The Baltic States in the Aftermath of the Financial Crisis: Macroeconomic Indicators and Budgetary Legislation

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Abstract
This paper is aimed at analyzing macroeconomic indicators and budgetary legislation in the Baltic states during and after the financial crisis. The paper starts off by outlining the economic performance of Estonia, Latvia, and Lithuania from the early 1990s to 2009. It then shows that the Baltic states succeeded in overcoming the crisis by adopting tough fiscal austerity policies and pinpoints Estonia as a meaningful example. According to forecasts, the three countries are also expected to meet with considerable economic growth in 2016. Part II of the paper provides an overview of budgetary legislation recently passed in Estonia, Latvia, and Lithuania to comply with principles and rules laid down at both EU and inter-governmental levels. Overall, the Baltic states appear to be championing the euro.

Introduction

The aim of this paper is to analyze macroeconomic[1] indicators and budgetary legislation in the Baltic states during and after the financial crisis. The paper is divided into two parts. Part I is mainly

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[1] A plethora of authors have sought to explain macroeconomics as a concept. Gordon, for instance, has defined macroeconomics as "the study of the major economic 'totals' or aggregates – total production (GNP), total employment and unemployment, the average price level of all goods and services, the total money supply, and others." ROBERT J. GORDON, *Macroeconomics*, 11 (Boston and Toronto, 1978). *See*, also, RUDIGER DORNBUSCH – STANLEY FISCHER, *Macroeconomics*, 3 (6th ed., McGraw-Hill, New York, 1993) (arguing that macroeconomics "is concerned with the behavior of the economy as a whole – with booms and recessions, the economy's total output of goods and services and the growth of outputs, the rates of inflation and unemployment, the balance of payments, and exchange rates.") Macroeconomics - the Author continues - "deals both with long-run economic growth and with the short-run fluctuations that constitute the business cycle." *Id*. Boulding has distinguished macroeconomics from microeconomics by pointing out that the former "deals not with individual quantities, as such, but aggregate of these quantities – not with individual incomes but with the national income, not with individual prices but with price levels, not with individual output but with national output." KENNETH E. BOULDING, *A Reconstruction of Economics*, 3 (John Wiley & Sons, New York, and Chapman & Hall, London, 1950). In addition, Dwivedi has pointed out that an important part of macroeconomics considered as a whole "studies the effect of government's economic policies – monetary policy (i.e., the effect of change in money supply, interest rate, etc.), and fiscal policy (i.e., the effect of changes in the government spending and taxation)." D.N. DWIVEDI, *Essentials of Business Economics*, 10 (New Delhi, 2009).

focused on showing how the economy of the Baltic states has been performing in the last few years. Macroeconomic indicators suggest that those countries, among which Estonia stands out, have overcome the crisis. Furthermore, the Baltic states are expected to meet with a significant increase in real GDP by the end of 2016. As it has been emphatically maintained, "the Baltic tigers start roaring again, though in a more sustainable manner, as the three countries are among the fastest growing in the EU."[2] Part I of the paper proceeds as follows. Section A outlines the economic performance of Estonia, Latvia, and Lithuania from the early 1990s – when the countries regained independence and took on a path towards accession to the EU – to the financial crisis. Section B intends to stress the fact that the Baltic states managed to get rid of the negative effects of the crisis by adopting tough fiscal austerity policies. The Estonian government's way of countering the crisis is given as a paradigm of implementation of fiscal austerity. Section C deals with the dynamics of the Baltic states' economic growth in 2015 and 2016 by relying on the latest forecasts released by the European Commission.

Part II provides an overview of budgetary legislation in Estonia, Latvia, and Lithuania. Those countries recently reformed their domestic framework on financial and budgetary matters to ensure compliance with measures taken at EU and inter-governmental levels. The Baltic states have proved to be very diligent in implementing supranational principles and rules. Part II is made up of four sections. Section A pinpoints the main principles and rules established by Council Directive 2011/85/EU on budgetary frameworks that EU member states have to be equipped with. Then, the three subsequent sections look through budgetary legislation that national parliaments of the Baltic states have passed in recent years. As far as Lithuania is concerned, Section D analyzes the Constitutional Law of 2014 that implemented the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) - also known as Fiscal Compact or Fiscal Treaty[3].

I. Recent Macroeconomic Indicators in the Baltic States: the Crisis Is Over

A. Economic Performance of the Baltic States from the 1990s to the Crisis

Estonia, Latvia, and Lithuania are often deemed to be so similar that each of them ends up being referred to as "a single unit of the 'Baltic states.'"[4] On the one hand, the phrase "Baltic states" should be used with due caution, for the three countries feature many differences in language, religion, and culture in general[5]. On the other hand, those countries "have experienced plenty of analogies in [their] political and constitutional history" since independence was restored in 1918[6]. In particular, they had communist

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[2] AGNIA GRIGAS ET AL., *The Baltic States in the EU: Yesterday, Today and Tomorrow* [hereinafter – *The Baltic States in the EU*], 33 (Paris: Notre Europe – Jacques Delors Institute, 2013), available at http://www.delorsinstitute.eu/media/balticstateseu-grigaskasekampmaslauskaitezorgenfreija-ne-jdi-july13.pdf).

[3] For an overview of the principles laid down in Chapter XI of the Constitution - "Finances and the state budget," *see* DALIA VASARIENĖ, *The Constitutional Foundations of the Financial System of the State of Lithuania*, Jurisprudence, 2012, 19(3), 988-991. At the end of her analysis, the Author comes to the conclusion that constitutional provisions and decisions of the Constitutional Court of Lithuania addressing budget legislation and relevant processes overall build up "a uniform system of legal regulation which is implemented through provisions of the Statute of the *Seimas*, the Law on the budget structure and other main laws." *Id.*, at 1001.

[4] GRIGAS ET AL., *The Baltic States in the EU*, *supra* note 2, at 14.

[5] I will take the liberty of referring the reader to a paper of mine – MARCO LUNARDELLI, *Estonia amid cooperation in the Baltic Sea region and EU membership*, Nomos, 2014(2), 4-5.

[6] *Id.*, at 4.

regimes for fifty years[7] but approached Western countries and began a transition to market economies after the collapse of the Soviet Union[8].

