new euro zone members. If the EU does not make the new populist political move to expedite the enlargement of the euro zone by the end of this decade (it can make such a move only with Germany's unconditional support), some new EU members, in the first place Bulgaria and Romania, might find themselves in the euro zone after 2020.

As for granting EU membership to new states, Croatia appears to be the best candidate. The prospects for other Balkan states are unclear as yet. The rate of integration of Macedonia, Montenegro and other countries may slow down considerably in case of a sharp destabilization of the situation due to the persistent borderline uncertainties, the problems of territorial integrity and the aggravation of the ethnic issue amidst the rapid growth of the Albanian population. Turkey will not become a EU member in the foreseeable future (for a wealth of reasons, including cultural and civilizational ones).

Although Turkey has objected to the proposed alternatives, this issue has not been discussed much, because Turkey is not yet ready for EU membership.

Iceland might join the EU provided it settles the bank debt with British and Dutch depositors, and overcomes the opposition to EU membership at home. As for Norway, its population is likely to opt against joining the EU on fears of a large gap in welfare with the rest of Europe (i.e. the unwillingness to "share", though Norway is ready to step up integration within the scope of a Common European space (EU-EAST). Switzerland will continue to value its political independence.

The economic crisis caused speculations that the EU which is experiencing financial problems will foremost give up the projects that do not directly concern its member-states, such as the allocation of considerable resources to support the development of non-EU states. However, the EU cannot fully suspend its foreign policy and the priority of relations with neighbours is not questioned either. The EU interest in neighbours might not get as much attention of the mass media and the leading European politicians as before, as they will be focused on the problem of global crisis and the fate of the euro, but it will certainly keep at the most important working level within the next few years. Furthermore, the EU, which does not want to see the economic collapse of its neighbours, as their situation might affect it, too, might lobby their interests at international financial institutions.

It is quite probable that the EU will give up its new ambitious initiatives and suspend the plans to boost the funding for the existing guidelines, yet it should remain committed to earlier allocation plans. The restriction might even play a beneficial role, as it will put an end to the continuous increase in unsubstantiated foreign policy initiatives.

The EU spends 7 to 8 billion euros on foreign policy annually, an insignificant amount compared with the resources to combat the financial crisis. Some two billion euros a year are spent on relations with the Neighbourhood Policy participants. The existing financial mechanisms within the Neighbourhood Policy are quite modest, too. All the 15 programs of border cooperation only draw 170 million euros a year. The EU Investment Fund (a loan fund) received 700 million euros from the European Commission and fees from the member-state (so far they have been quite modest, possibly because of the crisis). The Eastern Partnership program envisions an allocation of 600 million euros in 2010-2013.

It is not so much funding that is important for the Neighbourhood Policy as arranging specific relations with the EU for each country, regular contacts, and a common administering culture. In this sense, the crisis does not play the crucial role. Despite the economic problems, the EU remains an association to be looked up to.

The crisis added more uncertainties to the prospect for further significant EU enlargement. Some countries showed a motivated interest in the Neighbourhood Policy precisely because of the future prospect to join the EU (although there were no formal reasons for such expectations). Ukraine and southern Caucasus countries henceforth will feel less constrained in planning their foreign policy, understanding that the EU membership bid will not yield noticeable results in a short- or medium term. This does not imply they should give up the efforts towards easing the visa regime and bringing the technological standards closer.

The frozen conflicts pose the greatest danger to the situation in the countries participating in the Neighbourhood Policy. If even one of these conflicts escalates, the

EU may find itself unable to make significant efforts to settle the situation, due to the crisis-related financial limitations.

3.2. New impulses towards intensifying European integration

The situation in Greece made influential European politicians, in the first place German Chancellor A.Merkel to seek amendments to the agreement on the European Union. The protracted ratification of the Lisbon Treaty explains the unwillingness of several countries – where the ratification caused the largest controversy – to agree to such amendments. Further institutional adjustments will not require, if possible, a revision of the already effective treaty.

