The leading role of national governments

Determining the government positions of the new Eurozone Member States on the national and European level

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Abstract

This paper is dealing with the question of what the positions of the new Eurozone Member States determines for the decision-making under the Stability and Growth Pact between 2002 to present. The focus is placed on the economic interests of the national governments from Estonia, Latvia, and Lithuania. When focussing on the national level decisions there are interest groups, like trade unions, that try to influence the national government decisions. Dealing with the European level the national governments were sometimes very criticized by the opposition. However, the paper argues that the national governments of the Baltic States are hardly influenced by these trade unions or government opposition.

Key words Eurozone, Stability and Growth Pact, national government positions, internal devaluation, decision-making

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1 Introduction

> *"Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity."*
>
> — Robert Schuman

The year 1952 was marked by a key event, the start of the European Coal and Steel Community (ECSC). The ECSC Treaty was signed in Paris by Italy, the Netherlands, Germany, Belgium, France, and Luxembourg with the aim to organise the free access to the sources of production and free movement of both coal and steel. This treaty is at the origin of the later evolving complex structure and institutions from the European Union (EU), as known today.

A lot has changed over the years, the name is only one example. The institutions increased as did their powers, more countries joined, and there was the creation of the Single Market. Another change is the focus of the EU. While it started as a way to end the frequent wars between the countries, it currently tries to deal with topics as climate change, economic crisis and religious extremism.

One of the greatest achievements of the European Union is the Single Market, whereby "restrictions on trade and free competition between member countries have gradually been eliminated, thus helping standards of living to rise" (European Commission, 2014). The EU introduced several policies that help to ensure that as many of the consumers and businesses can benefit from the single market. Yet, the single market cannot be seen as a single economy, there are still some sectors that are part of the national laws, for example services that have general interest.

The single market is in 1999 accompanied by the euro, a single currency for 19 of the in total 28 Member States of the EU. This was done in two steps, in 1999 the euro came into use for the non-cash transactions, while in 2002 the euro coins and notes were introduced. Those Member States that use the euro are part of the Eurozone.

1.1 Introduction to the topic

One of the key steps taken by the EU to increase the economic cooperation and integration was to form an Economic and Monetary Union, by the Maastricht Treaty. The Maastricht Treaty, or also know as the Treaty on European Union (TEU), represents a new stage in the European integration process, since it is opening the way for political integration. The treaty establish the European Union and is there an EU citizenship granted to all the inhabitants of EU Member States. It also provided the introduction of a common currency (Britannica, 2007; EUR-lex, 2010).

Economic integration already started in 1957 when the ECSC was founded. The Economic and Monetary Union (EMU) is "taking the EU one step further in its process of economic integration [...] the economic integration should bring the benefits of greater size, internal efficiency and robustness to the EU economy as a whole and to the economies of the individual Member States" (European Commission, 2013). This is offering opportunities for more economic stability, more employment, and higher growth, outcomes that are of direct benefit for the EU citizens. Following the economic and financial crisis, the European Union took several measures that should improve the economic governance framework of the EMU, by for example strengthening the Stability and Growth Pact (SGP) and adopting new mechanisms that should prevent imbalances. There were also measures taken that should prevent that a new crisis will affect the EMU so strongly.

While all 28 Member States of the EU are part of the economic union, some Member States have taken integration one-step further and adopted the euro. These countries together make up the Eurozone. The decision making process for the Member States that use the euro is done in inter alia the Council of Ministers, but there is also the Eurogroup. The Eurogroup is an "informal body where the ministers of the euro area Member States discuss matters relating to their shared responsibilities related to the euro" (European Commission, 2013).

The SGP is put into position to safeguard the EMU and to have the possibility of punishing Member States that violate the rules of the EMU. However, since the creation of a common currency the SGP has been amended several times. The thesis will go into more detail on the positions of the Member States regarding the SGP changes, and is thereby focussing on the economic interests of the Member States. The thesis notes that there will be two main argumentations. First of all is that the economic interests influence the government positions and decision-making is influenced by interest groups. The second option is that that economic interests do not influence the government positions, and in this case the macroeconomic policy ideas are important. The government is making the decisions unrelated to the interest groups. The thesis will argue that the latter argumentation is prevailing for the Baltic States.

1.2 Research Question

All EU Member States are part of the EMU, however not all are using the euro. Both the EMU and the Eurozone are managed through national and several EU institutions, each with their own function. Managing the economic integration can be complex, but has to be done properly in order to realise the benefits of a single currency. The focus of the thesis will be placed on what is determining the positions of the new Eurozone members in the decision-making under the SGP. The research question therefore is:

> What determines the positions of the new Member States of the Eurozone for the decision-making under the Stability and Growth Pact?

The units of analysis and the units of observation are the new Member States of the Eurozone. The new Member States of the Eurozone are all the countries that joined the Eurozone after 2002, but in the methods section will provide more elaboration on this decision. The independent variable is the outcome of this research; while the dependent variable the government positions for the decision-making under the Stability and Growth Pact is. The setting of the Research Question is the European Union. This research question is a causal research question, since it tries to find an answer to what determines the positions of the new Eurozone members in the decision-making part of the SGP.

The methods section will focus elaborately on which of the new Eurozone Member States are examined, the selected SGP decisions and which interests of the new Eurozone Member States is selected. A quick and short note will be added in advanced here. For the new Member States of the Euro the Baltic States are selected, since their success story of dealing with the economic crisis. There are four SGP decisions selected, one decision was made in 2005, one decision from 2011 and two decisions taken in 2013. The focus will be placed on the economic interests of the Member States, since the SGP includes economic sanctions and the Baltic States took drastic economic measures to recover from the economic and financial crisis.To answer the research question there are also three sub-questions formulated, these are:

1. What are the positions of the governments of the new Eurozone Member States on the SGP decisions?
2. What are the interests of the government actors?
3. How are the government positions shaped during the SGP negotiations?

The first sub-questions unit of analysis and unit of observation are the selected governments of the new Member States of the Eurozone. The independent variable is the positions of the governments of the new Eurozone Member States and the dependent variable is the outcome of the SGP decisions. The setting for the first sub-question is the European Union. The first sub-question will focus on the four SGP decisions that were made since the start of the Euro and elaborate broadly on the positions the Member States had. The question is focussing on all the Member States, since it should provide a broad overview of the differences in government position of the new Eurozone Member States, but also allow a comparison with the older Member States.

The second sub-questions unit of analysis and unit of observation are the government actors. While the independent variable is the interests, the dependent variable is in this case the answer to the second sub-question. The setting is the European Union. For answering the second sub-question there are several variables that can influence the government position, ranging from ideas to economical and political interests. The focus in this paper is placed on the economic variables, the reasons for this are explained in the methods section. The economic variables, for example unemployment, that are selected are then tested for the Baltic States.

The third sub-questions unit of analysis and unit of observation are the government actors. The independent variable in the third sub-question is the outcome of the sub-question, while the dependent variable is the government position. The setting is the European Union. The third sub-question is focussing on how the economic interests were able to shape the government position.

1.3 State of the art and social and scientific relevance

There is a large pool of literature that is dealing with the Eurozone, key focus has been placed in recent years on the policy coordination and what is wrong with the EMU and how to fix the problems. Not all authors agree that the policy system of the Eurozone needs to change, because much has been achieved since the EMU started. There has been the transition to a new and common currency, the euro; macroeconomic management has improved significantly in Europe; further macroeconomic gains are expected from the increased integration; and the new policy regime is seen as a major success (Pisani-Ferry, 2002).

There is also literature that is focussing on how to improve the EMU and the Eurozone. A key aspect is that the EU has to learn from its past mistakes. There are only a few years since the start, so wide-ranging reforms should not be necessary, but there is a discussion needed for what is learned from these years (Pisani-Ferry, 2002). Some authors go further and note that the policymakers need a roadmap for where the integration has to go. Others focus more on the co-ordination. The economic growth of the Eurozone lagged behind compared to the United States, improved co-ordination should help improve the economic growth again (Jacquet & Pisani-Ferry, 2001).

A different stream of literature is focussing on the role of the European Central Bank. The Eurozone "periphery has witnessed a more than 100% increase in central bank credit to banks since 2007" (Tornell, 2012) and the Eurozone periphery is still needing major financial infusions for covering its current and fiscal account deficits (de Grauwe, 2012; Heinemann & Huefner, 2004). The leading role of Germany in the EU is another point of discussion. Since the first steps towards the European monetary integration in the 1960s, Germany and France had a principal role in "European monetary integration and in defining the institutional framework governing monetary policy and fiscal policy coordination" (Schild, 2012).

The current research is following from a previous bachelor thesis by L. Spielberger (2016). From this thesis were several conclusions drawn. One of them was that the new members of the Eurozone might have had more benefit from a looser application of the Stability and Growth Pact rules, that were tightened during the economic crisis, the proposals were all dismissed under the term of populism (Spielberger, 2016; Greeley, 2012; Grybauskaité, 2010). These countries were part of the group of Member States that advocated strict punishments for violations of the SGP and wanted automatic sanctions.

The paper should provide more insight in the decision-making of the new Eurozone Members under the SGP. While there is plenty of literature that deals with the Eurozone or the SGP, the decision-making under the SGP by the new Eurozone Members is not yet thoroughly dealt with. The focus is placed on the way the governments of the Baltic States are making the decisions, since it will provide a better insight in how governments are coming to a decision under the SGP.

1.4 Outline of the Thesis

The thesis will continue as following. First some background information is presented, with the Eurozone, Stability and Growth Pact and in broad lines the positions of the Member States towards the Stability and Growth Pact decisions. This is followed by a theoretical section that starts with the question: how do economic interests determine the position of the national government. This question will provide two hypotheses, one focussing on the Interest Group Politics and the other on the Macroeconomic Policy Ideas.

Part of the Interest Group Politics hypothesis are the theories of the 'two-level game' and the liberal intergovernmentalism theory; while the Macroeconomic Policy Idea hypothesis is build on the Macroeconomic policy theory from Moravcsik.

This is followed by the methods section, which elaborates on i.e. the operationalization, conceptualization, and research design. The analysis is split-up into two main parts. The first part is focussing on the internal devaluation policy the Baltic States all three opted for in order to deal with the economic and financial crisis. It will focus on the selected economic interests, whereby for each of the economic interests the government position is considered and the potential lobbying or disagreement from interest groups. The second part of the analysis will focus on the selected SGP decisions. For each decision the national government positions are considered and determined if this position changed, for example through the response/disagreement of their national parliament. The thesis will finish with a discussion on the hypotheses and results, and conclude with a short conclusion.

2 Background information: integrating the EU economies

The development of the Eurozone took several steps and many years before being introduced. The Economic and Monetary Union marked the start of several policies that aimed towards achieving convergence of the Member States economy. While all the 28 Member States were part of the EMU that was launched in 1992 by the Maastricht Treaty, there were some doubts by government leaders or ministers. One of these doubts came from the former finance minister of Germany, Theo Waigel; once a country was a member of the EMU it should not be able to free-ride. Therefore a set of rules was proposed that formed the Stability and Growth Pact (SGP). Some Member States have taken the economic integration a step further and adopted the euro; these countries make up the Eurozone. In this section there will be elaborated on the EMU and the SGP.

2.1 The Economic and Monetary Union

Ever since the European Union was founded in 1957, "the Member States concentrated on building a 'common market' for trade. However, over time it became clear that closer economic and monetary co-operation was needed for the internal market to develop and flourish further, and for the whole European economy to perform better, bringing more jobs and greater prosperity for Europeans" (European Commission, 2015c). In 1991 the Maastricht Treaty was approved (the Treaty on European Union), that included that the European Union would have a stable and strong currency in the 21st century. Also did it open the discussion to the next stages "[...] one of the decisions taken during the IGC negotiations was that countries would have to meet certain criteria, dubbed 'convergence criteria', in order to be allowed to join the EMU" (Buti & Giudice, 2002; Cini & Pérez-Solórzano Borragán, 2016). These Maastricht convergence criteria are:

- "Budget deficits should be no more than three per cent of gross domestic product (GDP);
- Accumulated public debt should be no more than 60 per cent of GDP;
- Exchange rates should have participated without devaluation or severe tensions in the exchange rate mechanism (ERM-2) for at least the previous two years;
- Inflation should not be more than one and a half percentage points above the rate of the three best-performing member states;
- Long-term interest rates should be not more than two percentage points above the rate of the three best-performing member states" (Cini & Pérez-Solórzano Borragán, 2016; Grieco, 1995).