The Baltic states, indeed, have faced the same economic and political issues since the 1990s. It has been noted that two "exogenous shock[s]"[9] markedly affected the dynamics of real GDP in the years between the twentieth and twenty-first centuries. The first shock – the financial crisis of 1998 in the Russian Federation[10] – was a negative one. Estonia, Latvia, and Lithuania suffered a steep shrinkage in growth due to close links to Russia's economy. The Baltic states, however, succeeded in copying with the downturn, especially because of their increasing interest in the euro area and "reorientation of Baltic exports from the Russian to the European market […]."[11] Actually, Estonia and Latvia reacted to the Russian crisis more strongly and quickly than Lithuania did[12]. The economies of eurozone countries, which the Baltic states were getting closer to, slowed down their expansion in the period 2001-2003[13], and yet this slackening did not affect the Baltic region much. In that period, indeed, economic growth remained steadily above 6% in Estonia, Latvia, and Lithuania[14]. The second shock, brought about by accession to the EU, benefited the Baltic states. They joined the European Union in 2004, thus being part of "the EU's biggest-ever enlargement."[15] An increase in the three countries' GDP, indeed, featured the years following the accession[16]. Macroeconomic indicators show that, overall, Estonia performed better than Latvia and

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7 *See* ANNELI ALBI, *EU Enlargement and the Constitution of Central and Eastern Europe*, 20 (Cambridge: Cambridge University Press, 2005) (underscoring that the Baltic states approved "Stalinist constitutions" as a consequence of annexation to the USSR). Those constitutions proclaimed "the principal Communist ideals: leadership of the Marxist-Leninist Party in society; state-owned means of production; centrally planned state economy; state monopoly in foreign trade; limited right to personal property, etc." *Id.* The Author adds that "[t]he constitutions were regarded as political rather than legal documents." *Id.*

8 LUNARDELLI, *Estonia amid cooperation in the Baltic Sea region and EU membership*, *supra* note 5, at 15-17. *See*, also, GRIGAS ET AL., *The Baltic States in the EU*, *supra* note 2, at 14 (noting that the Baltic states "have been fully integrated in the Soviet Union for more than half a century, they all have regained independence and built their nation states from scratch almost a quarter of century ago and they all have joined numerous international institutions, including the EU and NATO [in 2004].")

9 LUDMILA FADEJEVA - ALEKSEJS MELIHOVS, *The Baltic states and Europe: common factors of economic activities*, Baltic Journal of Economics, 8(1), 2008, 80.

10 *Id.*, at 79, note 12 (explaining that the Russian crisis "occurred as a result of unsustainable public debt dynamics and the corrections needed to an overvalued real exchange rate.")

11 *Id.*, at 83.

12 *Id.*, at 86 (pointing out that "[t]he response of the Lithuanian economy to the Russian crisis was weaker and the following recovery slower compared with neighbouring countries.") This observation is correct especially with reference to 1999 and 2000. In 1999, real GDP amounted to -0.6% in Estonia and +2.8% in Latvia, while it was -1.8% in Lithuania. As regards the year 2000, GDP grew by 7.3% and 6.8% in Estonia and Latvia, respectively. In Lithuania, instead, the increase in GDP was more limited (4.0%). *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2003*, European Economy, 2003 (5), 115.

13 The euro area's average growth was 1.9% in 2001, 0.9% in 2002, and 0.7% in 2003. *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2005*, European Economy 2005 (5), 121.

14 Estonian GDP grew by 6.5% in 2001, came to 7.2% in 2002 and then underwent a slight turndown in 2003 (6.7%). Latvia saw its real GDP grow as follows: by 8.0% in 2001, 6.4% in 2002, and 7.2% in 2003. Lithuania's economy experienced the same trend – a considerable growth, a minor slackening, and a fresh increase. GDP, indeed, came to 7.2% in 2001, amounted to 6.8% in 2002, and then reached 10.5% in 2003. *Id.*

15 EUROPEAN COMMISSION, *Understanding enlargement. The European Union's enlargement policy*, 5 (2007). Ten new countries – Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia – became EU member states as of May 1, 2004.

16 In 2004, Estonia and Latvia had an increase in GDP (7.8% and 8.3%, respectively), while the growth in Lithuania (7.0%) was lower than it had been the previous year. *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2005*,

Lithuania after the Baltic states took the path that led up to EU membership. The Estonian government itself pointed out that the country's annual economic growth rate was quite impressive before the financial crisis hit Europe[17]. However, the shift from boom to bust was astonishing, as well. GDP plummeted between 2008 and 2009[18]. The recession turned out to be even sharper in Latvia. The country's economy managed to curb the decline in 2008[19] but crumbled in 2009, when real GDP fell to -17.7%[20]. The Latvian government esteemed the macroeconomic situation to be so damaged that they called for the International Monetary Fund's assistance in December 2008. In the letter of intent, Latvian authorities requested that the IMF support an economic program of recovery "through a 27-month Stand-By Arrangement (SBA) in the amount equivalent to SDR 1.521626 billion (1,200.02 percent of quota or €1.7 billion) covering the period December 2008 to March 2011."[21] On December 23, 2008, the Executive Board of IMF approved an arrangement that resulted in granting Latvia about €1.68 billion comprehensively[22]. That sum of money was supposed to fund "the country's program [aimed at] restor[ing] confidence and stabiliz[ing] the economy."[23] Other international and European institutions also stepped in, for the resources made available by IMF were not adequate for Latvia's needs[24]. In the 2009 review of SBA, however, the IMF staff acknowledged that the recession turned out to be much deeper than envisioned when the program was launched[25]. This drastic downturn "reflect[ed] the collapse of domestic demand, the unwinding of the credit and real estate bubble, and the much worse than expected international environment."[26] The situation in Lithuania was somewhat different. The country attained economic growth in 2008, while GDP underwent steep contraction the following year[27]. Indeed, "a severe output decline" occurred in 2009[28].

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supra note 13, *id.* Estonia's and Latvia's economy kept growing in 2005 and reached its peak in 2006 (10.0% and 12.2%, respectively). The Lithuanian GDP, instead, grew at the same rate in 2005 and 2006 (7.8%). *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2009*, European Economy, 2009(10), 188.

17 *See* GOVERNMENT OF ESTONIA, *National Reform Programme "Estonia 2020"*, 3 (April 25, 2013) (reporting that Estonia's real GDP grew by roughly 8% per year on average in the period 2000-2007).

18 Estonian GDP came out at -3.7% in 2008 and dropped to -14.3% in 2009. *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2011*, European Economy, 2011(6), 206.

19 That year, Latvia's real GDP suffered a decrease of 3.3%. *Id.*

20 *Id.*

21 *Latvia: Letter of Intent* (December 18, 2008), in IMF, *Republic of Latvia: Request for Stand-By Arrangement - Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Latvia*, 60 (January 09, 2009), available at http://www.imf.org/external/pubs/ft/scr/2009/cr0903.pdf.

22 IMF, *IMF Executive Board Approves €1.68 Billion (US$2.35 Billion) Stand-By Arrangement for Latvia*, Press Release No. 08/345 (December 23, 2008), 1.

23 *Id.*

24 *Id.*, at 2 (stating that "[t]he Fund's Stand-By Arrangement [would] fill just over 20 percent of the country's 2009-2011 net financing gap.") The European Union, the European Bank for Reconstruction and Development, the World Bank, and other bilateral creditors committed themselves to covering the remainder. *Id.*

25 *See* IMF, *Republic of Latvia: First Review and Financing Assurances Review Under the Stand By Arrangement, Requests for Waivers of Nonobservance of Performance Criteria, and Rephasing of Purchases Under the Arrangement* (September 30, 2009), 4.

