

## NORDIC-BALTIC COOPERATION: OPPORTUNITIES, DIVISIONS AND EXTERNAL THREATS

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### ABSTRACT

The Nordic Baltic region (5+3)<sup>2</sup> is now closely interlinked via trade, investment, mobility of people, and banking. All the countries in this group have pursued some form of integration with the European Union (EU). Six of them are EU member states, four of them are members of the euro area, and all of them are within the European Economic Area (EEA) and are Schengen member states. But can these small countries as a group cooperate more closely and perhaps exercise more collective authority in Europe? The Nordic countries and the Baltic States cooperate in the Bretton Woods institutions, the World Bank and the IMF, and six of them are among European NATO member states. When it comes to European integration the lack of common approach complicates their cooperation. Within this group there are internal divisions between the hardcore EU and euro area member states (the Baltics and Finland), EU members (Denmark and Sweden) and EU outsiders (Iceland and Norway). Common pathways for the future cooperation in Europe may be hard to find. Also, the Nordics are high income welfare states, but the Baltics are neoliberal with minimal governments and low-tax regimes. Additionally, external forces continue to challenge the Nordic Baltic region, including revanchist Russian policies threatening Baltic Sovereignty, unpredictable US policies towards NATO as well as reduced military presence in Europe, and dismal EU and euro area post crisis economic performance. All point to a future of uncertainty including both economic and security risks. **KEYWORDS:** *European integration, small states, regional cooperation, Nordic countries, Baltic States.*

JEL CODES: F15, F50, P20

DOI:

### Introduction

The Nordic Baltic region is closely interlinked via trade, investment, mobility of people, and banking. Because of this integration, as well political, cultural and historical ties, these countries are sometimes referred to as the Nordic-Baltic countries (NB8). All the countries in this group have pursued some form of integration with the European Union (EU)<sup>3</sup> as will be discussed below.

Internally, the level of economic and political integration varies among these eight countries, for several reasons. These include, for example, different economic and political policies and priorities as well as different security concerns.

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<sup>2</sup> Nordics (5): Denmark, Finland, Iceland, Norway and Sweden. Baltics (3): Estonia, Latvia and Lithuania. All the eight countries together are sometimes referred to as NB8.

<sup>3</sup> The EU is an economic and political union between 28 European countries that together cover a large share of the continent. The EU was created in the aftermath of the Second World War. The first steps were to foster economic cooperation: the idea being that countries that trade with one another become economically interdependent and so more likely to avoid conflict, see further (European Union 2019a [https://europa.eu/european-union/about-eu/eu-in-brief\\_en](https://europa.eu/european-union/about-eu/eu-in-brief_en)). Current member states are: Austria, Belgium, Bulgaria, Croatia, the Republic of Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.

Externally the Nordic and the Baltic countries are greatly influenced by non-EU member states in Europe. Most notably the five countries in this group that share borders with Russia.<sup>4</sup> In fact, the Nordic-Baltic region has the distinction of being the only part of the EU that borders Russia. Countries in distant regions are also be important, especially the United States (USA) because of its role as security guarantor in Europe via its participation in the North Atlantic Treaty Organization (NATO)<sup>5</sup> (NATO, 2018) and leadership within that alliance.

While the focus of this article is mainly on the EU and NATO, it should be noted that those countries also cooperate in other institutions such as the Bretton Woods institutions (i.e. the World Bank and the International Monetary Fund) as well as the European Bank for Reconstruction and Development, the Council of Europe, the Organization for Security and Cooperation in Europe and the United Nations, amongst others.

The objective of this paper is to answer the question: Can the Nordic-Baltic countries as a group exercise collective authority in Europe? Answering this question requires considering internal differences including different approaches to European integration as well as different economic and social policies. External concerns also come into play, including proximity with Russia, reliance on the US and NATO, and finally economic and social performance of the EU and Euro Area post crisis.

## 1. The Nordic Baltic Region: EU integration and NATO membership

European integration is important for the Nordic countries and the Baltic States as their economies largely, albeit to varying degrees, depend on trade of goods and services with EU member states and thus access to the EU internal market. Dependence on trade with other nations is typical of small states which have relatively small domestic markets, produce a limited variety of goods and need to rely on cross-border trade to achieve economies of scale<sup>6</sup> in their production. Cross-border capital flows within the EU are also important to the Nordic countries and the Baltic States. This is especially true of the Baltic States, which are still in transition, catching up with richer EU member states. Access to the common labour market can be beneficial, especially if the flows of people are circular, that is, people migrating to other countries and returning with more experience and education. Nevertheless, this can be a challenge for the lower-income Baltic States, where young people may not have an incentive to return once settled in higher-income countries with better living conditions, including more advanced welfare systems. The austerity programmes in the Baltics have made them particularly vulnerable post 2008 crisis. Security issues also come into play as an important incentive to participate in European integration, and defence alliances are particularly important for small states that can be, and often have been, threatened by larger, more powerful neighbours. Iceland's situation is special in this regard as it is located in the Atlantic Ocean, far from continental Europe and has a bilateral defence agreement with the US in addition to NATO membership.

Because of their strategic locations, the Nordic and the Baltic countries have often been targets of conquest and control. During World War II Denmark and Norway were occupied by Germany. Finland fought against the Soviet Union. Iceland was under British and later US control. Only Sweden managed to remain neutral. All the Nordics regained their independence after World War II. In contrast, all three Baltic States suffered occupation for decades after World War II being annexed to the Soviet Union until 1991.

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<sup>4</sup> Finland, Estonia, and Latvia have eastern borders with Russia while Lithuania borders Kaliningrad. Norway borders Russia in the north-east.