Besides the Maastricht convergence criteria it was also agreed that the participating countries should not have public debts or excessive budgetary deficits, the national central bank should be politically independent, and "national monetary authorities could no longer use the printing press to reduce public debts and budgetary deficits (monetary financing)" (Cini & Pérez-Solórzano Borragán, 2016; van Rompuy, 2012). From the outset however there were built in 'escape clauses' into the Maastricht Treaty, only the budgetary criteria had to be met (Grieco, 1995).

The first two stages of the EMU are completed, and the third stage is under way. In principle, "all EU Member States must join this final stage and therefore adopt the euro (Article 119 TFEU). However, some Member States have not yet fulfilled the convergence criteria" (European Parliament, 2016). These Member States are benefitting from the provisional derogation till they can join the third stage of the EMU. Following the economic crisis, the European Union had to take unprecedented measures for improving the economic governance framework of the EMU, for example by strengthening the SGP. These emergency measures "need to be consolidated and completed in the long-term so as to avoid that a new crisis could affect EMU so strongly" (European Commission, 2017). The adoption of a common currency is part of the third stage towards the EMU (Praussello, 2012).

Before the introduction of the euro was the European Currency Unit (ECU) already in place. The ECU was a basket of the currencies used by the member states of the European Community (EC) (Giovanoli, 1989;

Works, 1986). It was used as the unit of account for the European Community before it was replaced by the euro. The common currency was introduced in two phases, in 1999 the non-physical form was introduced, while in 2002 the notes and coins were introduced (European Commission, 2015c; Praussello, 2012).

The main benefits however of the euro for the individual countries, especially for countries with a small and open economy (as for example the Baltic States), is relating to its potential for promoting trade (Criddle, 1993). Through eliminating the exchange rate volatility and at the same time providing a complete price transparency, the euro contributed greatly to economic activity that is conducted across borders (Emerson, Gros, & Italianer, 1992). The trade integration has increased rapidly among those countries that adopted the euro and showed a significant increase in Foreign Direct Investment and intra-euro area trade. At the same time, "the increase in trade with the rest of the world has recently been even greater than the increase in intra-euro area trade, with figures that are showing that the euro area is very open" (European Commission, 2015c; Geoghegan, 2014; Tumpel-Gugerell, 2007). Finally, adopting the euro may "provide stronger protection against international financial disturbances. Such disturbances have often had a disproportional effect on smaller economies, raising the risks of external shocks" (Tumpel-Gugerell, 2007).

2.2 Stability and Growth Pact

During the mid-1990s the then former finance minister of Germany, Theo Waigel, proposed to set-up rules for countries once they were part of the EMU. Once a country was a member of the EMU it should not be able to freeride, by for example incurring high deficits and debts, and the Stability and Growth Pact (SGP) was formed. Under the SGP, "member states that violate the rules to keep their public debt and budgetary deficit low can be penalized, and may have to pay a fine" (Cini & Pérez-Solórzano Borragán, 2016; Costello, 2001). The SGP is involving a multilateral budgetary surveillance (which is the 'preventive arm') and is specifying the deficit limit, or the excessive deficit procedure (EDP) (which is the 'corrective arm'). When, "on the basis of a Commission recommendation, the Council decides that an excessive deficit indeed exists, the member state concerned is obliged to reduce its deficit below the Treaty's reference value of three per cent of GDP; otherwise financial sanctions can be levied against the member state in question" (Beetsma & Uhlig, 1999; Cini & Pérez-Solórzano Borragán, 2016)

The preventive arm of the SGP is aiming to "ensure sound budgetary policies over the medium term by setting parameters for Member States' fiscal planning and policies during normal economic times, while taking into account the ups and downs of the economic cycle" (European Commission, 2015b). To keep the governments on track for meeting their commitments, each Member State has its own budgetary target, also known as the Medium-Term Budgetary Objectives (MTOs) (Annett, 2006). The MTOs take into consideration the business cycle swings as well as filter out the effects of temporary and one-off measures (Beetsma & Uhlig, 1999).

MTOs are set to ensure the sound fiscal health and are taking into account the need for achieving sustainable debt levels, while also ensuring that governments keep enough room to manoeuvre and a margin of safety against breaching the fiscal rules of the EU. MTOs are "updated every three years, or more frequently in the case a Member State has undergone a structural reform significantly impacting its public finances" (European Commission, 2015b). All the Member States are expected to reach the MTO that is set for them, or should be heading towards them through adjusting the structural budgetary positions with a benchmark set at a rate of 0.5% of GDP (Buti, Franco, & Ongena, 1997, 1998; Cabral, 2001). There are temporary deviations from the adjustment path towards the MTO or a MTO for specific cases, these are:

1. Major structural reforms (e.g. pension reforms) "which have a verifiable long-term (positive) impact on the public finances including by raising potential sustainable growth provided that the deviation from the MTO or the adjustment path does not exceed 0.5% of the GDP, the MTO is reached within the four-year programme period and an appropriate safety margin is continuously preserved so that the deviation from the MTO or the agreed adjustment path does not lead to deficit greater than the 3% GDP reference value

2. An unusual event outside the control of the Member State concerned which has a major impact on the financial position of the government, or

3. In periods of severe economic downturn for the euro area or the Union as a whole; a condition for all deviations is that they do not endanger fiscal sustainability in the medium term. Temporary deviations from the adjustment path are allowed, if a safety margin with respect to the nominal 3% of GDP government deficit is provided" (European Parliament, 2015).

The corrective arm of the SGP is governing the Excessive Deficit Procedure (EDP) (Artis & Onorante, 2007). The EDP is triggered when:

- "The deficit breaching the 3% of GDP threshold, or
- The debt being above 60% of GDP and not diminishing at a sufficiently rapid pace as defined by the debt reduction benchmark stipulating that the distance to the 60% threshold should be reduced by 5% on average per year (over the past 3 years or in the next 2 years), also taking the economic cycle into account" (EUR-Lex, n.d.; European Parliament, 2015).

If on the basis of the Commission recommendation the Council decides that a deficit is excessive, the Council will issue a recommendation to the specific Member State for correcting the excessive deficit and the time frame to do so. Including in the recommendation from the Council is a request to the Member State to achieve annual budgetary targets which "on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement of the structural balance of at least 0.5% of GDP as benchmark, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation" (European Parliament, 2015; European Commission, 2015a). Thereby is the so-called 'investment clause', that is part of the preventive arm of the SGP, not applicable for the corrective arm (Buti, 2006). The Council can decide, based on the recommendation from the Commission, that the deadline for the correction of the excessive deficit can be extended by one year, for two cases:

- 'effective action' has been taken "by the Member State owing to unexpected adverse economic events with major unfavourable consequences for government finances;
- 'severe economic downturn in the euro area or EU as a whole' provided that it does not endanger medium-term fiscal sustainability (like in the preventive arm)" (European Parliament, 2015).

When a Member State does not comply with the recommendations it can trigger further steps, these include the option of sanctions for the euro area Member States (Eijffinger, 1992; Mayer & Stahler, 2009).

2.3 The positions of the new Member States towards the SGP decisions

The new EU Member States were in a similar position as Ireland or Spain, since they had "large current account deficits before the crisis and double-digit contraction of their economies in 2008" (Spielberger, 2016, p.32). However the national governments were prioritizing low national debts and decided for deep budget cuts to be able to overcome the crisis (Walter, 2016). What at first appeared as mostly a national matter got quickly European importance "when those small countries advocated that approach for all other European countries too. Austerity poster child Estonia, one of the few countries that did not violate the SGP during crisis, frequently made reference to the pains it had gone through to justify austerity programmes in other countries" (Spielberger, 2016, p.34).

The Baltic countries had to make substantial adjustments for matching the criteria for joining the Eurozone, and at the same time were blaming the crisis countries since they were violating the SGP and its ideas that have never been questioned (Walter, 2016). The balanced budget rule and structural reforms changed only a little in these countries, since they already had modelled "their political economies largely on the neo-liberal model already before the crisis" (Bohle & Greskovits, 2007; Kukštis, 2015; Schmidt & Thatcher, 2013; Spielberger, 2016). Even though these countries could have benefitted from a stimulus programme or looser application of the SGP, these proposals were dismissed as populism (Greeley, 2012; Grybauskaitė, 2010). The new EU Members showed themselves as "the strongest advocates of more automatic sanctions, strict punishments of violations of the SGP and structural reforms, is consequently more easily explained through a commitment to neo-liberal norms than purely national interest" (Spielberger, 2016, p.34).

3 Theoretical framework and hypotheses: How do governments make decisions?

The background information showed that there is a difference in the government positions towards the Stability and Growth Pact. The reasons are different for each Member State, but the focus in this paper is placed on the three Baltic States. In this theoretical section the focus is placed on the question:

> Do economic interests determine government positions?

There are two answers considered. The first option arises when the question is answered with a 'yes'. In this case the government is basing its position, partly or largely, in a coalition with the interests of the several interests groups in the domestic society. This stream will be the Interest Group Politics (for short IGP), and consists of the theories of the 'two-level game' theory and the liberal intergovernmentalism theory. The second option arises when the question is answered with a 'no'. In this case the government is leading and does not involve the interest groups in its decision-making. This stream will be the Macroeconomic Policy Ideas (for short MPI) and consists of the Macroeconomic policy theory from Moravcsik. In the following sections the theories will be addressed.

3.1 The 'two-level game'

In the twentieth-century the metaphor of the 'two-level game' was developed to capture the quality of the international negotiations. The perception of "international negotiation being a 'two level game' with the state simultaneously engaging in the domestic sphere where domestic groups pursue their interests by pressuring the government, and in the international sphere where the state adopts these pressures as the national interest to satisfy the domestic groups" (Putnam, 1988, p.434). Following from this, Moravcsik is able to explain how the domestic pressure is resulting in the formulation of the national interests. These groups are "competing for political influence through a process of domestic political conflict where eventually new policy alternatives are recognized by governments and adopted as national interest" (Moravcsik, 1993b, p.481). Besides is there no hierarchy of interests, as the 'high' and 'low' politics described by Hoffmann indicated, instead the national interests are a reflection of issue specific and sectoral areas of concern for the domestic constituents. Also are the interests not 'uniform and fixed' but can vary across 'time and issues' that are depending on the domestic pressures (Moravcsik, 1998; Moravcsik & Schimmelfennig, 2009).

Moravcsik also addresses in his own work the 'two-level game'. In this metaphor the "statesmen are strategically positioned between two 'tables', one representing domestic politics and the other international negotiations [. . .] to conclude a negotiation successfully, the statesman must bargain on these two tables, both reaching an international agreement and securing its domestic ratification" (Moravcsik, 1993a, p.4). Thereby are the diplomatic strategies and tactics constrained by what other states accept and what the domestic constituency will ratify. This approach assumes that statesmen want to manipulate the international and domestic politics simultaneously.

Diplomacy is a "process of strategic interaction in which actors simultaneously try to take account of and, if possible, influence the expected reactions of other actors, both at home and abroad" (Moravcsik, 1993a, p.15). The outcome of the negotiations is depending on the strategy chosen by the statesman (Alesina, 1987). The two-level games approach "differs from previous theories in three essential respects" (Moravcsik, 1993a, p.16). First, the approach is a theory of international bargaining. Complex patterns of interdependence can constrain statesmen, but are also able to create new possibilities. Secondly, is the emphasis on the statesmen and its place as a central strategic actor. The third difference is that the two-level game approach is reflecting the 'double-edged' sides, of both opportunities and constraints on both international and domestic boards. The two-level game approach "recognizes that domestic policies can be used to affect the outcomes of international bargaining, and that international moves may be solely aimed at achieving domestic goals" (Moravcsik, 1993a, p.17).

3.2 Liberal Intergovernmentalism

European integration intergovernmentalism started as a critique of neo-functionalism. While it started with the primary focus on the attitude that was taken by President Charles De Gaulle during the 1960s, "Hoffmann argued that integration might work very well in the realm of low politics (i.e. economic integration) but encountered impermeable barriers if it tried to spill over to questions affecting key national interests" (Hoffmann, 1966). This was also the case for supranational institutions, because Member States considered some areas (high policy) to be theirs, as for example the area of foreign policy. In case of supranational institutions were "seen to infringe on those, they would not hesitate to curtail their competencies" (University of Portsmouth's European Studies Hub, 2013a).