26 *Id.*

27 Lithuania's GDP grew by 2.9% in 2008 and then fell to -14.8% in 2009. *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2011*, *supra* note 18, *id.*

28 IMF, *Republic of Lithuania: 2010 Article IV Consultation - Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Lithuania* (July 09, 2010), 3, available at http://www.imf.org/external/pubs/ft/scr/2010/cr10201.pdf. The IMF staff report clarifies that the Lithuanian economy's downturn began "in the third quarter of 2008 as a reversal in capital flows led to a collapse of domestic demand and the global recession caused exports to fall." *Id.*

B. Fiscal Austerity to Tackle the Crisis: The Case of Estonia

The three Baltic states succeeded in overcoming the negative effects of "the most serious economic crisis since the 1930s"[29] by adopting tough fiscal austerity[30] policies. In this regard, the Estonian government's way of coping with the financial crisis appears to be paradigmatic. The fiscal austerity program the government implemented in 2009 was devised so as to unfold throughout the year[31]. Firstly, the government adopted a set of measures which mainly consisted in expenditure cuts in January. Secondly, a package combining cuts and tax increases was released in June. Thirdly, some fiscal adjustments framed in Autumn completed the program. This harsh policy paid off as it resulted in containing the general government deficit. The budget deficit, indeed, decreased from 2.9% of GDP in 2008 to 2.0% in 2009[32], thereby scoring the third lowest among all EU member states[33]. The Estonian deficit of the whole government sector kept shrinking and turned into a surplus (+0.2% of GDP) in 2010[34]. Unlike Estonia, Latvia and Lithuania had to deal with a high budget deficit. The trend in those countries went in the opposite direction – while Estonia was striving to reduce the annual negative gap between net lending and net borrowing, Latvia's and Lithuania's budget deficit had a conspicuous increase[35]. The same holds true for the macroeconomic indicator concerning consolidated gross debt at end-year nominal value. This indicator, however, shows a peculiarity that differs Estonia not only from Latvia and Lithuania, but from almost all EU member states. Since accession to the EU, indeed, Estonia has stood out for the low amount of its gross debt. Estonia has never deviated from this trend, not even during the financial crisis or in the aftermath of it[36]. Only two member states had in that period – and still do – a modest gross debt – Luxembourg and Bulgaria[37]. Neither of them, however, could compete with

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29 NICHOLAS CRAFTS, *What Does the 1930s' Experience Tell Us about the Future of the Eurozone?*, 52(4) Journal of Common Markets Studies (2014), 713.

30 *See* BARRY ANDERSON – ELIZABETH MINNEMAN, *The abuse and misuse of the term "Austerity". Implications for OECD countries*, OECD Journal on Budgeting, 2014(1), 110 (pointing out that the term "austerity" derives from a Latin word – *austerus*, which means harsh or dry) (referring to FLORIAN SCHUI, *Austerity: The Great Failure*, 11 (New Haven: Yale University Press, 2014)). Anderson and Minneman highlight that it was not until the 1950s that economists and historians started to employ the term "austerity" in the field of economics. Over the twentieth century, however, austerity measures taken by governments used to "involve[e] rationing of consumption due to scarce resources." *Id.*, at 112. Austerity as meant nowadays, instead, usually implies "fiscal consolidation trough spending cuts or increases in taxes, rather than direct rationing of consumer goods out of necessity." *Id.*

31 For an overview of the fiscal austerity policy that Estonia realized in 2009, *see* RINGA RAUDLA, *Fiscal Retrenchment in Estonia during the Financial Crisis: The Role of Institutional Factors* [hereinafter - *Fiscal Retrenchment in Estonia*], Public Administration, 91(1), 2013, 38-39.

32 *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2011*, *supra* note 18, at 223.

33 In 2009, while the financial crisis was rampaging across Europe, only two countries – one in the eurozone (Luxembourg) and the other outside of it (Sweden) – performed better than Estonia in net lending/net borrowing. The general government deficit amounted to 0.9% of GDP in Luxembourg and 0.7% in Sweden. *Id.*

34 *Id.*

35 In 2008, the general government deficit came to 4.2% of GDP in Latvia and 3.3% in Lithuania. The deficit rose the following year markedly – final figures were 9.7% in Latvia and 9.5% in Lithuania. Analogy in the trend continued to exist in 2010 as the deficit slightly shrank in both countries. The budget deficit decelerate to 8.3% of GDP in Latvia and 7.0% in Lithuania. *Id.*

36 In 2008 and 2009, the Estonian gross debt amounted to 4.5% of GDP and 7.2%, respectively. The following year, the country witnessed a decrease in its sovereign debt, which was equivalent to 6.7% of GDP. *Id.*, at 225. The gross debt had a further shrinkage in 2011 and stabilized at 6.0% of GDP. *See* EUROPEAN COMMISSION, *Economic forecasts. Spring 2015*, European Economy, 2015(6), 174.

37 Bulgaria joined the European Union in 2007 but is not part of the euro area.

Estonia thereupon[38]. As it was the case with budget deficit, gross debt had similar dynamics in Latvia and Lithuania. The two countries' sovereign debt was low in 2008 but underwent a sharp increase in 2009 and kept expanding the following year[39]. Nonetheless, Latvia's and Lithuania's gross debt was much lower than the average of the euro area[40].

Raudla and Kattel have noted that Estonia's successful path to economic recovery prompted many analysts to consider the country "as a shining poster-boy of crisis management."[41] Implementation of a strict fiscal austerity policy allowed the Estonian government to achieve its primary purpose – to meet the Maastricht criteria, thereby being eligible for the eurozone[42]. Kattel has also maintained that "Estonia's numbers (public debt and expenditure, budget cuts) [were] sheer magic in the [then-existing] European context."[43] As a result of the government's approach, Estonia came to be seen as "an example par excellence of handling the crisis" by austerity advocates[44]. In 2010, the European Commission found that Estonia had fulfilled the Maastricht criteria and the Council of the EU formally established that Estonia was to adopt the euro on 1 January 2011[45]. It has been observed that had Estonia been forced to wait longer for joining the euro area, the EU would have conveyed a "perverse message" because of the very performance of Estonia in a critical situation[46]. The Estonian government praised its own approach to the crisis by arguing that the country was becoming "a model of the fiscal discipline that the EU [meant] to bring to the entire Euro area."[47] Famous economist Paul Krugman criticized the representation of Estonia as "the poster child for austerity defenders" by pointing out that the country's economic recovery was still

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[38] In 2008 and 2009, Luxembourg's general government debt amounted to 13.7% and 14.8% of GDP. The gross debt went up to 19.1% in 2010. As regards Bulgaria, the debt-to-GDP ratio was 13.7% in 2008, 14.6% in 2009, and 16.3% in 2010. *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2011*, *supra* note 18, at 225.