<sup>5</sup> NATO's essential purpose is to safeguard the freedom and security of its members through political and military means, see further (NATO, 2019) <http://www.nato.int/nato-welcome/index.html> Among the Nordic countries, Denmark, Iceland and Norway are members. All three Baltic States are members. Finland and Sweden are not NATO member states but cooperate closely with NATO. The USA has been the major guarantor of peace in Europe via NATO although recent developments after the 2016 presidential elections have raised concerns about its weakening commitment.

<sup>6</sup> Economies of scale mean the cost advantage that arises with increased output of a product. Average cost per unit decreases as volume increases.

While the levels of Nordic and Baltic European integration are different, all the Nordic countries and the Baltic States are within the European Economic Area (EEA)<sup>7</sup> and participate in Schengen (European Commission, 2018a).<sup>8</sup> Six out of the eight countries are EU member states and two are European Free Trade Association (EFTA)<sup>9</sup> member states. Four of the Nordic-Baltic EU member states are also euro area member states and have thus adopted the euro<sup>10</sup> (see Figure 1 below).

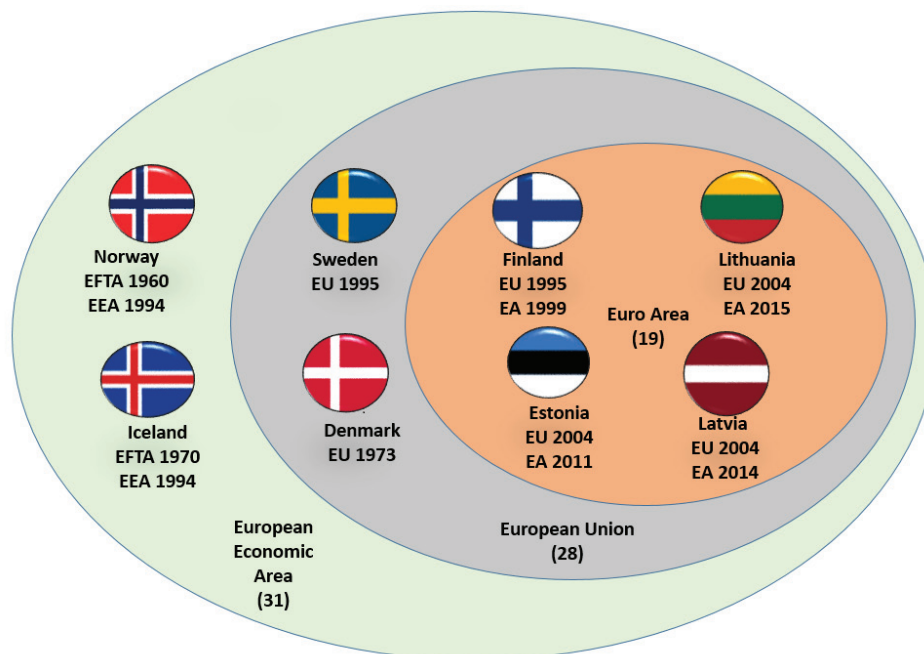


Figure 1. Different levels of European integration within the Nordic-Baltic region.

Source: Constructed by the author; EFTA 2014 and European Commission 2018b.

Euro Area (EA), European Economic Area (EEA), European Free Trade Association (EFTA) and European Union (EU)

<sup>7</sup> The EEA unites the EU member states and the three EEA EFTA States (Iceland, Liechtenstein, and Norway) into an Internal Market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms, see further (EFTA, 2019a) <http://www.efta.int/eea>

<sup>8</sup> The free movement of persons is a fundamental right guaranteed by the EU to its citizens. It entitles every EU citizen to travel, work and live in any EU country without special formalities. Schengen cooperation enhances this freedom by enabling citizens to cross internal borders without being subjected to border checks. Non-EU countries such as Iceland and Norway also participate in Schengen, see further (European Commission, 2018a) [http://ec.europa.eu/home-affairs/what-we-do/policies/borders-and-visas/schengen\\_en](http://ec.europa.eu/home-affairs/what-we-do/policies/borders-and-visas/schengen_en)

<sup>9</sup> EFTA is an intergovernmental organization set up for the promotion of free trade and economic integration for the benefit of its four member states. EFTA is responsible for the management of: (i) the EFTA Convention, which forms the legal basis of the organization and governs free trade relations between the EFTA states; (ii) EFTA's worldwide network of free trade and partnership agreements; and (iii) the European Economic Area (EEA) Agreement, which enables three of the four EFTA Member States (Iceland, Liechtenstein and Norway) to participate in the EU Internal Market, see further (EFTA, 2019b) <http://www.efta.int/about-efta/european-free-trade-association>

<sup>10</sup> All 28 EU member states are part of Economic and Monetary Union (EMU) and coordinate their economic policymaking to support the economic aims of the EU. However, a number of member states have taken a step further by replacing their national currencies with the single currency – the euro. These member states form the euro area. When the euro was first introduced in 1999 – as ‘book’ money – the euro area was made up of 11 of the then 15 EU member states. Of the Nordic countries, only Finland became a member of the euro area in 1999. Of the Baltic States, Estonia joined in 2011, Latvia in 2014 and Lithuania in 2015. Today, the euro area numbers 19 EU member states. Of the Nordic Countries outside the euro area, Denmark has “opted out” from joining (laid down in Protocols annexed to the Treaty) and Sweden has not yet qualified to be part of the euro area, see further (European Commission, 2018b) [https://ec.europa.eu/info/business-economy-euro/euro-area/what-euro-area\\_en](https://ec.europa.eu/info/business-economy-euro/euro-area/what-euro-area_en)

Among the Nordic countries and Baltic States, Iceland and Norway have the lowest level of European integration, being members of EFTA and parties to the EEA Agreement since 1994. While they are not EU member states, this arrangement provides them with access to the EU internal market critical for their export sectors. Denmark and Sweden have closer integration with the EU as full EU member states. However, neither country has chosen to enter the euro area and adopt the euro as their legal tender. Denmark has pegged its krona to the euro.<sup>11</sup> Sweden, on the other hand, maintains a floating exchange rate regime with an inflation target (Gylfason et al.: 167). Finland and the Baltic States have the highest level of EU integration among the Nordic countries and the Baltic States, being both EU and euro area member states.