At present, the treaty prohibits the EU to cover the debt liability of member-states (Article 125 of the Treaty on the Functioning of the European Union). This provision, however, was circumvented in Greece's case, as the EU invoked Article 122, which allows financial assistance the Member-State concerned, where a Member State is "threatened with severe difficulties," caused by "exceptional occurrences beyond its control."

Therefore, the effective treaty provides the opportunity to set up a contingency fund for members-states. It might be a solution for the next few years, as long as the consequences of the financial crisis are treated as such contingences.

In a more distant future, the EU might require something more than a fund, but by that time the allergic reaction to amending the Lisbon Treaty will have subsided. Part 3 of the Treaty on the Functioning of the European Union can be amended under a simplified procedure on short notice, without convening an intergovernmental conference, but this opportunity is severely limited. Supposedly, the effective treaty might have a whole range of European integration issues amended in ten to 15 years, as happened with previous documents

The necessity to tighten control over budget discipline of the member-states will cause fewer institutional, but more political problems. The Treaty commits the European Commission to monitor budget discipline and envisions a mechanism of sanctions against the countries that have exceeded the budget deficit targets. At present, the European Commission calls for checking the member-states' budgets before the budget voting in national parliaments, which some EU states might challenge as exceeding of the Commission's authority. In February 2009, the European Commission proposed to set up a European Systemic Risks Board (comprising the heads of the member-states' Central Banks) and a European Financial Supervisory System (a network of national supervisory bodies that interact with the EU bodies). They might begin to operate from 2011, if the EU succeeds in removing all the obstacles to their functioning in time. But while the Systemic Risks Board might become a mere symbol of attention to the problem, the Financial Supervisory System may truly help the anti-crisis policy and financial markets in the post-crisis period.

The question is not so much about imperfect EU institutions as a lack of enthusiasm to apply the existing mechanisms. A number of countries are borderline cases in terms of meeting budget deficit and national debt parameters, and are inclined to interpret this deviation as the call of the times that depends on the development of the world economy, which the Treaty of Lisbon does not account for. In the future, the EU

decisions on sanctions against the violators are likely to occasional, but a better understanding of possible consequences will be conductive to tougher measures. Independence remains the cornerstone of the ECB functioning, but, as other principles, it might have a broader interpretation in crises.

Making an association between the economic crisis and its influence on the euro zone on the one hand, and the condition of the world economy, and the EU imbalances, on the other, we might expect European countries to support the G-20 efforts to reform the global financial institutions and work consistently towards harmonizing the economic policy of EU states (in the first place within the euro zone).

Harmonization cannot happen all at once; the relevant decisions have to be made within the framework of the effective treaty, but in ten to 15 years, EU countries will be able to add provisions to the founding documents to give the EU more authority in shaping the economic policy, in particular, its tax policy. The backwardness of Southern Europe countries, as compared with other euro zone states (and even East European ones, which have made progress towards an innovative economy despite the low per capita GDP) is a constant factor. To resolve the exiting structural problems the EU must reform its supranational regional and innovative policy. To this end, it will have to strengthen its democratic institutions, possibly by giving the European Parliament a greater role to play.

An important consequence of the euro zone crisis was Germany's regaining its unquestionable leadership in European integration processes, which began to erode during the favourable 2000s. Despite a 4.9 percent slump in its GDP in 2009 (much worse than the EU average), the German economy has not lost its stability, and in 2010, it is expected to grow faster than its euro zone partners'. Also, EU partners acknowledge Germany's leading role in resolving the current crisis. The availability of the locomotive country, as the EU past experience has shown, is an important condition for stepping up European integration.

4. Consequences of the euro zone crisis for Russia

In the Euro-Atlantic space, the EU and the euro zone, its economic nucleus, make the main gravity centre for cross-border economic ties. For example, the EU accounts for more than half of Russia's foreign trade (with the euro zone accounting for 36 percent), and 75 percent of accumulated direct foreign investments (three-quarters of these investments came from the euro zone). Although the figures somewhat overstate the real scope of economic ties, given the registration in Cyprus, the Netherlands and Luxembourg of a significant portion of transactions involving Russian companies, the euro zone situation nonetheless has significance for Russian business, even in a formal use of euro zone states. Not only crises cannot pass unnoticed for any Euro-Atlantic region country, including Russia, they visibly enrich the world experience in developing integrating groups – especially with the habit of viewing EU achievements as a reference point for integration projects in the post-Soviet space.