[39] The debt of Latvia's general government sector was 19.8% of GDP in 2008. Then, it reached 36.7% in 2009 and 44.7% in 2010. Lithuania had a sovereign debt being equivalent to 15.5% of GDP in 2008. The country saw its gross debt go up to 29.4% in 2009 and 38.0% in 2010. *Id.*

[40] The eurozone countries' average general government debt was equivalent to 70.1% of GDP in 2008, 79.8% in 2009, and 85.6% in 2010. *Id.*

[41] RAINER KATTEL – RINGA RAUDLA, *The Baltic Republics and the Crisis of 2008-2011, Europe-Asia Studies*, 65(3), 2013, 435.

[42] *See* RAUDLA, *Fiscal Retrenchment in Estonia*, *supra* note 31, at 42 (arguing that "had the Maastricht criteria provided for a lower or higher level of deficit [than the budget deficit limit of 3% of GDP], the Estonian government would have set the goal accordingly.")

[43] RAINER KATTEL, *Should Greece Follow Estonia's Example?* (April 21, 2010), available at: http://www.networkideas.org/news/apr2010/news21_Rainer_Kattel.htm.

[44] *Id.*

[45] *See* Council Decision 2010/416/EU of 13 July 2010 in accordance with Article 140(2) of the Treaty on the adoption by Estonia of the euro on 1 January 2011, OJ 2010 L 196/1.

[46] *See* PIRET EHIN, *Green light to Estonia's Euro-accession amidst tumult in the Eurozone*, EU-27 Watch, 2010(9), now available at http://www.eu-28watch.org/?q=node/462 (quoting EDWARD LUCAS, *Euro not bust*, The Economist (13.05.2010)). Lukas, indeed, stated: "Estonia is almost the only country in the whole EU that actually meets the common currency's rules. All those that use the Euro have gaily breached the deficit and debt limits. The grit shown by Estonian politicians and the public in shrinking spending, raising taxes and cutting wages has been exemplary. Punishing Estonia, which obeyed the rules, while bailing out Greece, which has breached them flagrantly, would do little for the Euro's credibility with governments and investors alike." *Id.*

[47] *Id.* (quoting OTT UMMELAS, *EU's Least-Indebted State Is Model After Greek Crisis*, available at: http://www.businessweek.com/news/2010-05-11/eu-s-least-indebted-state-is-model-after-greek-crisis-update2-.html).

incomplete[48]. Nevertheless, Estonia was the first Baltic state to meet "the necessary conditions for the adoption of the euro."[49] Latvia came second and switched to the common currency on January 1, 2014[50]. Lithuania succeeded in fulfilling the Maastricht criteria only in 2014, and the changeover to the euro occurred on January 1, 2015[51].

C. Growth Prospects of the Baltic States in 2016

After getting out of the financial crisis, the three Baltic states are forecast to experience considerable economic growth in 2016. In the short term, adoption of the euro benefited Estonia, whose GDP had an outstanding increase in 2011[52]. In the two subsequent years, however, the country's economy underwent a steep slowdown[53]. The negative trend reversed only in 2014, and an increase in GDP was registered[54]. According to the European Commission's latest forecasts, Estonian GDP is expected to keep growing in 2015 and – above all – 2016[55]. The dynamics that featured Latvia's and Lithuania's economy in the past few years turn out to be dissimilar to the Estonian case. Latvia saw real GDP get to its peak in 2011 (5.0%)[56] – an extraordinary outcome as the preceding year had been marked by recession (-0.3%)[57]. Then, the country's economic growth met with a progressive and yet substantial downturn[58]. Forecasts say that real GDP will have a further contraction - albeit minimal – in 2015[59] and then grow by 3.2% in 2016[60]. Lithuania's GDP managed to get back on the right track already in 2010 (+1.4%), after the drastic decline occurred in 2009[61]. As it was the case with Latvia, Lithuania's growth reached its apex in 2011 (6.1% of

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48 *See* PAUL KRUGMAN, *Estonian Rhapsody*, The New York Times blog "The Conscience of a Liberal" (June 06, 2012), available at http://krugman.blogs.nytimes.com/2012/06/06/estonian-rhapsdoy/. His post reads as follows: "Since Estonia has suddenly become the poster child for austerity defenders — they're on the euro and they're booming! — I thought it might be useful to have a picture of what we're talking about. Here's real GDP, from Eurostat: [picture posted]. So, a terrible — Depression-level — slump, followed by a significant but still incomplete recovery. Better than no recovery at all, obviously — but this is what passes for economic triumph?" President of the Republic of Estonia Toomas Hendrik Ilves replied "with a vitriolic Twitter post, accusing Krugman of being 'smug, overbearing and patronizing' towards East Europeans […]". NICOLE LINDSTROM, *The Politics of Europeanization and Post-Socialist Transformation*, 62 (Palgrave Macmillan, London, 2015) (referring to JOSHUA KEATING, *President of Estonia goes ballistic on Paul Krugman*, Foreign Policy blog "Passport" (June 06, 2012), available at http://foreignpolicy.com/2012/06/06/president-of-estonia-goes-ballistic-on-paul-krugman/).

49 Article 1 of Council Decision 2010/416/EU, *supra* note 45, *id.*

50 *See* Council Decision 2013/387/EU of 9 July 2013 on the adoption by Latvia of the euro on 1 January 2014, OJ 2013 L 195/24.

51 *See* Council Decision 2014/509/EU of 23 July 2014 on the adoption by Lithuania of the euro on 1 January 2015, OJ 2014 L 228/29.

52 Estonian GDP grew by 8.3% from 2010 to 2011. *See* EUROPEAN COMMISSION, *Economic forecasts. Spring 2015*, *supra* note 36, at 154.

53 Estonia's economic growth decelerated to 4.7% of GDP in 2012 and to 1.6% in 2013. *Id.*

54 GDP growth stepped up to 2.1% in 2014. *Id.*

55 Estonia's GDP increase will be almost negligible in 2015 (2.3%) in comparison with the preceding year and more sizeable in 2016 (2.9%). *Id.*

56 *Id.*

57 *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2011*, *supra* note 18, at 206.

58 The negative gap in Latvia's real GDP growth was very narrow between 2011 and 2012 (from 5.0% to 4.8%). Increase in GDP, however, went on shrinking – it fell to 4.2% in 2013 and to 2.4% in 2014. *See* EUROPEAN COMMISSION, *Economic forecasts. Spring 2015*, *supra* note 36, at 154.

59 Latvia's growth will experience an increase by 2.3% of GDP at the end of current year. *Id.*

60 *Id.*

61 *See* EUROPEAN COMMISSION, *Economic forecasts. Autumn 2011*, *supra* note 18, at 206.

GDP)[62]. In the following years, the increase in Lithuanian GDP encountered a decided slackening[63]. The growth rate of GDP is expected to decrease slightly at the end of current year and advance, instead, in 2016[64].