The basic point that the intergovernmentalists were making was that when European integration flourished there would be guaranteed positive outcomes for all involved (one often used example is the Common Market), but these positive outcomes would stall "once the national interests of one or more countries directly contravened those of others (as during the Empty Chair Crisis and French veto of UK accession)" (University of Portsmouth's European Studies Hub, 2013a).

3.2.1 The switch from intergovernmentalism to liberal intergovernmentalism

Intergovernmentalism was reaching its prime during the "doldrum years of European integration during the 1970s, when the failure to get any further with political integration seemed to confirm most of its premises" (Wiener & Diez, 2009, p.6). Yet, intergovernmentalism started to meet events that did not fit its theoretical framework. Examples of these events are the signing of the Single European Act (SEA, 1986) followed by the Maastricht Treaty (1991) (Forster, 1998). These events put serious question marks next to the dichotomy between the low and high politics that was set at the intergovernmentals core (Rosamond, 2000).

Faced with this conundrum, Andrew Moravcsik started to adapt intergovernmentalism to fit the new European reality during the 1990s. Moravcsik used the concept of 'liberal intergovernmentalism', where its key difference with the classical intergovernmentalism is in the emphasised domestic interest rather than the national interest (Moravcsik, 1995; Moravcsik & Schimmelfennig, 2009). When focussing "on the domestic level, various interest groups would compete in order to influence national preference formation in integration. Then the outcomes of these struggles would go on to inform the positions taken by governments in interstate bargaining" (University of Portsmouth's European Studies Hub, 2013a; Moravcsik, 1995). If the governments feared that the resultant agreement "was not going to be lived up to by the other parties, they would favour the transfer of sovereignty to supranational institutions better placed to force compliance" (Schimmelfennig & Sedelmeier, 2004, p.676).

The position of the states vis-à-vis the supranational institutions remained strong, as the interstate bargaining occurred in situations where the government leaders know more about the others preference than the supranational institutions. Liberal intergovernmentalism remained strong in dealing with the European integration (Schimmelfennig, 2015; Tatham, 2011; University of Portsmouth's European Studies Hub, 2013b). When liberal intergovernmentalism is stripped down to its fundamental tenets, it is arguing the following:

1. "European states decides on their national policy preferences by aggregating the policy desired of the most influential sections of society;
2. Governments adopt these policies as national policy;
3. They tan take these positions to interstate bargaining situations;
4. Outcomes depend on the relative power of the states taking part and the amount that they had to lose by not finding a solution. If one state can walk away form the negotiation with little cost to itself, then it is in a more powerful position than those who cannot" (Moravcsik & Schimmelfennig, 2009, p.68-71).

When considering how states are determining that integration is in the national interest the differences between the classical and liberal intergovernmentalism becomes apparent. For the classical intergovernmentalism Hoffmann is drawing a distinction between 'high politics' and 'low politics' (Hoffmann, 1966).

European integration "will not occur in areas of high politics because they touch on key aspects of state sovereignty, such as security and foreign affairs, and so there is no solidarity between states on these vital issues" (Hoffmann, 1964, p.90). States are anxious in preserving their autonomy to act in these areas (Schimmelfennig & Rittberger, 2006).

However in the area is low politics integration is seen as possible (Nelsen & Stubb, 2014, p.163), these are areas such as agriculture and trade, where "low level cooperation can be pursued for limited purposes" (O'Neill, 1996, p.61). It is suggested that the classical intergovernmentalism suggests that "states consider international cooperation to be in the national interest by assessing their relative position in the states system" (Rosamond, 2000, p.137) that has the "ultimate goal of self-reservation in a globalised world, while largely ignoring domestic political factors" (Church, 1996, p.25).

Hoffmann is also suggesting a role for domestic political factors for determining the national interest, although the role and nature of this role remains unclear. Hoffmann notes that "national interest groups and parties can put pressure on governments through domestic politics, leading to a conception of the national interest which might be contrary to the state's purely business and economic interests" (Hoffmann, 1964, p.90-93).

3.2.2 The rationalist framework from Moravcsik

In the rationalist framework there are two key assumptions: states are seen as unitary actors, and unitary states can be seen as rational. This first assumption is comprising that states are crucial actors in an anarchic international system and are pursuing their objectives through intergovernmental bargaining. Furthermore, are state preferences and identities not identified as uniform, according to Liberal intergovernmentalism. The assumption of fixed preferences is, following Moravcsik, not sufficient for explaining the varying state behaviour. The objectives of states are underling their strategic interaction, and considered to be influential when analysing the influence and power of states.

Schimmelfennig and Moravcsik "describe state rationality as states calculating the potential utility of alternative options from which they will choose the alternative allowing them to maximize their utility. Thus, collective outcomes are the product of aggregated individual actions based on the pursuit of preferences" (Oelze, 2014, p.26). Moravcsik subdivided the process of international cooperation into three main stages: (1) national preference formulation, (2) interstate bargaining, and (3) institutional choice. Moravcsik puts notes in his work:

> "[...] European integration can best be explained as a series of rational choices made by national leaders. These choices respond to constraints and opportunities stemming from the economic interests of powerful domestic constitutes, the relative power of each state in the international system, and the role of international institutions in bolstering the credibility of interstate commitments". (Moravcsik, 1998)

Each of the three main stages of international cooperation will be discussed shortly. Moravcsik is employing a liberal theory on the preference formulation in order to explain the national preferences in EU negotiations. Accordingly the state policies are decided by the politicians, which are subject to constraints that are coming from the societal pressure. The relation between the government and society is mirrored in the principal-agent relationship. Consequently, groups, for example consumers, producers, tax payers, etc., are expressing their preferences that will be then aggregated by their government. Throughout this process, "identities, interests and influence of societal actors vary across time and place, but also take diverse shapes in the context of different issue areas. However, this does not imply that governments or state leaders cannot have own policy objectives, but they require supporting coalitions of influential groups, holding these specific interests. After all, governments strive to stay in office" (Oelze, 2014, p.9).

While using the intergovernmentalists theory on international cooperation, Moravcsik developed a bargaining game that is depending on the relative bargaining power from the involved actors. Goal of this bargaining is "an agreement about the terms of cooperation and the associated distributional consequences" (Moravcsik, 1995, p.496). Moravcsik also illustrates in detail the specific 'rules' of the game. The bargaining space is limited to the national preferences of the participating states. Following, Moravcsik is establishing three assumptions that underlie the bargaining game. First of all, states are cooperating voluntarily, there is no economic threat or military power employed. Secondly, the 'bargaining-environment' of the EC is information rich, what will mean that the actors are aware or have the information about the standpoint and preferences of other participants. Thirdly, the transaction costs are low, therefore little costs arise while the negotiations are taking place in a large time period, whereby issue linkages and side-payments are possible.

From these assumptions Moravcsik is concluding that on the one hand the bargaining leverages of states are depending on their national preference intensity, while on the other hand negotiation outcomes are seen as always efficient and generally pareto-optimal (Moravcsik, 1993b). The larger the desire of a state is to reach an agreement, the weaker will be its relative bargaining power, thereby is the state more likely to put effort into reaching an agreement and making concessions. The state will have to reach a compromise with the 'least forthcoming' government and often a lowest common denominator agreement is the result (Moravcsik, 1993b). The latter is resulting from the fact that the variety of possible agreements will be constrained by the preferences that are at hand. However, Moravcsik notes that "agreements do not necessarily need to be built on the lowest common standard, for regulatory policies are often two-dimensional. This enables to apply side-payments or linkages to achieve agreements above the lowest common denominator" (Oelze, 2014, p.12).

Moravcsik is picking up on the regime theory for employing the liberal intergovernmentalist framework in the institutional choice. Moravcisk declares that Member States accept supranational institutions, as long as these strengthen their control in domestic issues and is helping them for achieving otherwise unattainable objectives. Following Moravcsik, the EU is strengthening the Member States power in two ways: through increasing the efficiency of the interstate bargaining and secondly, by extending the autonomy of the national political leaders. The first mechanism is building upon the regime theory and is stating that institutions are enhancing the cooperation by increasing efficiency, facilitating agreements, providing information and reducing uncertainty. Therefore are institutions especially useful and most likely to exist when transaction costs are high and enforcement and monitoring of compliance seen as critically important.

3.3 Macroeconomic policy

During this section there will be a discussion of the macroeconomic policy framework and its measures. Macroeconomic policy that is made carefully and well considerate is resulting in macroeconomic stability, the "cornerstone of any successful effort to increase private sector development and economic growth" (Ames, Brown, Devarajan, & Izquierdo, 2001). Cross-country regressions that are using "a large sample of countries suggest that growth, investment, and productivity are positively correlated with macroeconomic stability" (Ames et al., 2001). The theory is therefore dealing with the overall functioning of the national economies, and critical for shaping the economic landscape (the World Bank, 2004).

> "Coordination of macroeconomic policies is certainly not easy; maybe it is impossible. But in its absence, I suspect nationalistic solutions will be sought - trade barriers, capital controls and dual exchange-rate systems. Wars among nations with these weapons are likely to be mutually destructive. Eventually, they, too, would evoke agitations for international coordination". (Buiter & Marston, 1986; Hallett, Mooslechner, & Schürz, 2001; Mooslechner & Schuerz, 1999)

The "international macroeconomic coordination in an independent world economy is seen as desirable when externalities and public goods are important" (Mooslechner & Schuerz, 1999, p.176). Through these international linkages the policy actions of one country will spill-over into other countries. These spill-over effects can arise from several changes, for example in the taxation, monetary or fiscal policy or trade (Lindgren, Garcia, & Saal, 1996). When there is no coordination the results are less optimal, although some economists argued that the international economic policy coordination might have undesirable effects (Fischer, 1993; Persson & Tabellini, 2002). The main argument is that "coordination might deflect the attention of national governments from domestic policy issues - which should have a higher priority" (Mooslechner & Schuerz, 1999, p.174). Another argument against coordination is shown by using a two-country model that is based on a rational-expectations framework and include a role for the interest rates. The explicit coordination can be counterproductive when a subgroup of players are cooperating when there is no relevant third party.

A great deal of the macroeconomic policy deals with responding to the contingencies that cannot be anticipated for. The policymakers in the national governments have the possibility and opportunity to "get to know each others' behaviour in international negotiations, and hence to form reasonable judgements about credibility and reputations. With the current state of knowledge of how the world economy functions, on the other hand, they cannot anticipate many contingencies and cannot be confident about how the consequences will be transmitted across national borders" (Buiter & Marston, 1986, p.218). Therefore can situations arise where it could be advantageous for all parties being time-inconsistent.

Consistent with the theories dealing with foreign economic policy, Moravcsik argues that "the specific conditions under which governments were willing to liberalize trade reflected their international economic competitiveness; the conditions under which they accepted monetary integration reflected prevailing macroeconomic policies and preferences" (Moravcsik, 1998, p.3). Yet, the EC was "shaped by more than the convergence of the national preferences in the face of economic change" (Moravcsik, 1998, p.3). The export opportunities created were followed by trade liberalization. While in monetary policy the preferences for integration was reflecting the relative macroeconomic preferences and performance of the national governments together with the commercial considerations. The economic interests are seen as primary, and pressures forming from economic standards as well as countries that are poorer with lower standards. In the case of monetary policy, "the many producer preferences are less sharply defined, whereas the constraints imposed by the general macroeconomic preferences and performance of different countries are more important" (Moravcsik, 1998, p.38).

3.3.1 Macroeconomic policy and the European Union

The draft European constitution was seeking to legitimate the EU through introducing more popular deliberation about the future of Europe. The constitutional project was based on several premises, the first premise is that "increases in institutional opportunities to participate tend to generate greater political participation" (Moravcsik, 2006, p.223). Focussing on this view, "the major reason why more citizens do not participate in mass politics in general, and European Union politics in particular, is because they lack sufficient institutional opportunities to do so" (Moravcsik, 2006, p.223). Thereby is the central statement made that the key problem with the EU, and the reason for the decline in popularity of the EU, is that its citizens were never asked for their input about Europe's future.