4.1. Impact on Russian-European economic ties

Specifically, Russia's trade with the euro zone is rather off balance by a range of parameters:

- Russia's commodity supplies to the euro zone exceed imports from the euro-zone two-fold – even after the devaluation of Russian raw-materials exports in the course of the global financial and economic crisis (see Table 5);
- Europe mostly exports to Russia machinery, equipment and chemicals and imports Russian fuels, raw-materials and semi-finished products;
- Two-way trade often does not match the size of the contractor country's economy in the euro zone – it might imply both the effect of neighbourhood (a small Finland is Russia's fifth largest trade partner in the euro zone) and the trade mix specifics (large-scale supplies of Russian natural gas to Slovakia and Greece).

Separately, we should note the mismatch in Russia-EU foreign trade settlements, i.e. the mostly euro-denominated imports and the dollar-denominated exports (because fuels are the main export item). The fluctuations of the euro-dollar rate make this settlement system potentially unstable, especially because of the high volatility of money markets. As the euro continues its downslide against the dollar, this pattern might contribute to the growth of imports from the EU in a medium-term period with the volume of export revenue keeping at the same level. To improve the structure of exports, it is important that the new advantage be used to boost the imports from the EU manufacturing sector, including advance technologies, not the imports of consumer goods.

Crisis-related developments in the euro zone might negatively affect the exports of fuels from Russia to the EU (and eventually cut Russia's export revenue). The rise of the dollar against the euro, together with the apprehensions that the euro zone crisis will slow down the world's economic upturn (and hence, the demand for fuels), may bring down oil prices.

Oil prices will fall if a majority of EU countries support the USA and Germany in their policy to tighten control over the financial markets, including over operations with energy derivatives (the U.S. law on reforming the regulation of financial markets will make groundwork of such accords). In longer term, the proposed measures for operations with derivatives will make oil prices less volatile giving the investors in large Russian energy projects a better idea of the risks involved, for example, in the Far East. In addition, restrictions on trade in oil derivatives may prevent the trade in natural gas from turning into a new financial market. For Russia, gas supplies now have more significance than the supplies of oil to foreign markets.

Table 5

Euro zone significance in Russian foreign trade

country	Foreign commodity trade				Foreign direct investment			
	2009 exports, mln dlrs	2009 imports, mln dlrs	2009 turnover, mln dlrs	Share in turnover, %	Accumulated as of late 2008, mln dlrs	Share in accumulated, %	Supply in 2009, mln dlrs	Share in supply, %
Euro zone-16	113 395	55 948	169 343	36,2	94 453	77,2	10 369	65,2
Germany	18 711	21 231	39 942	8,5	7 275	5,9	2 313	14,5
France	8 723	8 425	17 148	3,7	1 927	1,6	758	4,8
Italy	25 060	7 884	32 945	7,0	1 026	0,8	188	1,2
Spain	2 892	2 274	5 166	1,1	459	0,4	134	0,8
Netherlands	36 291	3 583	39 874	8,5	35 931	29,4	1 441	9,1
Belgium	4 044	2 539	6 583	1,4	633	0,5	490	3,1
Austria	1 625	2 059	3 684	0,8	2 489	2,0	440	2,8
Greece	2 290	342	2 632	0,6	44	0,0	4	0,0
Finland	9 159	3 954	13 113	2,8	2 113	1,7	676	4,2
Portugal	133	240	373	0,1	10	0,0	1	0,0
Ireland	161	669	830	0,2	480	0,4	119	0,7
Slovakia	2 981	1 808	4 789	1,0	51	0,0	3	0,0
Luxembourg	3	123	126	0,0	1 217	1,0	97	0,6
Slovenia	82	788	870	0,2	63	0,1	1	0,0
Cyprus	792	23	815	0,2	40 732	33,3	3 704	23,3
Malta	448	6	454	0,1	3	0,0	0	0,0
EU-27	160 705	75 359	236 065	50,3	101 867	83,2	11 524	72,5