Moreover, the three Baltic states share traditionally strong trade relations with the Russian Federation. Accordingly, recent geopolitical issues that involves Russia have had serious implications for the Baltic economies. As the European Commission has noted in its latest forecasts, "[t]he combination of much lower oil prices and economic sanctions are pushing the Russian economy into recession in 2015, with several key indicators having fallen in negative territory in the first months of the year (e.g. retail sales and industrial production)."[65] The economic situation in Russia is expected to get better during 2016, "given the assumed easing of geopolitical tension and a gradual pick up of oil prices as well as a strengthening of external demand."[66] In the meanwhile, however, exports – as well as imports – are forecast to be suffering a sharp decrease by the end of current year[67]. This contraction is affecting the Baltic states, especially Estonia[68] and Latvia[69].

II. Recent Budgetary Legislation in the Baltic States

A. Council Directive 2011/85/EU on Budgetary Frameworks in EU Member States

In the past few years, the Baltic states have passed new legislation to comply with Council Directive 2011/85/EU [hereinafter – the Directive], which lays down "requirements for budgetary frameworks" of EU member states[70]. The primary objective of the Directive is to ensure that EU member states observe "budgetary discipline as required by the TFEU."[71] In particular, Article 126 TFEU provides that "excessive government deficits" are forbidden in the EU[72] and empowers the European Commission "[to] monitor the development of the budgetary situation and of the stock of government debt in the Member States […]."[73] Two of the protocols annexed to the TEU and TFEU are relevant to the rules contained in Article 126. Protocol No 12 deals with the excessive deficit procedure mentioned in Article 126 TFEU, while Protocol No 13 explains what the euro convergence criteria actually consist of. The Council directive in discussion falls within a set of measures taken at EU and inter-governmental levels to tackle the financial crisis. The Directive came after the European Council decision of March 25, 2011, that opted for establishing a permanent financial crisis resolution mechanism within the euro area – the European

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62 *See* EUROPEAN COMMISSION, *Economic forecasts. Spring 2015*, *supra* note 36, at 154.
63 Lithuania's GDP grew as follows: by 3.8% in 2012, 3.3% in 2013, and 2.9% in 2014. *Id.*
64 The latest forecasts released by the European Commission set an increase in Lithuania's GDP that is equivalent to 2.8% and 3.3% in 2015 and 2016, respectively. *Id.*
65 *Id.*, at 46.
66 *Id.*
67 *Id.*
68 *Id.*, at 76 (stating that "[a]fter a fall of 15% in 2014, exports of goods [from Estonia] to Russia are expected to further drop by more than 50% in 2015, reflecting lower demand and the sharp depreciation of the Russian rouble.")
69 *Id.*, at 92 (pointing out that "[t]he growth outlook for 2015 is expected to be overshadowed by the fallout from economic turbulence in Russia, which constrains production and business investment in some sectors.") The European Commission also highlights the fact that roughly 11% of Latvian exports are directed to Russia. *See* European Commission, SWD(2015) 33 final, Country Report – Latvia 2015, 3.
70 Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, OJ 2011 L 306/41.
71 Recital 28, Council Directive 2011/85/EU.
72 Article 126(1) TFEU.
73 Article 126(2) TFEU.

Stability Mechanism (ESM) – by amending Article 136 TFEU. The Directive is part of the so-called "Six-Pack"[74], which entered into force on December 13, 2011. Moreover, adoption of the so-called "Two-Pack" in 2013 contributed to strengthening surveillance on member states' budgetary performance in the eurozone. All EU member states except for the Czech Republic and United Kingdom signed the Treaty on Stability, Coordination and Governance on 2 March 2012. It has been observed that "[o]n the one hand, the Fiscal Compact – together with the 'six-pack' and 'two-pack' legislative packages – marks a strengthening of the economic policy co-ordination approach, whilst avoiding the transfer of fiscal capacity to the EU level."[75] On the other hand, the TFEU amendment setting up the ESM – often simply referred to as the ESM Treaty – "does create a solidarity mechanism, which may aim to safeguard the eurozone but does so by shoring up eurozone members in difficulty."[76] Gaining access to ESM support requires "compliance with fiscal and economic policy co-ordination measures (conditionality) […]."[77] Dimopoulos has pointed out that "the ESM and the Fiscal Compact introduce[d] international law obligations in an area covered largely by EU law […]."[78] Therefore, the ESM and the Fiscal Compact end up establishing "a governance structure that supplements the EU legal order [because of] their intergovernmental nature […]."[79] The main purpose of this structure is "to foster fiscal responsibility and solidarity within the [euro area]."[80]

Recital 20 of the Directive states that "the approval of annual budget legislation is the key step in the [domestic] budget process" and yet acknowledges that state budget acts include fiscal measures whose effects exceed "the annual budgetary cycle." Sound fiscal and budgetary policies also call for a multi-annual perspective. Therefore, the annual budget legislation of (at least) EU member states sharing the euro "should be based on multi-annual budget fiscal planning stemming from the medium-term budgetary framework." Article 2(e) of the Directive defines medium-term budgetary frameworks as "a specific set of national budgetary procedures that extend the horizon for fiscal policy-making beyond the annual budgetary calendar, including the setting of policy priorities and of medium-term budgetary objectives." Furthermore, Article 6(1)(b) of the Directive requires member states to ensure that the oversight of compliance with fiscal rules at national level be carried out by independent bodies or bodies enjoying functional autonomy from domestic fiscal authorities. Under Article 9(1) of the Directive, each member state has to furnish its own legal system with a medium-term budgetary framework "providing for the adoption of a fiscal planning horizon of at least 3 years […]." Such a framework is supposed to include specific procedures concerning the items listed in Article (9)(2)[81].

B. Estonia

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[74] The EU enacted five regulations in addition to Council Directive 2011/85/EU, hence the name "Six-Pack".

[75] MAURICE ADAMS ET AL., *Introduction - The Constitutionalization of European Budgetary Constraints: Effectiveness and Legitimacy in Comparative Perspective*, in ID., *The Constitutionalization of European Budgetary Constraints*, 3 (Hart Publishing, Oxford, 2014).

[76] *Id.*

[77] *Id.*

[78] ANGELOS DIMOPOULOS, *The Use of International Law as a Tool for Enhancing Governance in the Eurozone and Its Impact on EU Institutional Integrity*, in *id.*, at 42-43.

[79] *Id.*, at 43.

[80] *Id.*

[81] *See* Article 9(2)(a)-(d).