There are three prominent macroeconomic issues: inflation, 'economic conditions', and unemployment. At first these three seem to be closely related with the EU, "since these aggregates are influenced to some extent by the activities of the European Central Bank. They might also be the subject of action under the so-called 'Lisbon strategy' and the 'Open Method of Coordination' (OMC). Yet neither fact renders them to a genuine electoral concern" (Moravcsik, 2006, p.225). The link between the monetary policy and the macroeconomic outcomes is remaining obscure, and the ECB is the independent body. For both reasons, it remains unclear why there is no proper connection to political participation. Since "most policy analysts believe that today the most influential and most policy-relevant instruments for influencing employment and growth, and to a lesser extent inflation, involve fiscal, labour market and educational policies - all of which remain national" (Moravcsik, 2006, p.226). The fiscal policy is outside of the mandate of the European Union, while labour market policy - with the exception of gender policy - is subject only for discussion under the OMC. The "empirical research is unanimous in concluding that it remains a 'talk shop' with almost no demonstrable impact on national policy, let alone macroeconomic aggregates" (Moravcsik, 2006, p.226).

3.3.2 The macroeconomic policy framework

In the recent literature it has been widely accepted that for sustainable economic growth a stable macroeconomic framework is necessary. The concept of this stable macroeconomic framework is thereby used as a macroeconomic policy environment conductive to growth. This macroeconomic framework is seen as stable when "the inflation is both predictable and low, real interest rates are appropriate, fiscal policy is stable and sustainable, the real exchange rate is competitive and predictable, and the balance of payments situation is perceived as viable" (Fischer, 1993, p.487).

The IMF thought, before the economic and financial crisis, "of monetary policy as having one target, inflation, and one instrument, policy rate. So as long as inflation was stable, the output gap was likely to be small and stable and monetary policy did its job. The thought of fiscal policy was to play a secondary cyclical role, with political constraints sharply limiting its de facto usefulness. And the thoughts of financial regulation as mostly outside the macroeconomic policy framework" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.3). Most of the prevailing consensus was playing an important role in shaping the institutions and policies.

The low and stable inflation is seen as the primary mandate of central banks. This resulted from a coincidence "between the reputational need of central bankers to focus on inflation rather than activity and the intellectual support for inflation targeting provided by the New Keynesian model" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.3). In the benchmark version of the New Keynesian model, a constant inflation is seen as the optimal policy, thereby delivering a output gap of zero, and which is turning out to be the best outcome for activity considering the imperfections that are present in the economy. This coincidence implied that policymakers are caring much for activity. When there were further imperfections (besides imperfections in the economy through for example oil prices or technology shocks) there were further deviations from the set benchmark. However the message remained the same: inflation that is stable is good for economic activity and good in itself.

There was another consensus regarding inflation, the inflation should be very low, and most of the advanced countries central banks determined a target of around 2%. This low inflation rate sparked a discussion regarding falling into a liquidity trap: "corresponding to lower average inflation is a lower average nominal rate, and given the zero bound on the nominal rate, a smaller feasible decrease in interest rate - thus less room for expansionary monetary policy in case of an adverse shock" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.4). There was however the thought that the dangers of a low inflation rate was small. The Great Depression and its liquidity traps, combined with a significant deflation and its low nominal rates, were seen as a part of history. The formal argument for a low inflation rate were that "to the extent that central banks could commit to higher nominal money growth and thus higher inflation in the future, they could increase future inflation expectations and thus decrease future anticipated real rates and stimulate activity today" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.4). After the financial crisis these low inflation rates started to be widely discussed.

The focus of the monetary policy was on the use of one instrument, "that was the policy interest rate, which is the short-term interest rate that the central bank can directly control through appropriate open-market operations" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.5). There are two assumptions behind this choice. The first assumption is the "real effects of monetary policy are taking place through interest rates and asset prices, not through any direct effect of monetary aggregates" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.5). The second assumption is all asset prices and interest rates are liked through arbitrage, "so that long rates were given by proper weighted averages of risk-adjusted future short rates, and asset prices by fundamentals, the risk-adjusted present discounted value of payments on the asset" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.5). Following these two assumptions, only the current and future expected short rates have to be affected and all other prices and rates follow.

After the Great Depression and following from Keynes, fiscal policy got a central role as macroeconomic policy tool. However, in the past two decades the fiscal policy was placed behind monetary policy, for several reasons:

1. There was a "wide scepticism about the effects of fiscal policy, itself largely based on Ricardian equivalence arguments;

2. If monetary policy could maintain a stable output gap, there was little reason to use another instrument;

3. In advanced economies, the priority was to stabilize and possibly decrease typically high debt levels; in emerging market countries, the lack of depth of the domestic bond market limited the scope for countercyclical policy anyway;

4. Lags in the design and the implementation of fiscal policy, together with the short length of recessions, implied that fiscal measures were likely to come too late;

5. Fiscal policy, much more than monetary policy, was likely to be distorted by political constraints" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.5).

For the long-term view of policymakers the focus in the advanced economies was placed on prepositioning fiscal accounts for the consequences of aging. While in emerging market economies, the focus was placed on reducing the likelihood for default crises, as well as on establishing institutional setups for constraining the pro-cyclical fiscal policies.

Financial supervision and regulation mainly focused on the individual markets and institutions, thereby largely ignoring the macroeconomic implications of financial regulations by the advanced economies. Financial regulations "targeted the soundness of individual institutions and aimed at correcting market failures stemming from asymmetric information, limited liability, and other imperfections such as implicit or explicit government guarantees" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.6). Emerging markets not always tended to ignore the macroeconomic implications of financial regulations, through "prudential rules as limits on their currency exposures were designed with macro stability in mind" (Blanchard, Dell'Ariccia, & Mauro, 2010, p.6).

Of the five criteria that were specified in the beginning of this section, only a stable and low inflation is readily quantifiable. Even though fiscal deficit does provide information about the fiscal policy, it remains however difficult to characterize fiscal policy with a single variable. None of the other variables besides inflation can be directly controlled for by a policy (Fischer, 1993).

4 Methods

In the methodology section the conceptualization and operationalization of the thesis will be discussed, as well as the research design, its drawbacks, and the data collection method.

4.1 Conceptualization

The research question that was posed in the beginning was: "What determines the positions of the new Member States of the Eurozone for the decision-making under the Stability and Growth Pact?" The identified independent variable is the positions of the governments of the new Eurozone Member States and the dependent variable is the outcome of the SGP decisions. There are a few concepts that need to be conceptualized, these are 'positions' and 'new Member States of the Eurozone'. The decisions that are selected from the SGP will be considered in the operationalization. The 'new Member States of the Eurozone' is first considered.

There are 19 member states part of the Eurozone, whereof there were 12 member states that started using the euro as of 2002. The member states that joined afterwards are seen as the 'new member states of the Eurozone', these are: Slovenia, Cyprus, Malta, Slovakia, Estonia, Latvia and Lithuania. The decision point for new or old member states of the Eurozone is set at the start of 2003, because there was already a large group of member states that joined the euro in 2002. There are those member states that still should adopt the euro, but do not fulfil the terms and conditions or want to wait.

Start date of the Member States of the EU that use the euro			
Austria	2002	Belgium	2002
Cyprus	2008	Estonia	2011
Finland	2002	France	2002
Germany	2002	Greece	2002
Ireland	2002	Italy	2002
Latvia	2014	Lithuania	2015
Luxembourg	2002	Malta	2008
The Netherlands	2002	Portugal	2002
Slovakia	2009	Slovenia	2007
Spain	2002		
Member States of the EU that do not use the euro			
Bulgaria		Croatia	
Czech Republic		Sweden	
Hungary		Poland	
Romania			
Member States with an opt-out			
Denmark		United Kingdom	

Table 1: Member States that use the euro (and their start date), Member States that do not participate in the euro, and the Member States that have an opt-out for the euro.
Source: (European Commission, 2016d)

For conducting this research a sample of 19 Member States is large and even too large when going into details. Therefore from these 19 Member States there are three Member States selected to view into more detail, these countries are: Estonia, Latvia, and Lithuania. Also Germany will be considered, since the new Eurozone members appear to support Germany in their decision-making for the SGP. Besides will it give a comparison on how the three Baltic States are doing compared to an older Eurozone Member State.

Since their independence, the Baltic states have "adopted a mix of policies advocated by the Washington consensus, including currency boards with fixed pegs (acting as nominal anchors for securing stabilization), fiscal discipline, liberalization of prices and trade, and wide-ranging privatisation" (Kattel & Raudla, 2013). These neo-liberal policy choices created an economic environment that gave the Baltic States an impressive growth track. The countries witnessed an unprecedented boom after their accession to the EU, the three states stood out for their growth rates, shown in table 2.

Country	Average growth rate
Latvia	10,3%
Estonia	8,5%
Lithuania	8,2%

Table 2: Average growth rates between 2004 and 2007 for the three Baltic States in percentage
Source: (Eurostat, 2017d; Organisation for Economic Cooperation and Development, 2017)

These growth rates were however accompanies by the signs of overheating, including a housing boom, accelerating wage growth, double-digit inflation, appreciating real exchange rates, "a fast accumulation of net foreign liabilities and soaring current account deficits. To a significant extent, the growth was fuelled by cheap credits, available through foreign-owned banks, which drove up domestic demand and which were channelled into real estate, construction, financial services and private consumption" (Deroose, Flores, Guidice, & Turrini, 2010; European Commission, 2010; Kattel & Raudla, 2013).

The growth of imbalances was coincided with slow gains in the productivity and rapid wage growth. The Baltic states were becoming massively indebted and at the same time rapidly losing competitiveness (Staehr, 2013). The high growth rates "induced a lulling effect, leaving the political elites oblivious to the few warning signals that pointed to increasing external imbalances. Furthermore, the governments even added to the overheating of the economies by loose fiscal policies" (Deroose et al., 2010; Kattel & Raudla, 2013; Purfield & Rosenberg, 2010).

The crisis hit the three Baltic States quickly and painfully. In early 2008 the domestic bubbles burst, at this moment in time the "credit supply decelerated and banks started tightening credit conditions. The downturn was further exacerbated by negative developments in the external economic environment after the Lehman Brothers' bankruptcy" (Kattel & Raudla, 2013; Purfield & Rosenberg, 2010). The decline in the real sector was mainly driven by two factors: the fall in the domestic demand and shrinking exports. While the deterioration in the private sectors was resulting from plunging consumer confidence and credit squeeze, and further exacerbated through a reduction in public sector spending (Kuokštis, 2015). In the three Baltic states the unemployment rates trebled between 2007 and 2009 (Masso & Krillo, 2011).

However, the policy responses in the three Baltic economies are exhibiting a similar pattern towards hardening of the neo-liberal paradigm. Even though there are some significant differences in the response of the Baltic economies towards the crisis, the Baltic republics also have a number of unique features in common that made their response towards the economic crisis possible. As Åslund has argued, "the East Europeans have emerged as the successful pioneers of a new, more liberal, and fiscally responsible all-European economic system" (Åslund, 2010). However, because of their unique features, it will be almost impossible to replicate the Baltic experience for other countries in Europe.

The crisis showed that the three Baltic countries, that appear to be seemingly homogenous countries, have some significant differences, especially when focussing on their effectiveness of the anti-crisis policies. The diverse outcomes of the policies were shaped by internal factors, "such as the sensitivity of their economies to foreign markets or the different response times of the governments to the first signs of the economic downturn as well as the socio-political background a the time of the crisis" (Dudzińska, 2013). Since 2011 the economic growth of the Baltic States accelerated, and their struggles related to the crisis appears to be a unique success story. The story continues with countries as Greece, that have a hard time in reforming their national policies. However the governments of the Baltic States do not want to lower any standards as can be noted from the following:

> "Let us fix things so that the stability and growth pact is not a piece of paper. Let us build up our institutions, pool our resources and respect our rules. And, most importantly, let us do

> our homework. The Baltics, the Iberians, Ireland and Slovakia show that even small countries on the eurozone's geographical periphery can reform their economies and streamline their budgets. Like us, the leaders of Greece must be bold and honest with their public as well." (Kazimir, 2015)

The next step is to conceptualize what is meant with 'positions' of the new Member States. Following from the theory it is expected that the governments of the Member States either make sure the interests of domestic interest groups are able to influence the government decisions or not. When trying to measure these positions the paper is divided into two parts.