Source: Federal Customs Service and the Federal State Statistics Service

On the other hand, the weakening euro, the increasing competitiveness of European goods, and a greater euro zone's interest in selling its products amidst economic difficulties open new opportunities for Russian importers to acquire high-tech equipment and other industrial goods. This also prepares the ground for improving the terms of foreign trade contracts (as partners tend to be more compliant in crisis). This may contribute to an increase in Russian imports and refine their structure.

The worsening economic crisis in South Europe countries does not have much influence upon Russia-EU trade dynamics because the share of Portugal, Greece and Spain in Russia's foreign trade only approximates 2 percent.

As for investments, we should draw a difference between foreign speculative capital – which may quickly flee in any crisis, and long-term injections in the Russian economy. With a larger geographical concentration of incoming capitals – compared with trade flows, the main sources of direct investments are the well-to-do euro zone states. The share of the most problem countries was insignificant even before the euro zone crisis (see Table 5). Of course, the crisis put on hold the European companies' foreign investment activity for some time, including in Russia. But in general, the investments by trans-national corporations depend on other factors, such as the success of the anti-corruption fight in Russia, a decrease in the bureaucratic pressure on private business and other investment climate parameters.

Russian investors abroad have stepped up their activity in the recent years, though the global financial and economic crisis has caused much damage to many domestic trans-national corporations. Some companies continue their foreign expansion. For them, the euro zone crisis opens new opportunities to acquire European assets which depreciated as the euro fell. However, one can hardly expect the EU to be less protective against the investors from the so-called growing markets, to which Russia belongs, mostly because many investor companies fail to meet the EU business ethics standards.

It would not be quite correct to reduce the influence of the euro zone crisis to Russia's trade and investment ties with individual EU countries. Overall, the crisis is likely to underscore pragmatic approaches toward the reform of the international currency and financial system. We might expect less anti-dollar rhetoric, a pause in the discussions over setting up new regional currencies (including the single currency of Russia, Belarus and Kazakhstan), and a more realistic outlook for international currency, to be issued by the IMF or some other international agency to replace national reserve currencies (such as the dollar, the pound, the euro or the yen). The supporters of this new international currency have always cited the euro as an example, claiming that if a regional organization was able to establish a currency of its own that rivals the dollar, the whole international community can accomplish it, too. The euro crisis has shown that the proposals to set up a new international currency in the foreseeable future have no substantial ground.

This reform of financial markets regulation which the G-8 supports to this or that extent, mostly meets Russian interests. The proposed rules to regulate the financial markets may decrease the speculative vector of the Russian financial market. Russian business is interested in scaling down the fluctuations of the main world currencies, in the first place the dollar and the euro.

4.2. *Crisis lessons from the standpoint of strengthening Russia's relations with former Soviet republics (CIS) and Central and East Europe countries*

Attaining the goals of economic integration is certainly an important strategic task for CIS states, which appears quite difficult in the present conditions. The repeated attempts to attain real progress in this endeavour for the past two decades have ended in failure. Of course, the success or failure of new plans or undertakings regarding the Customs Union of Russia, Belarus and Kazakhstan will largely depend on domestic factors of CIS's economic life, but the external factors, such as the euro zone crisis, cannot be ignored. **Russia, though much interested in the EU integration experience, cannot emulate it without taking into account the reality of the post-Soviet space.**