All eight Baltic and Nordic countries participate in Schengen along with 18 other European countries, enabling free movement of their citizens within the Schengen Area.<sup>12</sup> In addition to economic and security benefits from European integration, all the Nordic countries and Baltic States except Finland and Sweden are members of NATO.<sup>13</sup> It is notable, but perhaps not surprising given their history and security concerns, that the Baltic States are the most internationally integrated countries in the Nordic-Baltic group. For the Baltics, EU membership was to provide long term prosperity. NATO membership was to provide military protection and hard security. They want the closest possible links with the West not only the older EU 15 member states (i.e. the member states before the 2004 and 2007 enlargements) but also the USA.

## 2. Economic integration and some theoretical considerations

For the Nordic Baltic countries, free trade among themselves and within the EU Internal market is critical, and arguably the internal market is the EU's greatest asset. Classical economic theory documents gain from international trade, demonstrating that nations can improve the welfare of their populations by engaging in cross-border trade with other nations. Trade between nations can, at least in theory, result in a positive sum game, meaning that the trading countries are all better off, benefiting from their gains from trade.<sup>14</sup> To this day this is one of the fundamental principles underlying arguments for all countries to strive to expand and to promote free world trade (e.g. Czinkota et al. 2009). The efficiencies derived from economies of scale<sup>15</sup> are also a key argument for economic integration:<sup>16</sup> creation of a common market allowing larger production and trading volumes can benefit all participating countries. The EU pursues regional integration, where those who have access to its common market can benefit as described above. According to regional integration theory, the level of integration varies. From least to most integrative, they are: a free trade area, a customs union, a common market, and finally, an economic and political union.

### 2.1. The European Free Trade Association (EFTA) and the European Economic Area (EEA)

EFTA is a free trade area and represents the loosest form of economic integration where all barriers to trade among member countries are removed. This is the route that Iceland and Norway have chosen and currently maintain in addition to access to the EU internal market via the EEA Agreement that came into force in 1994. Both countries have been reluctant in participants in European integration and have so far chosen

<sup>11</sup> Denmark has a treaty-based exception, i.e. "opt-out" from monetary union, which is not the case for Sweden.

<sup>12</sup> A Schengen Visa is a document issued by the appropriate authorities for visiting/travelling to and within the Schengen Area. The Schengen Area comprises 26 countries that have agreed to allow free movement of their citizens within this area as a single country. Of the 26 countries bound by the Schengen agreement, 22 are part of the EU and the other 4 are part of EFTA. The Schengen area covers the majority of European countries, except for the UK and countries such as Romania, Bulgaria, Croatia, Cyprus and Ireland, soon to be part of the agreement. However, countries that are not part of the EU such as Norway, Iceland, Switzerland and Liechtenstein do belong in the Schengen area and enjoy the free movement policy, see further (Schengen, 2019) <http://www.schengenvisainfo.com/>

<sup>13</sup> NATO is always headed by a European Secretary General although most of the heavy lifting militarily has been done by the USA.

<sup>14</sup> Without trade, countries can consume what they produce, but with trade they can consume beyond their production capabilities.

<sup>15</sup> Economies of scale are factors that cause the average cost of producing something to fall as the volume of its output increases.

<sup>16</sup> In addition to the economic benefits of economic integration, important political and security concerns may also drive the integration process.

to stay out of the EU. The current arrangement pursued by Iceland and Norway does not require a common trade policy, such as a common external tariff, with respect to non-members, as do customs unions such as the EU. Nor does it require the surrender of numerous measures of their national sovereignty to supranational authorities in Union-wide institutions such as the European Parliament, the European Commission and the European Council. Nor, too, does it require participation in common agricultural or fisheries policies. Furthermore, Iceland and Norway do not take part in European Central Bank activities as they are not part of the monetary union and have their own currencies.

Initially, the Nordic countries Denmark, Norway and Sweden were among the founding members of EFTA in 1960. Other founding members were Austria, Portugal, Switzerland and the United Kingdom (UK). Given the size of its economy, as well as its regional and global importance, the UK was in a leadership role in EFTA from the beginning until it left and joined the European Economic Community (EEC) in 1973. By joining the EEC, the UK sought more influence in shaping the EEC, a difficult or perhaps impossible task had the UK remained an EFTA member state only. Recently the UK decided to exit the EU but future arrangements with the EU and the level of economic integration remain unknown at the time of writing. With Brexit, the UK is entering uncharted territory and was scheduled to leave the EU, with or without an exit deal by the end of March 2019, now extended until end of October 2019.

Iceland became a member of EFTA in 1970 and Finland in 1986. All the Nordic countries thus decided to take part in this early regional integration effort led by EFTA. The Baltic States could not have participated in EFTA since they were occupied by the Soviet Union until their independence was re-established in 1991. To date the only Nordic countries that remain members of EFTA are Iceland and Norway. Denmark left in 1973 to join the EEC, while Finland and Sweden left in 1995 to join the EU, (see Table 2. below). Those Nordic countries were willing to surrender some of their national sovereignty to supranational authorities in Union-wide institutions and possibly hoped that they, as a like-minded group on many issues, would be able to influence the EU, that is, by being *systems-affecting* in the sense suggested by Keohane (Keohane, 1969) *that is*, states that cannot affect the international system if acting alone but that can exert significant impact on the system if working through small groups or alliances or through universal or regional international organizations.