The first part is focussing on the internal devaluations policy of the three Baltic States. There are four indicators selected that should provide a comprehensive picture of the economy of the Baltic States. The four observable moments are: wages, unemployment, current account and fiscal restraint. For each variable is considered the changes over time, the position of the national government for each of the three countries and the reactions of trade unions on the government decisions. The second part is focussing on the EU decision-making under the SGP, the government positions related to the specific SGP decisions and to determine if the government changes its position towards the SGP reforms during the negotiations, and if so, what are the reasons behind the change in position.

4.2 Operationalization

The next step is the operationalization of the research. To test the research question there will be a stake-holder analysis conducted of economic and foreign economic policy regarding Eurozone rules. This is still broad and can be unpacked into more observable moments. This section will go into more detail on the operationalization of: the decisions that are selected from the SGP and explain into more detail on the reasons of the selection of the four indicators that focusses on the national economic policy.

To select cases for the decision-making under the SGP there are several options possible. It is possible to select only one decision, however this approach can have severe drawbacks, since this specific case does not necessarily have to reflect or be comparable to the other decisions made. Since the start of the Eurozone there have been four decisions made under the SGP. Since not all new Eurozone members were part in the decision-making of all the four decisions (European Commission, 2016b), all four cases will be selected for further analysis. These can give a better impression on the possible influence of new members for the decision-making, and through this wide time span there are some circumstances that can be controlled for, for example the economic crisis.

The first of these decisions is taken in 2005 and named as the 'SGP amendment'. The SGP was amended by the EU lawmakers to allow for individual national circumstances to be better considered and adds more economic rationale in the rules that need to be complied with. In 2011 the 'Six Pack' is adopted, which makes the SGP more predictable and comprehensive "with a major enhancement of the EU's economic governance rules through a collection of new laws, known as the 'Six Pack'. The monitoring of both budgetary and economic policies is organised under the European Semester and further details on the implementation of the SGP's rules are laid down in a 'Code of Conduct"' (European Commission, 2016b).

In 2013 there are two measures adopted, the first is the 'Fiscal Compact'. Under the SGP's preventive arm there are budgetary targets that can be set and these are strengthened through a law, this law is known as the fiscal compact. This law is part of the Treaty on Stability, Coordination and Governance (TSCG). The second measure is the 'Two Pack', to strengthen the adherence of the SGP. It thereby reinforces the economic coordination between the Member States and is introducing new tools for monitoring.

There are two further steps taken in the SGP. In 2014 the 'SGP review' was taken, in which the 'Six Pack' and 'Two Pack' rules "which was called for in the legislation, determined that the legislation had contributed to the progress of fiscal consolidation in the EU. The review highlighted some strengths as well as possible areas for improvement" (European Commission, 2016b). The final decision is the 'SGP Flexibility', in which the Commission has issued guidance on how the SGP rules are applied for strengthening the link between investment, structural reforms, and fiscal responsibility in support of growth and jobs. However these did not involve the decision-making of the Member States, and are therefore not considered.

There are therefore four decisions considered from the SGP in the years 2005, 2011 and 2013. The following sections will deal with the selection of the Member States and economic indicators for the analysis. The identified variables for the research question were the positions of the new Member States and the decision-making under the SGP. These positions were furthermore focused to the economic variables, however till now the explanation lacked on why the focus is placed on specifically the economic variables. The Economic and Monetary Union (EMU) is resulting from progressive economic integration in the European Union. The EMU is "an expansion of the EU single market, with common product regulations and free movement of goods, capital, labour and services" (European Parliament, 2016). There has also been the introduction of a common currency, the euro, that has been introduced in the Eurozone. While "a single monetary policy is set by the European Central Bank (ECB) and is complemented by harmonised fiscal and coordinated economic policies, within the EMU there is no single institution responsible for economic policy" (European Parliament, 2016). Instead, the responsibility is divided between various EU institutions and the Member States.

Finally the indicators used to measure the economic interests for the internal devaluations policy have to be considered, these are: wages, unemployment, current account, and fiscal restraint.

While the choice for the internal devaluation was "anchored in the domestic consensus of policy makers and expert communities [...] for most part, the external devaluation as an adjustment strategy was not even given serious consideration" (Kattel & Raudla, 2013; Kuokštis & Vilpišauskas, 2010). The choice for an internal devaluation has several reasons, ranging from symbolic to practical (Kuokštis & Vilpišauskas, 2010). Given that the Baltic States did not want to opt for an external devaluation a "number of economists have concluded that to close the 'competitiveness gap', in particular with Germany, requires downward adjustments in relative wages" (Black, 2010; Kersan-Škabić, 2016). During the internal devaluations it is expected that the wages are affected through the government policy (Pettinger, 2013b).

The unemployment in a country is one "of the key economic indicators that describes the labour market conditions in a country" (Herrmann, 2016). The national unemployment rate is often defined as the percentage of unemployed workers of the total labour force. As noted by the Bureau of Labour Statistics (BLS) in the U.S., "when workers are unemployed, their families lose wages, while the nation as a whole loses its contribution to the economy in terms of the goods and services that could have been produced" (Picardo, 2015). Adding to that is that the workers who are unemployed also loose their purchasing power, this can lead to that other workers can become unemployed, creating a domino effect through the economy.

The current account is selected as an indicator to measure the economic interest. The current account is an important indicator for the economy's health and defined as "the sum of the balance of trade (goods and services exports less imports), net income from abroad and net current transfers" (Pettinger, 2013a). While there are economists that have argued that "current account is financed by capital flows, it should not be of great concern; others argue that a large current account deficit is a sign of an unbalanced economy and could lead to depreciation in the currency" (Pettinger, 2013a).

The current account is nevertheless selected as an indicator since it is an "important signal of competitiveness and the level of imports and exports. A large current account deficit usually implies some kind of imbalance in the economy, which needs correcting with a depreciation in the exchange rate and/or improved competitiveness over time" (Pettinger, 2013a). One of the biggest concerns related to a current account deficit is when this is financed through borrowing, but "a crisis of confidence causes this borrowing to dry up. This can cause a dramatic drop in the exchange ate, adversely affecting living standards" (Pettinger, 2013a).

While for monetary policy the principle of delegation towards the EU has become well established on national level, the fiscal policies though are "remaining in the hands of the national policy makers that are depending on rent-seeking interest groups" (Rotte & Zimmermann, 1998). Scholars have argued that "the Maastricht Treaty has provided a unique international commitment that enables governments to follow restrictive fiscal policies by attributing their negative side-effects to Europe, and to implement austerity measures despite rising unemployment or a decline in growth [...] the popularity of the European idea is instrumented to enforce fiscal discipline" (Rotte & Zimmermann, 1998).

This variable is selected since austerity measures are often a large part of the national government expenditure (Directorate-General for Internal Policies, 2014) and fiscal policy itself has already been discussed in the macroeconomic policy framework. Fiscal restraint is comparing the budget to GDP figures. The GDP is an importance measure since it "gives an overall picture of the state of the economy to that of a satellite in space that can survey the weather across an entire continent. GDP enables policymakers and central banks to judge whether the economy is contracting or expanding, whether it needs a boost or restraint, and if a threat such as a recession or inflation looms on the horizon" (Samuelson & Nordhaus, 2009). The government budget is important for every country and several factors are of direct and indirect influence. The budget now often "also come to be used to achieve specific goals of economic policy and is affecting the overall economy" (Due, Poole, & Kay, 2017).

4.3 Research Design

To get an answer to the research question that was proposed earlier, there is a comparative case study performed. The Baltic States are most similar in their governments ways of dealing with the economic and financial crisis, but there remain minute differences between the three countries. From the literature there are two main hypothesis formed. One is states that interest groups are having influence on the government decisions, whereby the government is acting in coalition with the interest group(s) and the other notes that only the government is leading without influence of interest group(s). Thereby is data used from Eurostat, official documents, newspaper articles, press releases and interviews. The analysis will focus on the three Baltic States and Germany. The data is collected in a time span from 2002 (since the euro was introduced in its physical from) to present. There is a wide time span selected so that some circumstances can be controlled for, for example the economic crisis.

There are some drawbacks towards this research design, one of them is making a type I error. This is the case when a hypothesis is true, but is rejected in the analysis. Through using different indicators of economic interests and the data is coming from reliable sources (e.g. Eurostat and the European Commission) the risk of making a type I error should be decreased. A different threat is possibility of omitted variables. Another possibility is that the economic interests are only a partial explanation of the positions, this leaves room for a discussion relating to the unexplored possible indicators of economic interests and the importance of ideas of countries in determining their positions. To prevent this it will remain key throughout the paper to avoid bias as much as possible. Another related problem is that of multicollinearity, because third variables can be related somehow to each other or there is likely some complex causal relationship between them (Babbie, 2012). This threat will be hard to adjust before the research and most likely will be found when drawing the conclusions.

4.4 Data collection method

When focusing on the data collection method, the focus can be placed on the data for the observable moments, the data related to government decisions and interest groups, and the positions of the government during the SGP decision-making process.

When focusing on the identified observable moments, these were: wages, unemployment, current account and fiscal restraint. The fiscal restraint can be measured when comparing the budget to GDP figures of the Member States. This indicator can can be found at the Alert Mechanism Report for the Macroeconomic Imbalances Procedure (European Commission, 2016a). These Alert Mechanism Reports is "the starting point of the annual cycle of the Macroeconomic Imbalance Procedure (MIP)" (European Commission, 2016a) and is conducted since 2012. Therefore, the data for these the figures for the fiscal restraint will be used from 2012 till present.

The current account is providing information "on the balance of transactions of a country with the rest of the world" (Eurostat, 2016a), and the data for the indicator is used from Eurostat. When measuring the wages, the data is collected from Eurostat and consists of the annual net earnings (Eurostat, 2017a). To determine the difference in wages before and after the economic crisis hit the Baltic States, data about the annual gross wages is used. The amount of taxes and the contribution of the employee on social security depends on the individual situation, because these variables can change it is hard to determine the annual net earnings for a person. Therefore is the decision made that the annual gross wages is used based on a single person that is working full-time (European Commission, 2016c). The data to measure the unemployment is from Eurostat as well and measures the total unemployment rate as a percentage of the labour force (Eurostat, 2017e). Eurostat is the statistical office of the EU and its mission is providing high quality statistics for Europe. Providing the "European Union with statistics at European level that enable comparisons between countries and regions is a key task" (Eurostat, 2017c).

The data for the government decisions and interest groups (related to the specific observable moments), and the positions of the government during the SGP decision-making process is collected in different ways. The interest groups that are able to be influential for the government decisions are for example the labour and business associations. However, it is key to remain this option open, since it is also possible that specific groups in society are uniting and existing through economic circumstances or government decisions. Data on the government decisions and SGP decision-making process is from official documents, press releases, newspaper articles, stability reports, parliamentary reports and/or interviews.

4.5 The Reliability and Validity

When conducting research the research should be both reliable and valid. When looking at the validity and reliability of this paper, the validity of the proposed operationalization is split up into four types of validity (Babbie, 2012). The face-validity and the criterion-related validity are both covered in this paper, because focusing on the multiple variables should provide a good overview of the positions (from both the government as the interest groups) that are important for the decision-making. The construct validity covers the logical relationship between variables. The dimensions proposed earlier do have a relation to each other, and the construct validity seems covered.

The final type of validity is content validity, in this case the content validity is still low, because there will be looked at several factors that can help explain the positions of Member States in the decision-making process under the SGP, however there can still be variables that are not included. Another related point of concern is the problem of undefined third variables. This threat will be hard to adjust before the research and most likely will be found when drawing the conclusions. When the controlled variables are missing or there are undefined third variables, the now identified variables shall in that case be rejected and this should give an indication that there could be more or different third variables that have an influence. Another point of concern is that not only economic interests (on which the focus is placed for the determining the government positions) can influence the positions of the Member States, also ideas or other interests, for example political interests, can have an influence.

The reliability can be defined as "that quality of measurement method that suggests that the same data would have been collected each time in repeated observations of the same phenomenon" (Babbie, 2012). The reliability should not be problematic when considering the four observable moments: wages, unemployment, current account, and fiscal restraint. The data for these indicators is from either Eurostat or the Alert Mechanism Report. However the data from the official documents, press releases, newspaper articles, stability reports, parliamentary reports and/or interviews can form issues for the reliability. Since there often the results will be interpreted by the author and a different author can have a different opinion about the noted results. Therefore there is a latent coding. When manifest coding would be used, the exact results would be easier to get when another researcher would do the coding. However, the viewpoint and the argumentation of the governments towards a specific reform or agreement in the SGP for example is not directly stated, this makes manifest coding difficult to perform. The latent coding does provide the option of interpreting a specific sentence or group of words as a change in opinion or viewpoint towards the reform for example.