For example, one of the main objectives of the common economic space (CES), to be established in the CIS territory, is to transfer to mutual settlements in national currencies. Russia has called for expanding the use of national currencies in mutual settlements. But for transferring to truly multi-lateral trade and establishing a system of mutual settlements and payments, the CIS has to ensure mutual convertibility of their national currencies, coordinate the mechanism of setting the exchange rates and fixing them to each other, or create a single currency. One of the advantages of a single currency unit is lower transportation costs. At present, the CIS effects a sizable portion of settlements through third currency. There is little doubt, however, that launching a single currency is time consuming, and appears unfeasible amidst the ongoing crisis. At present, single currency discussions are a distraction from more serious problems. There is a considerable probability that it is not the currency of a CES member that will play the role of single currency, but an entirely new currency similar to the euro. It will imply ceding part of sovereignty in the monetary and credit policy for CES participants, to which they will hardly agree. Furthermore, Russia, as the strongest economy in this association, will subsidize weaker economies through the single currency mechanism.

Although the European Currency Union was established after long work towards a uniformity of the economic policy and levelling out the key macro-economic indicators within the euro zone, a number of countries violated the EU-coordinated requirements after attaining the maximum harmonization in government tax policy, government spending, the maximum permissible budget deficit and combating inflation. The consequences are obvious, and the anti-crisis measures are mostly aimed at tightening the above requirements. Therefore, the main lesson for the integration-minded CIS states is to reach such inter-state relations in the fiscal policy, which would envision preventive measures to rectify the financial and budget situation, to as far as introducing early sanctions against the violators of the coordinated principles and criteria.

Meanwhile, the strengthening of relations with Kazakhstan, for example, should not be detrimental to ties with Russia's East European neighbours, CIS participants or EU members.

In politics and behaviour, the EU members in Central and Eastern Europe and the three Baltic states have shown increasing stability and consistency in relations with Russia. They are completing the formation of national elites, their political institutions are as good as established, they have seen a generation change, and are protected with EU and NATO membership. National specifics survive, for example, Poland's policy remains more volatile and ideologized, despite the recent progress. It is caused not so much by

the “Russian factor,” as the strengthening of Russian-German partnership, especially against the background- and in connection with the crisis, as well by the uncertainty of the U.S. position in Central and Eastern Europe.

There has been no headway in the approaches by other Central and Eastern Europe countries. The Baltic states’ approaches are gradually normalizing. The crisis accelerates these trends and presents not only external, but also home policy reasons for normalizing economic relations with Russia.

The crisis revealed that new EU members and the countries seeking EU membership have much more resistance to stress, mostly because of a lower standard of living, and high adaptability the population developed during the years of post-socialist transformation.

These countries basically keep their attitude toward the EU unchanged, although the crisis showed to Central and Eastern Europe countries and European CIS states that the EU was in short supply of a common strategy and a mechanism of adequate response. The plunging image of the European socio-economic development model became an unpleasant surprise to them. Replacing the ambitious Lisbon strategy to make the EU states the most competitive knowledge-based economic area with the Europe-2020 strategy that does not envision an effective mechanism to put the backward states on innovative track has not added optimism. Also, Central and Eastern Europe states fear that the future post-crisis rebuilding strategy would excessively tighten Brussels’ control over their national economic policy. But despite the disruption in financial flows from individual countries, including the most developed ones, the EU has kept its supranational funding, which is particularly important for Central and Eastern Europe countries. A tighter control made EU countries more disciplined. Bulgaria acknowledged the falsification of data presented to the EU, having doubled the budget deficit estimate. Romania and Bulgaria stepped up their anti-corruption fight. Hungary, Romania and Latvia launched measures to normalize their economies ahead of others, with the EU membership easing their efforts to attract IMF assistance. Despite the shrinking, the EU market remains open for exports of their goods, services, and, to a lesser extent, labour force.

This positive aspect retained, the Central and Eastern Europe countries felt the negative consequences of the crisis because of considerable dependence on the EU economy in general and individual leading EU members. A surge in economic patriotism in developed countries considerably worsened the situation in individual branches of industry and at enterprises, especially in finance and car-making. The countries where German investments prevailed were least affected (the Czech Republic and Poland), while those with the prevailing Italian capital (Hungary and Romania) and, especially the Scandinavian capital (the Baltic states) fared much worse.