In Estonia, the State Budget Act was passed on February 19, 2014,[82] and amended four months later – on June 19[83]. The act expressly repeals the legislation that was previously effective[84]. Section 1(1) clarifies that the aim of the act is to lay down "the conditions and procedure for the drafting and passage of the state budget and the use of the funds in the state budget." Section 5(1) of State Budget Act defines the budget position of the general government sector as "the difference between the total revenue and total expenditure of the general government sector." The structural budget position of the general government sector, instead, is "the cyclically adjusted budget position of the general government sector […]."[85] Pursuant to Section 6(1), the annual state budget shall ensure that the structural budget position of the general government sector be "in balance or in surplus." The budget has to be drafted by taking into account the financial forecast, whose function is "[to] describ[e] the revenue, expenditure and investments of the general government sector together with the likely changes."[86] The macroeconomic forecast, instead, is aimed at outlining "the state economic environment together with the likely developments […]."[87]

The Fiscal Council must assess both the state macroeconomic forecasts and the state financial forecasts and is also vested with the more general function of overseeing the observance of budgetary rules in Estonia[88]. Section 4(2) requires that the government give reasons if it disagrees over the (technical) opinion expressed by the Fiscal Council. The Bank of Estonia Act[89], as recently amended, specifies what role the Fiscal Council has in the Estonian legal system. Section 4^2 of the act, added in 2014[90], defines the Fiscal Council as an advisory body entrusted with two tasks set down in Paragraph 1. The first task is "to evaluate the economic forecasts which serve as foundations for the economic policy of Estonia;" the second one consists in "monitor[ing] compliance with internal budgetary procedures in Estonia." Pursuant to the same provision, the Fiscal Council fulfills its tasks by acting "as an independent body which accepts no instructions from the Bank of Estonia, the Government of the Republic or any other private or public body."

Section 7 of State Budget Act addresses the case in which the structural budget position of the general government sector is neither in balance nor in surplus by providing for an adjustment mechanism. The state financial forecast must certify a situation of deficit in order for the mechanism to operate. In such a case, the Minister of Finance is to acquaint the government with details concerning the deficit "within one month following the publication of the forecast […]"[91] Section 7(2) requires that the government adopt all measures it deems necessary to reduce the deficit. In particular, a deficit that has been assessed by the state financial forecast to exceed 0.5% of GDP compels the government to act accordingly. Furthermore, the government will have to take action if the European Commission and the Council of the EU find that the structural budget position of the general government sector "differs to a

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82 *Riigieelarve seadus* – RT I, 13.03.2014, 2.
83 RT I, 29.06.2014, 109.
84 Section 109 of the act, indeed, repeals the former state budget act – RT I, 1999, 55, 584. For an analysis of the rules governing the budget formulation process prior to approval of recent legislation, *see* DIRK-JAN KRAAN ET AL., *Budgeting in Estonia*, OECD Journal on Budgeting, 2008(2), 2.
85 Section 5(2), State Budget Act.
86 Section 15(2), State Budget Act.
87 Section 15(1), State Budget Act.
88 *See* Section 4(1), State Budget Act.
89 Bank of Estonia (*Eesti Pank*) Act. The act was enacted on 18 May 1993 (RT I, 1993, 28, 498) and last amended by RT I, 19.03.2015, 3.
90 RT I, 13.03.2014, 2.
91 Section 7(1), State Budget Act.

significant extent from the medium-term budgetary objective [...] or from the adjustment path for the achievement thereof [...]." Section 7(4) states that the objective of implementing the measures adopted by the government is to improve the structural budget position of the general government sector "by at least 0.5 per cent of the GDP per year until the structural budget balance is achieved."

Section 8 of State Budget Act provides for a compensation mechanism. This mechanism applies when, according to the financial forecast, the structural budget deficit went beyond 5% of GDP in the year preceding the drafting of the state budget. After the structural budget balance is reached, the government has to plan a structural surplus of the general government sector that be equivalent to at least 0.5% of GDP per year. The structural surplus is to remain as long as it equals the amount of the budgetary deficit in euros.

C. Latvia

The *Saeima,* Latvia's 100-seat unicameral parliament, approved the Law on Fiscal Discipline (LFD) on January 31, 2013[92]. Pursuant to Article 1 LFD, the law[93] lays down principles and rules on fiscal policy aimed at ensuring a balanced state budget in Latvia[94]. The essential purpose of the law, pursued by establishing those principles and rules, is to guarantee macroeconomic stability and lessen the negative impact of external factors on national economy. Article 5 LFD requires that a medium-term budgetary framework law be drawn up every year for a three-year period. In particular, the budgetary expenditure ceiling for the first two years is "inherited"[95] from the one established in the previous framework law with reference to the second and third years. Article 10 LFD prescribes that the general government structural balance set in the draft framework law may not be lower than -0.5% of GDP for each of the three years. This figure, therefore, accounts for the minimum medium-term objective (MTO). The draft framework law is permitted to derogate from the minimum MTO only if extraordinary circumstances come about. Those circumstances are laid down in Article 12 LFD. In addition to an expenditure growth condition set in Article 13 by referring to Regulation (EU) No 1175/2011, Article 14(1) is aimed at ensuring that the Maastricht criterion concerning the debt-to-GDP ratio be observed. The provision, indeed, prescribes that the general government debt contained in the draft framework law not exceed 60% of GDP at current prices for each financial year. Pursuant to Article 17(2) LFD, the framework law is also to determine the fiscal security margin in accordance with quantifiable fiscal risks as detected in the relevant statement. The margin just mentioned may not be lower than 0.1% of GDP. Moreover, Article 19 LFD takes into account the case in which the state budget produces an actual surplus as revenue exceeds public expenditure. Article 19(3) empowers the Cabinet of Ministers to decide annually whether to use the surplus to fund the long-term stabilization reserve or to reduce the sovereign debt. Article 20(1) vests the Minister for Finance

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92 *Fiskālās disciplīnas likums* - OP 2013/36.1.

93 I need to use the terms "act" and "law" as synonyms, since different countries pick either the former or the latter in turning their domestic legislation into English. Estonia tends to use the term "act" to refer to an act of Parliament passed by following the ordinary legislative procedure. By contrast, Latvia appears to prefer the term "law," which is traditionally believed to have a broader meaning. The Oxford English Dictionary, indeed, defines "law" as "[t]he body of rules, whether proceeding from normal enactment or from custom, which a particular state or community recognizes as binding on its members or subjects." *Entry - "Law"* (I.1.a), Oxford English Dictionary Online (OED).

94 For a study of budget rules and procedures existing in Latvia before recent reforms were brought in, *see* DIRK-JAN KRAAN ET AL., *Budgeting in Latvia*, OECD Journal on Budgeting, 2009(3), 185.

95 Z. RASNAČA, *Constitutional change through euro crisis law: "Latvia"*, European University Institute (January 16, 2014), available at http://eurocrisislaw.eui.eu/latvia/.

with the power to formulate medium-term macroeconomic forecasts. In drafting the forecasts, the Minister has to cooperate with the Bank of Latvia and the Ministry of Economics.

Finally, Article 21 LFD provides for a fiscal discipline council. The first version of the law - i.e., the one discussed by the Parliament at first reading - opted for a different solution[96]. This solution consisted in conferring an oversight function on the Cabinet of Ministers, thereby excluding the institution of a brand new public authority. The Cabinet of Ministers, indeed, was assigned the task to supervise the observance of fiscal rules. On the contrary, the final version of the law introduced the Fiscal Discipline Council. The council is devised as an independent collective body whose function is to oversee compliance of Latvia's budget with fiscal rules.