Currently EFTA has four member states; Iceland, Liechtenstein, Norway and Switzerland. EFTA has three core tasks: The first is the liberalization of intra-EFTA trade. Second, the EFTA states have built networks of preferential trade relations throughout the world.<sup>17</sup> Third, three of the four EFTA states □ Iceland, Liechtenstein and Norway – are parties to the European Economic Area Agreement,<sup>18</sup> which ensures their participation in the Internal Market of the EU (EFTA, 2014).<sup>19</sup> Switzerland, also an EFTA member state, does not participate in the EEA Agreement, but has a bilateral agreement with the EU.<sup>20</sup>

As EFTA/EEA member states, Norway and Iceland have no formal influence on the decision-making phase on the EU side. They cannot directly affect EU laws and regulations governing the EU internal market that they are part of. EFTA/EEA member states can, though, participate in what is called ‘decision-shaping’. This means that in the phase of preparatory work undertaken by the European Commission in drawing up new legislative proposals, the EEA Agreement contains provisions for input from the EEA EFTA side at various stages before new legislation is adopted (see Figure 2 below).<sup>21</sup>

<sup>17</sup> EFTA is not a customs union.

<sup>18</sup> The EEA Agreement does not include the following EU policies: Common Agriculture and Fisheries Policies; Customs Union; Common Trade Policy; Common Foreign and Security Policy; Justice and Home Affairs (the EFTA States are part of the Schengen area); Economic and Monetary Union (EMU).

<sup>19</sup> The EEA EFTA States do not have the right to participate in political decision-making within the EU institutions. The EEA Agreement does, however, enable EEA / EFTA State experts to contribute to the shaping of EU legislation (EFTA, 2014).

<sup>20</sup> More information can be found about this agreement on the European Commission website [https://eeas.europa.eu/delegations/switzerland\\_de](https://eeas.europa.eu/delegations/switzerland_de) and on the Swiss Federal Administration website (Swiss Federal Administration, 2019) <https://www.eda.admin.ch/dea/fr/home/bilaterale-abkommen.html?lang=en>

<sup>21</sup> Decision-shaping is the phase of preparatory work undertaken by the European Commission to draw up new legislative proposals. The European Commission has an exclusive right to propose new legislation but is obliged to call on advice from external sources when doing so. The EEA Agreement contains provisions for input from the EEA / EFTA side at various stages before new legislation is adopted. Input can take the form of participation by EEA / EFTA experts on European Commission committees or submission of EEA / EFTA

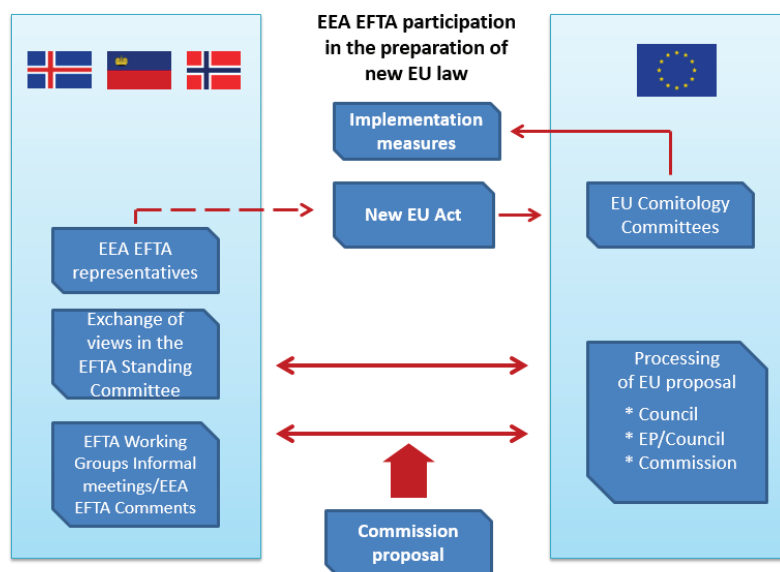


Figure 2. Decision Shaping i.e. EEA EFTA participation in the preparation of new EU law.

Source: EFTA (2014)

Given how small the EFTA/EEA member states are compared to the EU, it is questionable whether they can be classified as *systems-affecting* in the EU context. The reality is that Iceland, Liechtenstein and Norway receive the rules and laws governing the single European market via email without being able to directly influence the process of making them. In this regard, we can speak of sovereignty infringement. Since Iceland and Norway can only comment on those laws and regulations at an early stage of preparation at an expert level, they are not part of the final decision-making process and must adopt whatever decision is made finally by EU member states. This is the cost of enjoying access to the single market. So far the benefits have been assessed as higher than the costs.

As Table 1 shows, EFTA has lost most of its members, who chose closer economic integration by joining the EEC and later the EU, including the Nordic countries Denmark, Finland and Sweden. The Baltics never joined EFTA and immediately sought full EU membership.

Table 1. European Free Trade Association (EFTA)<sup>22</sup> membership through the years

1960	Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the UK establish EFTA
1970	Iceland becomes a member of EFTA
1973	Denmark and the UK leave EFTA to join the EEC
1985	Portugal leaves EFTA to become a member of the EEC
1986	Finland becomes a full member of EFTA
1991	Liechtenstein becomes a member of EFTA
1995	Austria, Finland and Sweden leave EFTA to join the EU

Source: EFTA, 2014; Constructed by the author

comments, as well as adoption of resolutions in response to European Commission initiatives. Bearing in mind that the EEA/ EFTA States have little influence on the decision-making phase on the EU side, it is all the more important for them to be actively involved in the decision-shaping process of EEA legislation (EFTA, 2019c) <http://www.efta.int/eea/decision-shaping>

<sup>22</sup> EFTA is an intergovernmental organization set up for the promotion of free trade and economic integration for the benefit of its member states (today Iceland, Liechtenstein, Norway and Switzerland). The Association is responsible for managing the EFTA Convention, which forms the legal basis of the organization and governs free trade relations between the EFTA States; EFTA's worldwide network of free trade and partnership agreements; and the Agreement on the European Economic Area, which extends the EU Internal Market to three of the four EFTA States (Iceland, Liechtenstein and Norway) (EFTA, 2014).