5 Analysis: decision-making on a national and European level

In order to find an answer to the research question, the analysis is divided into two sections. The first section is focussing on the national level and addresses the internal devaluations policy of the three Baltic States. The four selected variables: wages, unemployment, current account, and fiscal restraint are considered into more detail, since each of these variables has been affected by the internal devaluations policy and are able to influence the government position when dealing with the SGP decision-making. For each of the variables the national policy and the response of the trade unions for each country is considered separately. The second section is focussing on the EU level and the bahavior of the national governments. Thereby, are the the four Stability and Growth Pact decisions earlier selected considered and discussed what each decision is about, the position of the national government, and if the government position changed during the negotiations (for example through the intervention of trade unions or the government opposition).

5.1 The threat of internal devaluations: case study of the Baltic States

The start of the economic and financial crisis in the European Union showed the substantial internal trade imbalances. These internal trade imbalances are "widely recognized as important contributing factors to the crisis of the Euro system because persistent current account deficits come with increasing external liabilities" (Stockhammer & Sotiropoulos, 2014). The economic policy regime of the Euro area is focussing since 2014 on rebalancing the Euro area through either fiscal contraction in countries with high deficits and/or internal devaluation. This part of the analysis will focus on Estonia, Latvia, and Lithuania that each underwent an internal devaluation in order to keep their currency peg and comply with the Eurozone rules. Since 2011 the economic growth of the Baltic States accelerated again and their internal devaluation policy seems unique compared with the other Member States.

The internal devaluations section of the analysis will focus on the internal devaluations all three Baltic States underwent. First the question is raised why the three countries opted for an internal devaluation, followed by how the countries coped with the policy selected and the national response towards the policy. This is followed by four variables that are selected to give a more in-debt view on the internal devaluations policies in four areas: wages, unemployment, current account, and fiscal restraint. Each area has its own section and starts with a graph that is showing the trend of the area for a given time period. In each graph there are also black vertical dotted lines that are showing the years for the selected SGP decisions. For each area the focus will be placed on the rules and regulations in place, the government policy and the potential influence of the trade unions. Each indicator will start with a small paragraph on what can be expected or derived from the theory, followed by the analysis of the government and trade union actions.

5.1.1 Why opting for internal devaluation?

Within a currency board or a monetary union, bilateral adjustments cannot be carried out anymore through exchange rate depreciation, there needs to be a direct action on the prices. Internal devaluation is defined as an "aim to pursuing this adjustment through plummeting production costs caused by deflation and the implementation of structural reforms. In practice however, governments have no influence on overall prices and must rely on the propagation of a substantial cut in civil servants' wages to the private sector's salaries, and eventually to producer prices" (Piton & Bara, 2012). This process is leading to a shift in the investment, while structural reforms allow increased productivity (Organisation for Economic Cooperation and Development, 2016).

In order to deal with the crisis all the three Baltic States decided for an internal devaluation instead of an external devaluation. This choice implied a "downward adjustment of nominal wages throughout the economy and fiscal contraction" (Kattel & Raudla, 2013, p.432). While the choice for the internal devaluation was "anchored in the domestic consensus of policy makers and expert communities [...] for most part, the external devaluation as an adjustment strategy was not even given serious consideration" (Kuokštis & Vilpišauskas, 2010, p.22). The governments of the Baltic states strongly objected towards an external devaluation of their domestic currencies for several reasons, ranging from symbolic to practical (Raudla & Kattel, 2011b; Kuokštis & Vilpišauskas, 2013).

Importantly, the "nominal exchange rate adjustment would have precluded joining the Eurozone as an exit strategy from the crisis" (Kattel & Raudla, 2013, p.432). Besides, a large proportion of the loans are denominated in euros, an external devaluation would impose large costs on a large part of the population and reduce the private sector net worth. This could then potentially lead to a surge in load defaults and contagion effects for the other parts of the economy. However, local experts and policy makers had the prevalent belief that currency devaluation would be potentially disastrous and wrong. It was felt that through the devaluation of the currencies, the national governments would lose the focal point for action (Raudla & Kattel, 2011a). In addition, none of the Baltic states "had experience with alternative exchange rate regimes and hence no existing competencies to manage non-automatic systems" (Kattel & Raudla, 2013, p.432).

The internal devaluation as the adjustment strategy was supported by the EU, which was "afraid that devaluation of the Baltic currencies would cause havoc in the financial markets and, potentially, lead to spill-overs to other Central and Eastern European countries, inducing capital flight from this region" (Kattel & Raudla, 2013, p.432). Besides, when the governments revealed their plan for an internal devaluation, the national-symbolic importance of their currencies as well as the corresponding exchange rates should be kept in mind. Since the creation of the new currencies in the 1990s the currencies were linked to the restoration of nation-building, democratisation and independence in the three Baltic countries. The devaluing of the currencies was equated with devaluing of the statehood, sovereignty and self-identity in the three countries (Åslund, 2010).

Another point that should be addressed is that the majority of the population of the three Baltic States is supportive towards the currency peg. In the Baltic States is a prevalent 'causal belief' among expert-community, politicians and the general population, that is supportive towards the commitment and political consensus necessary for "keeping the exchange rate peg. This causal belief notes that keeping currency exchange rate pegs is the right economic strategy, and that in the case of the Baltic States an alternative course of action would have been clearly wrong and potentially disastrous" (Kuokštis & Vilpišauskas, 2013, p.9).

The government's strategy of the Baltic countries to deal with the crisis and its challenges was centred on maintaining macroeconomic stability. The adjustment had to be achieved through a mix of policies that can also be defined as internal devaluation. Even though the emphasis and content differed between the three Baltic states, they all included the same four elements (Purfield & Rosenberg, 2010). The first element is the sizable fiscal adjustment. The purpose was "to (i) reduce fiscal funding needs, (ii) restore fiscal sustainability, (iii) bring deficits to the Maastricht fiscal limit of 3 percent of GDP as soon as feasible and, (iv) support a correction of the real exchange rate by containing domestic demand growth, thus keeping open the option of speedy euro adoption" (Purfield & Rosenberg, 2010, p.12). The authorities of the three countries recognized that the adjustment could deepen the recession. Fiscal consolidation in the three Baltic countries entailed both revenue and expenditure measures. There were cuts made in all expenditure categories, though it appeared that the transfers and operating expenses took a bigger hit than the investments.

Secondly is the adjustment of the nominal wages. The competitiveness was enhanced by reducing the factor costs, in both the private and public sector. This was supported by the traditionally high flexibility on the labour market of the Baltics', which made the modification of the work contracts and labour shedding relatively easy (Purfield & Rosenberg, 2010). Each government of the Baltic States made prominent cuts in the operating expenses of the public sector, mainly salary reductions. The wage cuts will be discussed in more detail later on (Krillo & Masso, 2010; Masso & Krillo, 2010).

Thirdly is preserving the financial stability. The authorities initial focus was to securing liquidity in banks. As the non-performing loans started to increase, the attention was than turned on the adequate capitalization. The governments and authorities started to strengthen the crisis response capacity and banking supervision through regulatory and legislative reforms. The last element is the repairing of private corporate and the household balance sheets. The Baltics have a tradition of non-intervention, and in line, this task was "left to private agents as the authorities were reluctant to directly get involved in debt restructuring. They did, however, look into ways to improve legal frameworks to facilitate out-of-court restructurings and incentivize voluntary debt restructuring" (Purfield & Rosenberg, 2010, p.13).

When focussing on the social benefits, sickness and pension benefits took the first hit. All the three countries curtailed their sickness benefits, although in different forms. In Estonia the benefits for the first day of a sick leave were cut, while in Latvia the payments were reduced when they exceeded a specific threshold by 50%. The pension benefits in Estonia were raised with 5%, however when following the indexing formula this should have been a 14% increase (Staehr, 2013). In Latvia and Lithuania the pensions were cut completely, however the cuts were contested by judicial review in both countries, and were found unconstitutional. Following the ruling of the constitutional court in Latvia, the government cancelled their pension cut and had to compensate for the parts that were left unpaid of the pensions. Nevertheless, the pensions indexation was frozen starting from the end of 2013. While in Lithuania the progressive pension cuts were implemented in 2010, whereby larger pensions faced larger cuts. In Estonia the planned increase in the unemployment benefits got postponed, while parts of the new employment law to make layoffs and redundancies easier were still enacted (Staehr, 2013). In other words, from the so-called 'flexicurity' package that should have been introduced, the security elements were postponed while the flexibility aspects were introduced.

Instead of increasing only one specific tax significantly, the government of each country opted to spread the increases across a wide range of taxes, both direct and indirect. There was in increase in the nominal tax rates, but also an "extensive broadening of tax bases, especially in Latvia and to a lesser extent in Lithuania" (Kattel & Raudla, 2013, p.434). All the three countries increased their taxes on alcohol, fuel, excise duties on cigarettes and the value added tax. The personal income tax was changed by lowering the number of allowances and the income tax rates was changed.

It should be noted that, the governments of Estonia and Latvia primarily imposed tax increases, the picture in Lithuania is more complex. The Lithuanian government imposed not only increases but also some reductions, as shown by the personal income tax rates. The international community supported the strategy that the Baltic countries selected. Not long after the crisis hit the Baltic countries the European Commission, bilateral donors, and IMF had to decide, "whether to commit financial resources to Latvia based on a program that would maintain the peg" (Purfield & Rosenberg, 2010, p.13).

The Baltic countries retained their 'peg' to the euro, which offered "foreign banks that had been major creditors of Baltic households to secure loan repayments" (Woolfson, 2010). The possibility of joining the Eurozone always had a special aura among the three Baltic States, often this is associated with the nation-building efforts. To many Estonians, the euro is meaning security, a step towards 'Europe' and moving away from Russia (the Economist, 2010). The costs for keeping an independent currency are rising while the benefits are shrinking. Since each of the three countries pegged their national currency to the euro the only flexibility these countries could loose is the possibility for devaluation, an option the countries not wanted to use with the economic and financial crisis.

For countries as Estonia, Latvia, and Lithuania "having a seat at Europe's top table is not just symbolically important: it is a national-security issue" (Lucas, 2013). Russia has a growing clout in the former Soviet region and the Baltic States are feeling this. Latvia's finance minister, Andris Vilks, noted that "joining the euro meant 'we have completed our mission' of joining all the main institutions in Europe from the EU to NATO" (the Economist, 2014). Also in Lithuania there is a feeling that joining the euro will provide a symbolic defence against Russia. There remains also other reasons to join the euro, where there is often pointed at the economic benefits of the euro. A different reason is the size of the economies, since "it affects foreign trade dependence (whereby external market forces tend to discipline fiscal policy more effectively than in larger ones) and exchange-rate regime choices (since it is establishing monetary policy credibility)" (Johnson, 2011). In order to get a better understanding of the political context and changes made as part of the internal devaluations policy in the three Baltic States, each of the three Baltic States is discussed separately.

5.1.1.1 Estonia

The political landscape in Estonia remained stable throughout the economic and financial crisis. Prime Minister A. Ansip formed three governments with his party, the Reform Party, in 2005, 2007, and 2011. His party remained popular "in spite of economic reforms and stringent austerity measures taken during the crisis, winning the regular parliamentary elections in both 2007 and 2011. The effectively conducted economic policy enabled Estonia to adopt the Euro on 1 January 2011, in the midst of the economic crisis" (Laatsit, 2014, p.2). Estonia can be seen as a country that faithfully followed the rules of the Eurozone (n.d., 2010).

The Estonian government had to undertake drastic cuts in their budget, raised the pension ages, cut job protection and made it more difficult to claim health benefits; all as an attempt to keep in line with the Eurozone rules. While "Greeks planted bombs at the prospect of economic reform, the Baltic citizens barely raised a whisper of complaint, protests were limited and generally directed at corruption rather than the cuts [...] Estonians even re-elected the politicians that brought in the stringent measures" (Moulds, 2012). Estonia wants to show with "the economic price that may have to be paid to meet the standards of the Eurozone, given political will, it is possible for countries to shoulder that cost" (n.d., 2010).