The Law on Budget and Financial Management (LBFM)[97], amended many times, lays down rules on the budget process at national and local levels in Latvia. The Preamble states that the purpose of the law is "[to] determine the procedure for the formulation, approval and implementation of the State budget and local government budgets and the responsibility in the budget process." Sections 3-8 LBFM pinpoint the main contents of different types of budgets, thereby settling some classifications. Section 3(1), in particular, draws two major lines - one between the state budget and local government budgets, and another one between budgets of derived public persons partially financed from the state budget and budgets of the institutions non-financed from the budget. Section 3(2), however, adds that despite being different, the state budget and local government budgets both consist of a basic budget and a special budget. Moreover, there exists the long-term stabilisation reserve, that Section 8^1(1) LBFM defines as "a fiscal policy instrument" aimed at achieving predetermined purposes. The provision, amended in 2008, lists three purposes, all of them implying financial stabilization: "to reduce general economic risks;" "to avoid socio-economic crises or to reduce the impact thereof;" "to ensure the availability of financial resources in the case of emergency situation." Section 8^1(2) clarifies that a law on long-term stabilisation reserve is supposed to lay down rules for the establishment and handling of the reserve. The annual state budget law encompasses diverse state budget appropriations[98], all of which "cease to be in effect" at the end of the financial year[99]. The annual state budget law is also required to decide on an appropriation reserve that "ministries, other central State institutions and local governments request and use according to the procedure determined by the Cabinet [of Ministers]."[100]

Chapter III of LBFM (sections 16-22) deals with the procedures for drafting, submitting and adopting budget laws. The Minister for Finance is empowered to prepare the draft medium term budget framework law and the draft annual state budget law - the so-called "package of budget bills."[101] Section 16^1(1) LBFM establishes November 30 of each year as the deadline for submitting the package of budget bills to the Cabinet of Ministers. Furthermore, Section 16^2(1) provides that the Minister for Finance annually updates the forecasts on Latvia's medium-term macroeconomic development by cooperating with the Minister for Economics and the Bank of Latvia. Section 16^2(2) requires that the draft medium term budget framework law contain a good deal of information with reference to each of the three financial years covered by the law. The information that the Minister for Finance is supposed to furnish includes: the objectives set down by the government on fiscal policy; forecasts of GDP; "the amount of the State

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[96] *Id.*

[97] *Likums par budžetu un finanšu vadību - Latvijas Vēstnesis*, 41 (172), 06.04.1994.

[98] *See* Section 9(1) LBFM.

[99] *See* Section 9(4) LBFM.

[100] Section 9^1(1) LBFM. Section 9^1 was added in 2007 and amended in 2009.

[101] Section 16 LBFM.

budget financial balance (maximum deficit level or minimum surplus level) expressed in per cent from the gross domestic product of the relevant year;"[102] "the maximum permissible total amount of the State budget expenditure."[103] Under Section $16^2(10)$, the Cabinet of Ministers has to submit the draft medium term budget framework law for the subsequent three years to the Parliament by April 30. Article 18 LBFM deals with budgetary requests for appropriations submitted by ministries and other central-state institutions. Those requests have to be presented to the Minister for Finance[104]. In formulating their requests, ministries and state bodies may not exceed "the maximum permissible amount of the State budget expenditure specified in the Medium Term Budget Framework Law for the relevant year."[105] The power to decide on state budgetary requests is vested in the Minister for Finance. Section 19(3) requires that the Minister for Finance "evaluate the budgetary requests on the basis of their conformity with the purposes provided for, the results to be achieved, the conformity with the budget purposes and priority development directions determined in the Medium Term Budget Framework Law, as well as economy and efficiency and, if necessary, request necessary additional information for the relevant evaluation." Pursuant to Section 20(1) LBFM, the Minister for Finance is to transmit the draft annual state budget law to all ministries and central-state institutions, which may put forward "reasoned objections." The Minister tries to reach an arrangement with dissenting authorities. If differences are not settled, those who still disagree upon the Minister's choices are allowed to prepare a statement that is attached to the draft law[106]. Then, the Minister submits the draft annual state budget law to the Cabinet of Ministers, which has to take into account the opinions expressed by fundamental state institutions such as the Supreme Court, the Constitutional Court, and the State Audit Office[107]. The Cabinet of Ministers, which "decide[s] as to submission of the Draft Annual State Budget Law [...] to the *Saeima*,"[108] is bound to follow a specific deadline. Section 21(1) LBFM, indeed, provides that the Cabinet of Ministers is to submit the draft annual state budget law to the Parliament by October 1 of the relevant year. Finally, Section 22 LBFM concerns adoption of the annual state budget law by the Parliament.

D. Lithuania

On November 6, 2014, Lithuania adopted a constitutional law that implemented the TSCG [hereinafter - Constitutional Law (CL)][109]. The Constitutional Law entered into force on January 1, 2015, as prescribed in Article 10(1)[110]. The European Central Bank (ECB) dealt with implementation of the TSCG in Lithuania in two opinions which came out before the Constitutional Law in discussion was approved. The ECB rendered the first opinion on December 11, 2012[111]. The ECB started off by stressing that implementation of the TSCG would be extremely important for Lithuania, since the country had been

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102 Section $16^2(2)(5)$ LBFM.
103 Section $16^2(2)(6)$ LBFM.
104 Section 18(1) LBFM.
105 Section $18(1^1)$ LBFM.
106 *See* Section 20(2) LBFM.
107 *See* Section $20(4^1)$ LBFM.
108 *See* Section 20(5) LBFM.
109 Constitutional Law on the Implementation of the Fiscal Treaty - *Fiskalinės Sutarties Įgyvendinimo Konstitucinis Įstatymas, 2014 m. lapkričio* 6 d. Nr. XII-1289.
110 Article 10(2) CL, however, postpones the entry into force of Article 4(2) to 1 January 2018. Furthermore, Article 10(3) provides that Article 4(3) and 4(4) shall become effective as of 1 January 2016.
111 EUROPEAN CENTRAL BANK (ECB), *Opinion CON/2012/105 of 11 December 2012 on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*.

undergoing an excessive deficit procedure since July 2009. The excessive deficit procedure was called off in June 2013 "based on the 3.2-percent-of-GDP deficit in 2012."[112] A sound fiscal and budgetary framework - the ECB continued - does contribute to preventing "renewed macroeconomic imbalances."[113] The ECB delivered the second opinion, which took up the contents of the previous one, on April 30, 2014[114]. In this opinion, the ECB pointed out that the entry into force of the draft constitutional law was to coincide with adoption of the euro by Lithuania. Both events, indeed, occurred on January 1, 2015. The ECB also praised the Lithuanian Parliament's decision to implement the TSCG by passing a constitutional law. This source "represents a ranking in the Lithuanian hierarchy of laws in line with the requirements of the TSCG."[115]

Article 2 CL lays down some relevant definitions. Article 2(3) defines the structural adjustment target as "a targeted annual adjustment of the structural general government sector balance indicator towards the medium-term objective the result of which is calculated as a percentage [of GDP] at current prices and rounded to one decimal place." The medium-term objective covers a four-year period during which the objective itself, which indicates "a structural general government sector balance indicator," has to be achieved[116]. The objective must be attained in a shorter space of time if exceptional circumstances come about. The year affected by such circumstances, indeed, is not counted in the time frame for reaching the goal. Pursuant to Article 2(2), the concept of exceptional circumstances embraces any "unusual event" that is beyond the control of Lithuania's public authorities and has "a major impact" on public finances. The provision gives further elucidation of the actual meaning of the concept by referring to EU legislation germane to the subject[117]. The technique of reference to other legal acts is also employed to explain all terms contained in Constitutional Law but not addressed by it. Article 2(5), indeed, provides that the meaning of those terms can be grasped by drawing upon a series of Lithuanian laws expressly mentioned[118].