The crisis did not give any particular advantages to the euro zone or euro-pegged currencies in combating it. The least affected were the countries which, unlike Hungary and Baltic states, had no significant debts in foreign currency and whose national banking sector that was more resistant to speculative trade. Poland, which leaned on its large domestic market, was the only EU country to post a GDP increase in 2009.

The same trends and consequences were characteristic for European CIS states with a meagre supranational support from the EU. Most importantly, the crisis made the prospect for their EU membership even more distant. Belarus was the only country that took advantage of the Eastern Partnership program, as it enabled it to draw an IMF loan.

Regional countries view cooperation with Russia as an additional stabilizing factor. In 2009, Russia ranked 1st to 6th largest importer in a majority of countries of Central and Eastern Europe, and took the 1st to the 9th place in their exports. It was the largest exporter and importer for Belarus and Ukraine and second largest for Moldova. Central and Eastern Europe is still interested in attracting Russian investments while keeping balance in this field. For example, Lithuania refuses to participate in building the Kaliningrad nuclear power plant, but agrees to let Russia return as strategic investor to the Mazeikiu oil refinery; Poland and Baltic states continue to object to the North Stream gas pipeline project, but agree to expand cooperation in the gas sphere in traditional formats.

The EU has lost an interest in Eastern Partnership countries for a short- and medium term. Cooperation with Russia partially compensates the lack of interest; it directly boosts the inflow of Russian capital, and indirectly stirs more interest in them on the part of western investors. For example, the guaranteed supplies of Russian oil and gas make the chemical, oil-refining and metallurgical industry of Ukraine and Belarus attractive to western investors.

Rapprochement with Russia may help European CIS countries resolve their foreign policy issues. Due to shrinking resources and a change in the attitude of EU countries towards enlargement, Eastern Partnership countries no longer have priority in the foreign policy of their traditional advocates in Central and Eastern Europe (Ukraine-Poland, Moldova-Romania). The EU attempts to counteract the trends toward the strengthening of Russia's role have been symbolic, such as the 20-million-euro package for small projects to develop the Crimea.

Russia received the opportunity to develop its activity along the guidelines which earlier were contained by the EU policy (transport and infrastructure (Broad Gauge Track 1520), use of ports, and energy sector).

Pulling out of the crisis and the first stage of post-crisis revival may last in the countries of Central and Eastern Europe and Baltic states until 2013-2014, and in Belarus, Moldova and Ukraine – until 2015-2017. This period (in the first place its initial stage, which will run until the end of 2013), is particularly favourable for Russia's intensifying its trade and economic relations with these Central and Eastern Europe countries, as struggle will unfold to specify the guidelines, timeframes and forms of implementation of the Europe-2020 strategy in Central and Eastern Europe, as well as the search for compromise in forming and distributing the EU budget for 2014-2020 by guidelines and countries.

During this period, Russia may consider using political leverage in securing an economic rapprochement with Ukraine, Moldova's political and economic instability, and a possible worsening of the socio-economic situation in Belarus.

Limited economic offers from Russia remain a problem. Given CIS states' lagging behind in the development of the state and national elites, Russia's attempts to base multi-party integration formats on bilateral economic rapprochement appear unproductive.

On Euro-Atlantic Security Initiative

The EASI project, launched by the Carnegie Endowment for International Peace, is implemented by the group of prominent politicians and experts from Russia, the USA and Europe with the goal to elaborate proposals on the new Euro-Atlantic security structure.

The EASI Commission co-chairmen are: former Senator Sam Nunn for the USA, former German Deputy Foreign Minister Wolfgang Ischinger for Europe, and former Russian Foreign Minister Igor Ivanov for Russia. IMEMO is the key partner of the project in Russia. All participants in the project see the solution of the problems not through the prism of Russian-Western relations, but in the context of common threats to security. Such an approach effectively promotes the Russian vision of all-European security. The President of the Russian Federation and the Ministry of Foreign Affairs recognized as expedient the EASI project and Russia's active participation in it.