5.1.1.2 Latvia

Before the economic and financial crisis the last parliamentary elections in Latvia were held in 2006. However, the political landscape in Latvia changed during the crisis through two elections - the ordinary elections held in 2010 and an emergency election in 2011 (The Central Elections Commission of Latvia, 2015). Although sometimes it is not directly noted or only seen as small developments, adopting parliamentary measures in light of the Eurozone rules and internal devaluation policy resulted in opposition.

In January 2009 a "big demonstration took place asking the President to dismiss the Parliament due to the general dissatisfaction with the way the government was dealing with the crisis (around 10.000 people participated); but these demonstrations remained without results" (Rasnača, 2014, p.2). This also remained the only significant demonstration that was concerning matters related to the economic crisis, and can be seen as the biggest demonstration since Latvia regained its independence in 1991. However in February 2009 the Prime Minister, which was at that time I. Godmanis, resigned and was followed in March by the new Prime Minister, V. Dombrovskis. He was in a beneficial position, since he opposed the stabilization programme for being insufficient and had been outside the government (Dahan, 2012). He "managed to achieve an almost symbolic meaning of being a 'new figure' capable of dealing with the mistakes of previous governments. Therefore, he enjoyed a broad mandate to act and this allowed him to successfully carry out austerity measures without significant opposition" (Rasnača, 2014, p.2).

In the beginning of 2010 the National Party withdrew from the coalition, leaving a minority coalition. The minority coalition remained working relatively successful, but often had problems with getting political support for adopting new legislation. In October 2010 scheduled parliamentary elections were taking place and in 2011 new elections followed from a referendum where the population voted in favour of dismissing the parliament, both governments did not show to have problems with implementing new policies as part of the internal devaluations or complementing the Eurozone rules.

While Latvia had to implement several changes to deal with the economic and financial crisis, which, as will be discussed in more detail later on, resulted in demonstrations or by simply emigrating from Latvia. The position of the population towards the European Union and the Eurozone rules did not suffer much during the crisis (Dimitrovs, 2015). The measures Latvia had to take related to crisis measures that were adopted at the EU level and to stay in line with the Eurozone rules were hardly blamed. It "has even been argued that the EU has nothing to do with the situation when its competences are considered and the social responsibility has to be taken by the government and, in general, by the country itself" (Rasnača, 2014, p.6).

5.1.1.3 Lithuania

Before the economic and financial crisis hit Lithuania, the majority in parliament was held by the Social Democratic Party. In "2007-2008 the government, supported by the opposition, made a number of decisions significantly increasing budgetary expenses (e.g. increasing public sector wages and social expenditure, including maternity leaves and pensions as well as introducing an automatic indexing of the budgetary payouts)" (Šaltinytė, 2015, p.2). The first elections during the crisis took place in 2008, a month after the collapse of Lehman Brothers. However, "the topic of possible austerity measures never was on the political agenda. It is considered that the reason for that is that the possible impact of the external financial crisis was never sufficiently appreciated either by the opposition or the incumbent government" (Šaltinytė, 2015).

There was a coalition government formed by the Conservative Party, joined by the National Revelation Party and two liberal parties. The newly formed government was presented with a macroeconomic forecast of 0% growth during its first meeting. There had to be taken immediate measures to adjust the draft budget. The government became "notorious for its 'night reforms', introducing sharp spending cuts and tax rises only a few days before the start of the new financial year of 2009" (Šaltinytė, 2015, p.3).

The austerity measures were provoking a massive protest on January 2009, the first since the start of the crisis. However, Lithuania also showed a form of 'silent' protest, since at the end of 2009 the number of residents was decreased by 16.000 persons compared to the end of 2008. The government was not popular in Lithuania, but managed to serve a full four-year term in office. The parliamentary elections in October 2012 were won by the Social Democratic Party that would form a coalition with the Labour Party. While the Lithuanian population was described as a 'culture of patience' towards the crisis, this could also be the result of the previous two significant economic crisis experienced by Lithuania, in the 1990s and 1998-99. However, throughout the crisis the Lithuanians remained relatively positive towards the Eurozone integration and its rules.

5.1.2 Wages

When moving to the theory section, there are two potential outcomes expected from the analysis of the wages. When focussing on the Macroeconomic Policy Ideas, it is expected that through the internal devaluation programmes that were initiated in the Baltic States the wages are cut for everyone. When focussing on the Interest Group Politics there is the option that interest groups are forming or actively engage in the process of cutting in the wages, since everyone experiences wage decreases but the private sector wages might be influenced harder than the public sector wages.
Although at first appearance the situation shows to be rather similar for the three Baltic States, there are some differences when focussing on figure 1. The internal devaluation policy shaped the wages differently for Estonia than for Latvia and Lithuania. In Estonia the wages increased, compared to the previous year, with 1.2% for the second quarter of 2010; while the wages in Latvia and Lithuania averagely decreased with respectively 6.3% and 5.4% (Sippola, 2011). Therefore can be concluded that the internal devaluations were more 'successful' in both Latvia and Lithuania, but less in Estonia.

The Baltic States share many features with each other and with other CEE countries, including the unprecedented economic depression that started in 1989, the effects of an obligatory union membership that ended, a decline in their old manufacturing sector, and "the challenges of building unions in a post-communist society in which capitalism is popular but the effects of primitive capital accumulation are not" (Sippola, 2011, p.4). One can "argue that voters think left but vote right" (Sippola, 2011, p.4), as pointed out regarding the Latvians. Regarding the disparity between the desired outcomes of politics and voting behaviour, the economic and financial crisis that began in 2008 started to change the behaviour of some citizens. The labour market changed, which went from tight into loose, and soon the employers started to propose salaries to be cut up to one third. The employed policy by the governments has not let to industrial unrest. There were some signs of social unrest in 2010, most noticeable in Lithuania, but these transformed quickly into 'muted' protest.

The internal devaluation showed to have a large impact on the wages in the Baltic labour market. Latvia cut their public wages on average by 28% in one year during the economic and financial crisis. Besides were the wage cuts not restricted to the public sector, in Estonia the salespeople in the private sector had a wage decrease of 12% up to 15%. For now the three Baltic States will be considered separately to determine the influence of the large wage cuts.

5.1.2.1 Lithuania

When the government of Lithuania decided to adopt the internal devaluation policy, the government introduced tax rises and public sector cuts at the same time. This included that the public sector wages were

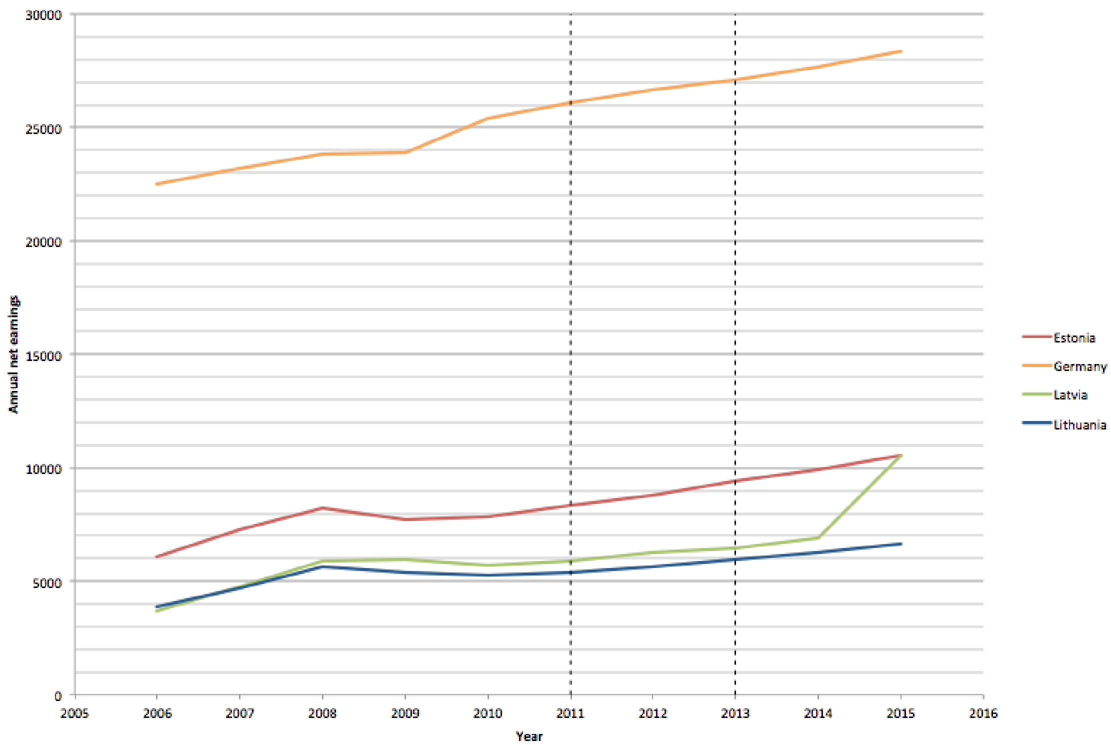


Figure 1: The development of the gross annual wages in the Baltic States between 2006-2015
Source: (Eurostat, 2017a)

reduced by 20% to 30% and the pensions reduced by 11%. The corporate taxes increased by 20%, while the Value Added Tax (VAT) was set to 21% (Thomas Jr., 2010). The chosen direction of the Lithuanian government had far-reaching effects for the citizens, not only because the unemployment figures increased while the economy was shrinking in 2009, there were also social consequences.

The government also decided that new societal groups, as artists, were obliged to pay for their social insurance contributions to be covered with the social insurance. In the summer of 2009, "the prime minister Andrius Kubilius appealed to the nation, on TV broadcast, to take unpaid leave to help saving employers' and budget funds, which eventually led to average of 2-3 weeks unpaid leave for every worker in Lithuania in 2009" (Petrylaite, 2010). Pensioners who were realising that their pensions were cut, had to line up at the soup kitchens, the unemployment tripled between 2006 and 2010, and the suicide rates increased while the country already faces one of the highest suicide rates in the world (Thomas Jr., 2010).

Lithuania also faced a different problem, protests, these were "derived from the disillusionment in the face of the economic crisis. It is to be noted that the Baltic uprising that led to the independence of the FSU countries started from Lithuania" (Sippola, 2011, p.5). The country has a smaller population of Russians as a legacy of the Soviet Union than Estonia or Latvia. Accordingly, the need to eradicate everything that is associated with the Soviet Union is smaller, including labour demonstrations and trade unions. However, Lithuania got one of the strictest anti-strike legislation compared to the FSU countries. There is a virtual ban of strike action. Whereas there were in 2000 a total of 55 strikes that involved 3300 employees, in 2005 there was one strike involving 70 employees (European Commission, 2008). However, 2007 and 2008 there were dozens of teachers' who were striking. Although the effect of these strikes in 2007 and 2008 were only modest, some commentators concluded that "the era of mere accepting unsatisfactory labour conditions is over and that Lithuanian employees are seeking new avenues to express their dissatisfaction" (Sippola, 2011).

A survey held by "the Civil Empowerment Index of the Lithuanian society in 2008, based on the figures for 2007, reveals a rather ambivalent attitude of the country's citizens towards striking" (Sippola, 2011, p.5). About 4% of the respondents participated in strikes, while one-third of the respondents noted that they would abstain from any strike action in the light of the national economic problems. Nearly 50% of the respondents were afraid to loose their job as a result from striking. Besides was the following statement made:

> "The findings of the research suggest that more than half the Lithuanian population are of the opinion that people who initiate or actively participate in industrial action may lose their jobs or may be seen as mentally unstable; they may be openly attacked, defamed, or suspected by others of acting from unjustified motives and are likely to be treated with summary dispatch. An assessment of the index of risk of civic activity shows that fear of the consequences of taking part in industrial action is pre-dominant in Lithuania." (Petrylaite, 2010)

Against this backdrop, the only remarkable protest attendant by many employees was in 2009, which led to nothing or had no influence on the policy implemented by the government. In this event, around 7000 citizens gathered, which is one of the largest gatherings since Lithuania re-gained its independence. The gathering was organised by the trade unions and defensive in nature: "it was meant to calling on government to guarantying certain social benefits and rights as well as keeping its obligations to consult unions within the framework of 'social dialogue"' (Sippola, 2011, p.5). This desperate attempt in order to make the unions 'voice' heard by the government did not succeed in the desired manner, an throughout 2009 the protest took a 'muted' form (Woolfson, 2010). It should also be noted that the campaign of the prime minister "for unpaid leaves in 2009 did not provoke any significant opposition on the part of the trade unions despite its apparent contradiction to the established Labour Code. Eventually, all three Lithuanian trade union confederation endorsed a 'historical' social pact with the government and employers, which in effect suspended union protests in exchange for government promises to continue social dialogue but, however, with entailed wage cuts and benefit cuts" (Sippola, 2011, p.5-6).