Article 3 CL lays down rules aimed at ensuring that the finances of the general government sector be in surplus or in balance and at curbing the increase of public expenditure. Article 3(1) explains that the handling of the structural general government sector balance indicator is essential to implementing the commitments that Lithuania took on by signing the TSCG. The provision pinpoints four different conditions whose fulfilment enables the Lithuanian government to meet budgetary obligations arising from the Fiscal Compact. The government is required to guarantee that one of the conditions (and terms) included in the list be achieved every year, unless a year registers exceptional circumstances as meant by

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112 IMF, *Republic of Lithuania. Staff Report for the 2014 Article IV Consultation* (May 08, 2014), 6, available at https://www.imf.org/external/pubs/ft/scr/2014/cr14113.pdf.
113 ECB, *Opinion CON/2012/105*, *supra* note 111, at 2.
114 ECB, *Opinion CON/2014/30 of 30 April 2014 on public finances*.
115 *Id.*, at 3.
116 *See* Article 2(4) CL.
117 In particular, Article 2(2) makes reference to two regulations adopted at EU level: firstly, Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ 1997 L 209/1; secondly, Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011, which was aimed at amending Council Regulation (EC) No 1466/97, OJ 2011 L 306/12.
118 Domestic laws referred to in Article 2(5) of Constitutional Law are the following: the Law of the Republic of Lithuania on the Budget Structure (Law 30 July 1990 - No I-430, last amended by Law 6 November 2012 – No XI-2318); the Law of the Republic of Lithuania on State Debt (Law 22 August 1996 – No I-1508, last amended by Law 23 November 2010 – No XI-1162); the Law of the Republic of Lithuania on Fiscal Discipline (Law 8 November 2007 No X-1316, last amended by Law 16 October 2012 – No XI-2276); the Law of the Republic of Lithuania on Public Sector Accountability (*Valstybės žinios* (Official Gazette), 2007, No. 77-3046).

Constitutional Law. The first condition points to the desirable situation in which the general government sector is in surplus in structural terms. In the second condition provided for in Article 3(1), "[the] actual structural general government sector balance indicator in absolute value is lower than the medium-term objective in absolute value and is annually decreasing [...]."[119] In the third condition, the relation between the structural general government sector balance indicator and the medium-term objective is the same as in the second condition. Unlike the previous case, however, the relation that links up the indicator and the MTO occurs "in the year when the output gap is negative."[120] Finally, the fourth condition takes into account a situation in which the adjustment of the actual structural general government sector balance indicator towards the MTO equals - or is higher than - "the targeted structural adjustment in absolute value."[121]

Article 3(3) CL establishes an expenditure growth limitation rule. This rule refers to a situation in which "arithmetic average" of the general government sector balance indicators in the past five years comes out negative - i.e., in deficit. In that case, the aggregate increase in expenditure of individual budgets within the general government sector exceeding 3% of GDP may not "[be] higher than 0.5% of the average multi-annual growth rate of the potential GDP at current prices." Therefore, the average increment of expenditure that pertains to individual public budgets and exceeds 3% of GDP may not go beyond "half of the average multi-annual potential GDP growth."[122] Article 3(3), however, also provides for some exceptions to the spending growth limit. The first exception, for instance, applies when the growth rate of Lithuania is lower than the multi-annual growth rate of the European Union. In that case, the EU's GDP at current prices is increased by 2%. The third exception concerns the case in which arithmetic average of the general government sector balance indicator registered in at least five successive years is in surplus and amounts to at least 0.1% of GDP. The fifth exception, instead, requires a negative output gap in Lithuania in the relevant year. The output gap "[is] calculated on the basis of the economic development scenario which is made public by the Government or its authorised institution and in regard to which the monitoring authority published its conclusion [...]."[123]

Article 8 CL considers the case of failure to implement the structural adjustment target. Under Article 8(1), if the government finds that the structural adjustment target has not been achieved, the government itself has to inform the Parliament and the monitoring authority. They receive a notice in which the government has to set out "the reasons for failure to implement the structural adjustment target" and the measures aimed at implementing the target. The monitoring authority is to assess the notice and submit the results of its appraisal to the Parliament[124]. Article 8(3) provides that, after taking into account the opinion expressed by the monitoring authority, the government submits a notice to the Lithuanian Parliament. Such a notice has the same contents as the previous one, but in this case the reasons for failing to achieve the structural adjustment target and the measures aimed at implementing it are final. The government is required to attach information on measures for implementation of the target "[w]hen submitting [to the Parliament] a draft law on approval of financial indicators of the state budget and municipal budgets for the next year [...]."

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119 Article 3(1)(2) CL.
120 Article 3(1)(3) CL.
121 Article 3(1)(4) CL.
122 ECB, *Opinion CON/2014/30*, *supra* note 114, at 2.
123 Article 3(3)(5) CL.
124 *See* Article 8(2) CL.

Conclusion

Recent macroeconomic indicators show that the Baltic states have overcome the financial crisis. Estonia has long stood out for its economic performance within the Baltic area, apart from an interlude of harsh recession. Latvia and Lithuania have also succeeded in copying with the crisis and reaching financial stability. The three Baltic states have been characterized as a sort of role model for EU member states because of their determination in implementing fiscal austerity policies to shake off the negative effects of the crisis[125]. Those policies enabled Estonia, Latvia, and Lithuania to achieve their primary objective - to meet the Maastricht criteria and join the eurozone, albeit not simultaneously. Furthermore, the Baltic states have faithfully complied with principles and rules established at both EU and inter-governmental levels, as recent budgetary legislation proves. Overall, the Baltic states have been justly deemed to be "the orthodox [advocates] of the euro."[126]

[125] GRIGAS ET AL., *The Baltic States in the EU*, *supra* note 2, at 33 (arguing that "the way the Baltic states dealt with the crisis and the near-miraculous current economic recovery invites the austerity-supporters to proclaim the countires as an example, in particular for the Southern EMU member states caught in protracted recessions.")

[126] MARIA ANGELA ORLANDI, *Decisione di bilancio e sistemi di Governo nell'Europa centro-orientale*, in ANGELO GIOVANNELLI (ed.), *Aspetti della governance economica nell'UE e in alcuni stati dell'Unione*, 129 (Torino, 2014).