## 2.2. The European Union (EU) and the Euro Area

The EU has been moving towards an economic and political union. This involves not only abolition of tariffs and quotas among members – as in the case of a free trade area such as EFTA – but also a common tariff and quota system, abolition of restrictions of factor movements, as well as harmonization and unification of economic policies and institutions. While EFTA has lost membership, the EU has expanded its membership, with currently 28 countries. This has included three Nordic countries and all the Baltic States.

Denmark joined (the then EEC) in 1973, Sweden and Finland joined the EU in 1995, and the Baltics – Estonia, Latvia and Lithuania – in 2004, (see Table 2 below). Norway rejected EEC membership in a referendum in 1973 and rejected EU membership in a referendum in 1994. Iceland applied for EU membership in 2009, but in 2013 the Icelandic government requested that ‘Iceland should not be regarded as a candidate country for EU membership’ (see Table 2. below). This decision was made without a public referendum, but by a cabinet coalition formed in 2013 (Hilmarrsson, 2017). Opinion polls show that support for EU membership immediately after the crisis evaporated in Iceland in light of the failure of the EU leadership in handling the crisis (see for example Hilmarrsson, 2015 and 2017; Hannibalsson, 2017). There are no signs of change and the new cabinet formed in 2017 is not seeking EU membership.

Table 2. The EU and the Nordic-Baltic Region

1962	<i>Norway</i> , the UK, <i>Denmark</i> and Ireland apply for membership in the EEC.
1973	<i>Denmark</i> , Ireland and the UK become members of the EEC. <sup>23</sup> <i>Norway</i> rejected EEC membership in a popular referendum.
1994	The <i>Norwegian</i> referendum rejects accession to the EU.
1995	<i>Austria</i> , <i>Finland</i> , and <i>Sweden</i> become members of the EU. <sup>24</sup>
2004	<i>Estonia</i> , <i>Latvia</i> and <i>Lithuania</i> join the EU. <sup>25</sup>
2009	<i>Iceland</i> applies to join the EU. <sup>26</sup>
2013	The <i>Icelandic</i> government requests that ‘Iceland should not be regarded as a candidate country for EU membership’ <sup>27</sup>

Source: Constructed by the author.

The formation of an economic union requires nations to surrender some measure of their national sovereignty to supranational authorities in union-wide institutions. Iceland and Norway have not been prepared to join the EU.

Surrendering sovereignty is not controversial only in the Nordic region, as the recent decision of the UK to leave the EU demonstrates. British exit was decided in a 2016 referendum whereby British citizens voted to exit the EU: Brexit.<sup>28</sup> It remains to be seen how Brexit will be implemented and if some other EU member states will follow the UK and also consider exiting. This also depends on what kind of a deal, if any, the UK manages to make with the EU. EFTA nations are closely watching EU and UK negotiations as the final outcome could result in demands for a changed EEA agreement.

EU member states clearly have different opinions on what regional integration should include and how far it should go. This has resulted in varying levels of integration among countries within the EU. Nineteen out of 28 member states have adopted the euro (€) as their common currency and sole legal tender (see Figure 1). Among the Nordics, Denmark and Sweden, both EU members, have chosen to stay out of the euro area.

<sup>23</sup> (European Union, 2019b) [https://europa.eu/european-union/about-eu/countries\\_en](https://europa.eu/european-union/about-eu/countries_en)

<sup>24</sup> (European Union, 2019b) [https://europa.eu/european-union/about-eu/countries\\_en](https://europa.eu/european-union/about-eu/countries_en)

<sup>25</sup> (European Union, 2019b) [https://europa.eu/european-union/about-eu/countries\\_en](https://europa.eu/european-union/about-eu/countries_en)

<sup>26</sup> (European Commission, 2019) [https://ec.europa.eu/neighbourhood-enlargement/countries/detailed-country-information/iceland\\_en](https://ec.europa.eu/neighbourhood-enlargement/countries/detailed-country-information/iceland_en)

<sup>27</sup> (European Commission, 2019) [https://ec.europa.eu/neighbourhood-enlargement/countries/detailed-country-information/iceland\\_en](https://ec.europa.eu/neighbourhood-enlargement/countries/detailed-country-information/iceland_en)

<sup>28</sup> Brexit is an abbreviation for ‘British exit’, which refers to the 23 June 2016 referendum whereby British citizens voted to exit the EU.

The formation of a common currency area can bring economic benefits to the members of the currency union, particularly if there is a high degree of international trade among them – that is, a high level of trade integration. This is primarily because of reductions in transaction costs in trade and the reduction in exchange-rate uncertainty.

However, joining a currency union also involves costs, namely, loss of independent monetary policy and loss of the exchange rate as a means of macroeconomic adjustment. Among the Nordic countries, only Finland has adopted the euro. All the Baltic States have also done so (see Table 3 below). Denmark and Sweden rejected euro area membership and adoption of the euro in referendums. Iceland and Norway would not be eligible for membership in the euro area and could not do so unless first joining the EU and then fulfilling the euro area criteria for at least two years.

Table 3. The Euro Area and the Nordic-Baltic Region

1992	Denmark granted opt-outs from participating in the euro.
1999	Finland becomes a member of the euro area and adopts the euro. <sup>29</sup>
2003	Sweden decides not to adopt the euro for the time being in a referendum.
2011	Estonia becomes a member of the euro area and adopts the euro. <sup>30</sup>
2014	Latvia becomes a member of the euro area and adopts the euro. <sup>31</sup>
2015	Lithuania becomes a member of the euro area and adopts the euro. <sup>32</sup>

Source: Constructed by the author

### 2.3 The lack of common approach in European integration

In addition to economic theories on gains from trade and economies of scale, as well as theories on the economics of integration, including a common currency area, there are theories on the behaviour of small states within multilateral arrangements. Small states as well as large states have a choice to engage in bilateral negotiations and/or multilateral arrangements to address issues that cannot only be resolved within their borders. Bilateral negotiations are carried out between two countries focusing only on their own interests. On the other hand, multilateralism is the international governance of the many, for example, EFTA with four member states, the euro area with 19, the EU with 28, and the EEA with 31 member states, large and small. Schengen has 26 member states and NATO 29.

Arguably, the lack of a common approach among the Nordic countries to European integration is unfortunate (see Figure 1) and is not in their best interest collectively. The Nordics have rather homogenous populations and are often considered like-minded, with a similar social and cultural background as well as political traditions. A Nordic group with a coordinated approach could have become a stronger voice within EU decision-making bodies. This might help to further the interest of the Nordics as well as influencing the future direction of European integration efforts (Gylfason, 2010: 167).

On the other hand, the Baltic States have a common European integration approach, but are neoliberal, with their approaches in terms of both economic and social policies differing from the Nordics. On this account the Nordics and the Baltics are not like-minded countries.

The Baltics along with Finland all have the same level of integration, being both EU and euro area member states.<sup>33</sup> Finland adopted the euro in 1999, Estonia in 2011, Latvia in 2014 and Lithuania in 2015. The

<sup>29</sup> European Union, 2019c) [https://europa.eu/european-union/about-eu/countries/member-countries\\_en](https://europa.eu/european-union/about-eu/countries/member-countries_en)

<sup>30</sup> European Union, 2019c) [https://europa.eu/european-union/about-eu/countries/member-countries\\_en](https://europa.eu/european-union/about-eu/countries/member-countries_en)

<sup>31</sup> European Union, 2019c) [https://europa.eu/european-union/about-eu/countries/member-countries\\_en](https://europa.eu/european-union/about-eu/countries/member-countries_en)

<sup>32</sup> European Union, 2019c) [https://europa.eu/european-union/about-eu/countries/member-countries\\_en](https://europa.eu/european-union/about-eu/countries/member-countries_en)

<sup>33</sup> The Baltic States are also NATO member states so arguably their level of integration is higher than that of the Nordic Countries, none of which is an EU and euro area member as well as a NATO member.



Baltic States made huge sacrifices to ensure euro area membership by implementing austerity programmes during the 2008/9 global economic and financial crisis.

It would be hard, if not impossible, for the Nordics to implement such policies without social unrest. The level of tolerance for such radical government decisions is lower in the Nordics. Arguably, income and wealth inequality within the Baltic States has undermined democracy in those countries with divisions between the elite and the poor much sharper not only as compared to the Nordics but also as compared with countries at a similar income level such as the Czech Republic, the Slovak Republic and Slovenia (Hilmarsson, 2014).

### 3. Security concerns, Euro Area and NATO

In addition to economic considerations when joining the euro area, Finland and later the Baltic States had political motives to settle their political identities once and for all. Finland has for long lived in the shadow of either the Soviet Union or Russia. The Baltic States were occupied by the Soviet Union after the end of World War II until regaining independence in 1991. Finland, Estonia and Latvia have eastern borders with Russia, while Lithuania borders Kaliningrad,<sup>34</sup> since 1945 part of the Soviet Union and then Russia. For those countries, EU and euro area membership are more than merely an economic integration arrangement. Security concerns too are of utmost importance for Finland and the Baltics. The EU could hardly ignore an attack on a member state without responding. Large EU countries, especially Germany and France, both euro area member states, could hardly tolerate an attack on the euro area. In addition to EU and euro area membership, the Baltic States were also keen on NATO membership and all became members in 2004.<sup>35</sup> It is notable that while EU enlargement proved to be a very lengthy and complex process for new member states, including the Baltics, NATO enlargement, which proceeded in parallel, proved much simpler and faster. Perhaps US support helped?

Of the Nordic countries, Denmark, Iceland and Norway joined NATO in 1949 and thus had been members for 55 years when the Baltic States joined (see Figure 3). NATO still remains the primary actor in European collective defence. The Baltics thus participated in a twin enlargement of the EU and NATO in 2004, driven by economic, political and security motives. Since the Ukraine crisis the Baltics have been increasingly concerned with the emerging security threat from Russia, looking to the USA to lead NATO for protection. NATO can be viewed as the alpha and omega of their security, but EU membership and especially euro area membership is also important. It is notable that while NATO was expanding and its commitment increasing, the USA was reducing its military presence in Europe. Increased commitment thus coincided with reduced military power in Europe. This has weakened NATO as a guarantor of peace in Europe.

Recently, the US commitment to NATO has also come under question. During the 2016 presidential campaign, Donald Trump stated that NATO may be 'obsolete' and the European allies would have to start paying their way in NATO.<sup>36</sup> Trump considers the Europeans as free-riders.

Regardless of Trump's views and intentions, Europeans may need to recognize that the USA may not be able – financially, politically or militarily – to play the role of global policeman it assumed in 1945 (see, for example, Howorth, 2017). The USA is faced with many challenges, most notably in the Middle East and in the Pacific region. The US economy represented about half of the world economy's GDP at Bretton Woods conference, but this is now merely 25%. Times have changed and Europe may increasingly be forced to take more charge of its own security. As Angela Merkel recently stated, Europe's fate is "in our own hands."<sup>37</sup>

There is a need to rethink relations between the EU and NATO. The EU may increasingly need to take over NATO, recognizing that the world has changed and the USA has other security priorities than it had

<sup>34</sup> The Russian exclave of Kaliningrad on the Baltic Sea is sandwiched between Poland to the south and Lithuania to the north and east. Annexed from Germany in 1945, the territory was a closed military zone throughout the Soviet period.

<sup>35</sup> Estonia, Latvia and Lithuania became members of NATO on 29 March 2004. Prior to NATO membership they were members of the Warsaw Pact since 1955 as part of the Soviet Union.

<sup>36</sup> Merkel hits back at Trump: Europe's fate is "in our own hands" (Business Insider, 2017).

<http://uk.businessinsider.com/merkel-hits-back-at-trump-europes-fate-is-in-our-own-hands-2017-1?r=US&IR=T>

<sup>37</sup> "(Business Insider, 2017) <http://uk.businessinsider.com/merkel-hits-back-at-trump-europes-fate-is-in-our-own-hands-2017-1?r=US&IR=T>

post-World War II, when NATO was established. Arguably the euro area may to some extent have replaced NATO as a security alliance backed up by Germany and France as military powers. Since the Baltics and Finland are euro area countries, those main euro powers would have to respond to any attack on them. The EU powers may also increasingly need to take over NATO as US commitment weakens, because US relative economic power has diminished, its presence in Europe has been reduced and also because the USA is busy in other regions, most notably in the Middle East and in the Pacific.

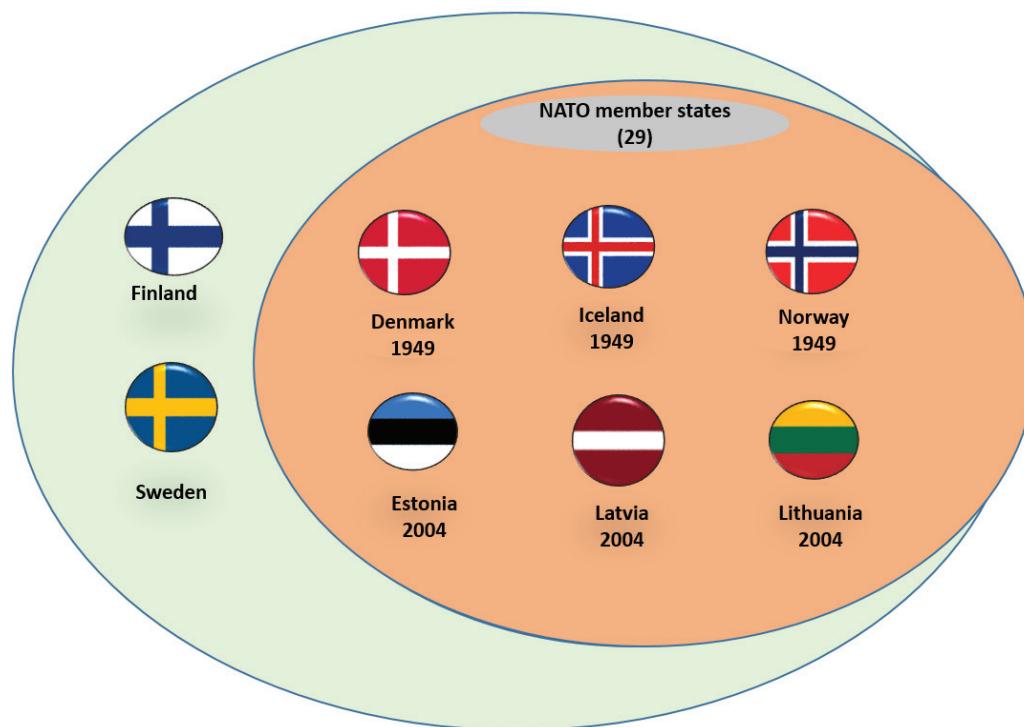


Figure 3. Nordic and Baltic membership in NATO

Source: Constructed by the author

Denmark, Iceland and Norway were founding members of NATO post-World War II. The Baltic States took part in a twin enlargement of EU and NATO, becoming members of both institutions in 2004. Russia has warned it would respond to any move by Finland or Sweden to join NATO, see for example Guardian (2016) <sup>38</sup>

## Conclusions

Can the Nordic-Baltic countries as a group exercise collective authority in Europe?

If all eight Nordic countries and Baltic States (NB8) had a united position on European integration issues, they might be able to influence the other 22 EU member states to a greater degree than they can today. The same level of integration within the EU could make the Nordic countries and the Baltic States *system-affecting*, that is, states that cannot affect the international system if acting alone but that can exert significant impact on the system if working through small groups or alliances or through universal or regional international

<sup>38</sup> “Russia has warned it would respond to any move by Finland or Sweden to join NATO. In a meeting with his Finnish counterpart in early July, Vladimir Putin claimed (wrongly) that Russian troops had been withdrawn 1500km from the Finnish border, but suggested that decision would be reviewed if Finland moved towards NATO membership” (Guardian, 2016). <https://www.theguardian.com/world/2016/aug/22/finland-us-russia-military-security>

organizations. Considering security, the NB8 countries are also divided vis-à-vis NATO with six countries as member states while two countries, Finland and Sweden, remain out of NATO.

In retrospect, the most effective and successful exercise of the EU in recent decades has been the transformation of most Central and Eastern European states, including the Baltics, from authoritarian polities and command economies into democracies embracing market forces and the rule of law. However, the Nordics are welfare states and with economic and social policies that differ sharply from the neoliberal Baltics with minimal governments, low-tax regimes and weak social safety nets. How much benefit they could gain from cooperation is questionable, especially when the countries have different economic and social policies and continue to be at very different levels of economic development, with the Baltics still poorer than the Nordics now almost 30 years after regaining their independence.

Furthermore, the EU and the euro area have not shown impressive economic performance since the 2008/9 crisis. Economic growth remains relatively low and unemployment remains high, especially among young people, resulting in large outward migration, especially from poorer EU member states such as the Baltics to richer EU15 member states.

Iceland and Norway have chosen to stay out of the EU with access to the common market via the EEA agreement. Denmark and Sweden, both EU member states, have chosen to keep their own currency, the former with an exchange rate pegged to the euro, and the latter with a floating exchange rate and an inflation target. They have kept the option to manage their own exchange rate should the need arise. In contrast, Finland and the Baltic State both EU and euro area member states are locked in a fixed exchange policy as long as they keep the common currency.

From an economic perspective, euro area membership means giving up monetary autonomy for member countries, and comes at the cost of increased macroeconomic instability should asymmetric shocks become significant. The only Nordic country adopting the euro is Finland.

Small states are also vulnerable when dealing with the EU and larger EU member states during times of crisis, as the case of Iceland and Latvia (Hilmarrson, 2014) clearly demonstrates. The Baltics were also vulnerable when dealing the Nordics (most notably Sweden) when the latter sought to protect its banking interests in the Baltics during the 2008/9 crisis insisting of fixed exchange rate policy in the Baltics.

Within the Nordic-Baltic group there are thus internal divisions between are hardcore EU/euro area member states (Baltics and Finland), EU members (Denmark and Sweden) and EU outsiders (Iceland and Norway). Common pathways for future cooperation in Europe are not obvious.

External forces also continue to challenge the Nordic Baltic region, including revanchist Russian policies threatening Baltic Sovereignty, unpredictable US policies towards NATO and reduced military presence in Europe, as well as EU and Euro Area dismal economic performance post crisis. All point to a future of uncertainty including both economic and security risks for the Nordic Baltic region.

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## ŠIAURĖS IR BALTIJOS ŠALIŲ BENDRADARBIAVIMAS: GALIMYBĖS, BENDRADARBIAVIMAS, IŠORINĖS GRĖSMĖS

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### Santrauka

Baltijos šalių Šiaurės regionas (5 + 3) glaudžiai susijęs prekybos, investicijų, žmonių judumo ir bankininkystės sritymis. Šiaurės šalys (5): Danija, Suomija, Islandija, Norvegija ir Švedija. Baltijos šalys (3): Estija, Latvija ir Lietuva. Visos aštuonios šalys kartu vadinamos NB8. Visos šios grupės šalys siekė tam tikra forma integruotis į Europos Sąjungą (ES).

Šešios iš jų yra ES valstybės narės, keturios – euro zonos narės, visos yra Europos ekonominėje erdvėje (EEE) ir yra Šengeno valstybės narės. Bet ar šios mažos šalys, kaip grupė, gali glaudžiau bendradarbiauti

ir galbūt vykdyti daugiau kolektyvinių įgaliojimų Europoje? Šiaurės ir Baltijos šalys bendradarbiauja Bretono Vudso monetarinėje sistemoje, Pasaulio Banko ir Tarptautinio Valiutos Fondo veikloje, šešios jų yra Europos NATO valstybių narės. Kalbant apie Europos integraciją, bendro požiūrio nebuvimas apsunkina jų bendradarbiavimą. Šioje grupėje išlikęs vidinis pasiskirstymas tarp senųjų ES šalių ir euro zonos valstybių narių (Baltijos ir Suomijos), ES narių (Danija ir Švedija) ir ES nepriklausančių šalių (Islandija ir Norvegija). Gali būti sudėtinga surasti bendrą būsimo bendradarbiavimo Europoje būdą. Jei visos aštuonios Šiaurės ir Baltijos šalys (NB8) Europos integracijos klausimais laikytųsi bendros pozicijos, jos galėtų paveikti kitas 22 ES valstybes nares. Be to, tai gali padaryti įtaką Šiaurės šalims ir Baltijos valstybėms, kurios, veikdamos atskirai, negali daryti įtakos tarptautinei sistemai apskritai, bet gali daryti didelę įtaką sistemai, dirbdamos per mažas grupes ar aljansus, visuotines, regionines, tarptautines organizacijas. NB8 šalys yra susiskaldžiusios ir kalbant apie saugumą: šešios valstybės yra NATO narės, dvi – Suomija ir Švedija – nėra NATO.

Žvelgiant iš ekonominės perspektyvos, narystė eurozonoje reiškia, kad valstybės narės turi atsisakyti pinigų autonomijos. Vienintelė Šiaurės šalis, įvedusi eurą, yra Suomija. Beje, Šiaurės šalys yra stiprios ekonomikos šalys su dideliais mokesčiais (gerovės valstybės), tuo tarpu Baltijos šalys yra neoliberalios, jų mokesčių režimas – mažas. Be to, išorinės jėgos ir toliau meta iššūkį Šiaurės Baltijos regionui, įskaitant revanšistinę Rusijos politiką, kuri kelia grėsmę Baltijos šalių suverenitetui, nenuspėjamą JAV politiką NATO atžvilgiu, mažesnę karinę grėsmę Europoje ir niūrias ES bei euro zonos ekonomines pasekmes po krizės. Kalbama apie ateities netikrumą, kuris apima ir ekonominę, ir saugumo riziką.

**PAGRINDINIAI ŽODŽIAI:** *Europos integracija, mažos valstybės, regioninis bendradarbiavimas, Šiaurės šalys, Baltijos šalys.*

JEL KLASIFIKACIJA: F15, F50, P20.

*Received: 2019-09-15*

*Revised: 2019-09-30*

*Accepted: 2019-10-01*