As a consequence, one can speak of a failure of the voice. These failures can contribute to more protests or an increase in the migration figures. As commented by Charles Woolfson, a professor in labour studies and who has expertise of Lithuania:

> "The internal devaluation strategy may have succeeded in delivering short-term stabilization, but at what cost? Moreover, as emigration from Lithuania has peaked a second time since the country joined the EU in 2004, Woolfson draws even darker picture: Then it was the migration of the hopeful, [...] now it is the migration of the despairing." (Woolfson, 2010)

5.1.2.2 Latvia

Among the three Baltic States - and in general from the European Union, Latvia was the worst hit by the financial and economic crisis in 2008. The country's president Valdis Zatlers argues that the main reason why Latvia was so badly hit was that the economic and financial crisis coincided with a domestic downturn (European Institute, 2011). The economy experiences a drop of 25% to 30% in GDP, which is a greater loss than the downturn of the U.S. Great Depression between 1929-1933 (Weisbrot & Ray, 2010). In the end of 2009, the situation in Latvia generated protest from students, around 5000 students decided to protest in Riga towards the deep spending cuts. The government already made cuts in the social security, state-sector wages and education, but repeated this in 2010. An "alarming sign in the protest were the warnings of young, educated people to leave the country completely; one banner at the rally claimed: 'The last student to leave will turn out the light at the airport"' (Sippola, 2011, p.6).

In economic terms, the governments decision to opt for an internal devaluation seems to be relatively successful, since the economy is growing; exports are back at the level before the crisis and the budget deficit only decreased to 3% of GDP in 2012. However, through the selected policy there are growing social tensions. Latvia is facing a possible emigration crisis due to the social reasoning. According to estimations, over 12% of the overall population of Latvia - and a larger percentage of the Latvian labour force - is now working abroad (Hudson & Sommers, 2011). However, the choice of the Latvian government for internal devaluation does not seem to have only drawbacks. Since "the public cost of bank losses has been far smaller than anticipated, and the that gross foreign debt has remained considerable (not doubled, as it would have been in the case of devaluation). Other benefits gained include higher productivity due to structural reforms conditioned by the fixed exchange rate, and social equity due to the cutting of wages of well-to-do senior officials while maintaining subsidies to the poor and pensioners" (Sippola, 2011, p.7).

Due to the internal devaluation policy the unemployment levels increased and this could have been lower, since "devaluation would have slashed euro wages drastically but thus also the standard of living" (Åslund & Dombrovskis, 2011). This is also the reason why the Latvian government is afraid for massive emigration of those who seek higher euro wages. Given the cuts in the public sector, the increasing levels of unemployment and the large-scale emigration, it remains the question whether the government and the Latvian economy is able to resolve the dilemma:

> "The key question is whether Latvia - a country that has been most affected by the crisis - will in the foreseeable future become a country with a successful and modern economy, educated society, and highly qualified labour force and where best performing companies of the world are willing to invest." (Åslund & Dombrovskis, 2011)

Since government policies are highly influential on whether foreign investors are opting for a 'high road' or the 'low road' to economic growth and investment (Sippola, 2010). In case of the 'low road', "that is to say when low standards in salaries and labour conditions constitute the competitive edge of firms, highly educated and skilled employees are likely to seek jobs abroad" (Sippola, 2011, p.7). This has been happening already before in 2006 in Latvia. Also for Latvia did Charles Woolfson analysed the situation and considered that since the Baltic labour market was tight, it could have provided the employees with a possibility for standing up for their rights:

> "...there are opportunities for labour to organise in tight labour markets and also opportunities for creating skills-based workforce in the longer term. Whether the unions, or the employers will take these opportunities is more doubtful. [...] My guess is Baltic employers will increasingly look to FSU labour to fill gaps emerging in their workforces, rather than acknowledge the Baltic labour force as having basic right of participation and organization, even if they offer them some money in wages." (Sippola, 2011, p.7)

According to Woolfson, wage premium will not mean that the emigrant workers will be attracted to work back home, while the problems of: poor safety, health, and lack of rights to organise; labour conditions; and gender discrimination prevail. Even though over the years increased occupational accidents and diseases are reported, as well as increased violations in the industrial relations (Homko, 2003). There are two main reasons for this increase over time: or the workers are starting to become aware of their poor working conditions, or it is more of a sign of under-regulated conditions on the work floor (Rajevska & Vanags, 2005). A high rate of the respondents that mentioned these types of violations were part of the group that had lower wages or were unemployed.

In 2011, Latvia is faced with a second, potentially damaging, emigration crisis after the country joined the European Union in 2004. Surveys from 2011 show that almost one-third of the Latvians are determined to seeking jobs abroad. When this second emigration crisis would happen it would highly influence the Latvian economy, since it will decrease the supply of labour that is capable for paying the taxes as well as to sustain the budget. Short-time emigration "might be an asset for an individual and the state, since it is likely to increase skills and language competence of Latvians, but long-term emigration proses a risk of losing the skilled segment of labour force completely" (Sippola, 2011, p.8). Experts are expecting that the majority of those who determine to emigrate, to do so for only a certain time and come back to Latvia.

5.1.2.3 Estonia

During the European Union accession procedure, Estonia "set the goal of achieving the average level of the EU in the future, albeit later in Estonia, the object was set to become one of the five most prosperous countries of the EU in the near future" (Sippola, 2011, p.8). It was however questionable if Estonia would be able to reach its goals, since the country had to gain competitive advantage by means of its neo-liberal politics and was facing the economic and financial crisis.

Estonia did not have to resort to heavily as the other two Baltic States to the internal devaluation policies, is recovering more rapidly, compared to Latvia and Lithuania, from the financial and economic crisis from 2008. The government of Estonia decided in 2009 to cut the wages of the public sector by 10%, imposed lay-offs, and dismissed employees. These decisions did not in fact lead to any protests of employees that work in the public sector. The wage cuts in the private sector did lead to a few protests, since the workers appealed to the unions. Through the fact that the "private sector wages have not kept pace with public sector cuts may have served for many workers as a rescue from a poverty trap. With relatively modest public sector cuts - compared to Latvia and Lithuania - the average wages levels have not plunged in Estonia, which as it can be argues, has been one source of Estonia's rapid recovery" (Sippola, 2011, p.9). The average wages in Estonia increased in 2010, compared to previous year, by 1.2%, whereas the average wages in Latvia and Lithuania decreased over the same time period with 5% to 6%.

Compared to the Latvians and Lithuanians, the Estonians appear to be more optimistic towards future opportunities. Estonians are more likely to take an optimistic attitude towards their future labour market prospects, whereas Lithuanians have the most pessimistic attitude regarding future employment possibilities. Although these differences "can be explained by 'political choice' factors, which in the case of Estonia means the most radical privatisation and 'shock therapy' economic policies associated with successful campaigns to attract FDI after the collapse of the Soviet Union, also geographic factors may have played a role" (Sippola, 2011, p.9). Finland is one of the prosperous welfare states in the north and helped the Estonians in dealing with the problems through offering short-term jobs in the services, construction and other industries.

Obviously, the traditional union membership is not functioning properly in defending the employees' rights. Some authors claim that the Estonian workforce is more individualistic, and therefor the trade union membership is rather low. In connection with the financial and economic crisis in 2008 there would have been more room for the union movement to gain ground, also given the apparent disillusionment that is associated with the policy of internal devaluation.

The small attendance of the industrial action cannot only be explained by the mere individualistic workforce. The attitude towards "trade unions could not be characterised in terms of indifference, but it must rather be seen in terms of ambivalence consisting of both past and present prejudices" (Sippola, 2011, p.10). One manifestation is reflected in the media coverage and reactions towards the labour unrest that was present in many European countries in 2010 focussing on the cuts in the public sector. The Estonians however, pulled out from defending their own rights, contrary to most other Europeans. Estonians, as can be argued, are often more rationalistic when it comes to their withdrawing from protesting against the rise in pensionable age. Although this argument got a lot of critique, there are also authors that agree with this viewpoint.

The acquiescence of the Estonian and Latvian labour is not only related to the prevailing uncertainty that is on the labour market, but on the other hand also intertwined with the so-called 'Russian question'. This, in turn, can be compromised of two mutually reinforcing and substantial factors: "the nation-building with negation of everything associated with the Soviet past (i.e. trade unions) and the spectre of the experiences of Russification under the Soviet regime. This factor, on its part, is hampering the emergence of effective coherent civil society, that is, the cohesion between Russian and titular nation parts of population" (Sippola, 2011, p.10). The non-citizens Russians perceived that the trade unions are not the key way of defending the causes, since the trade unions are perceived to be too near "to be associated with the strive for restoring the previous regime" (Sippola, 2011, p.10).

5.1.3 Unemployment

When moving to the theory section, there are two potential outcomes expected from the analysis of the unemployment. Focussing on the Macroeconomic Policy Ideas, one can argue that through internal devaluations the unemployment levels increased, however, the government decided on internal devaluations to keep the exchange rate regime and being able in the near future to join Eurozone. There is expected to be no collaboration with trade unions. However following the Interest Group Politics logics, one can argue that through internal devaluations the unemployment levels increase, since these figures rose sharply the trade unions were active in supporting the unemployed and provide better protection for them.

All of the current labour market policies in the Baltic States have developed after the collapse of the Soviet Union, and these developments are based in many respects on the experiences of the OECD. The unemployment benefits were introduced in 1991 for all the three countries, because of the emergence of unemployment problems. However throughout the 1990s the unemployment benefits were reconsidered for the Baltic States through the introduction of the unemployment insurance systems (Latvia in 1997; Lithuania in 1996; and Estonia as last of the three countries in 2002).

It is in the literature no uniform opinion on how the first unemployment benefits system of the Baltic States can be classified; either as Unemployment Assistance (UA) or Unemployment Insurance (UI). A general "feature of UA is means-testing, but the first unemployment benefits of the Baltic States were not means-tested. However, the rates of the unemployment benefits were so low in the 1990s that guaranteeing some minimum resources seems to have been a much more realistic goal than income smoothing" (Masso & Paas, 2007). Based on considerations, the first unemployment benefits were classified as UA. While Latvia and Lithuania later replaced their unemployment assistance with unemployment assurance, in Estonia both systems are still existing in parallel.

For the eligibility conditions that are otherwise strict in Latvia and Lithuania, there are some exceptions made, for instance women that have pre-school children. While in Estonia the "minimum contribution record requirement for unemployment insurance has been strictly enforced, and the unemployment who fail to fulfil this criterion may apply for unemployment assistance" (Masso & Paas, 2007). The eligibility for the assistance is requiring active job search and a record of the previous employment. The active job search criterion is a key condition for benefits for all the Baltic States. This is also including a "registration as unemployed at the local labour office and active search for employment, which means visits to the labour office at least every 30 days in Estonia and Latvia and on appointment in Lithuania" (Masso & Paas, 2007). If the person is refusing a suitable job offer the payment of benefits can be terminated. These rules are also applicable during the economic and financial crisis.

Through the austerity measures the Baltic States took to deal with the financial and economic crisis, the unemployment rates shot up, and substantial emigration followed in the three countries (Staehr, 2013). The decline in output particularly affected the labour-intensive sectors, for instance retail services, manufacturing and construction. The unemployment effect was first only small, since most companies kept "their excess staff on the payroll until the depth of the crisis became evident" (Staehr, 2013, p.296). The unemployment declined in the start of 2010, which was reflecting the upturn of the economies of the Baltic States that already started in 2009, but it was also possible because of the increasing emigration. The emigration problems were most present in Latvia and Lithuania.

When summing up the different circumstances and events of the Baltic States together, some authors argue that the three countries are entering the same stage as East Germany had during the 1980s:

> "In sum, the direct obstacles to voice, that is, to any political movements of resistance or dissidence, were enormous. They must be added to the indirect undermining of voice by the real or imagined availability of exit to the West." (Hirschman, 1993)

Following the EU accession and the 'return to the West' of the Baltic States, together with the increasing unemployment rates through the economic and financial crisis (shown in figure 2), a massive emigration occurred. Most of the emigrants went to Scandinavia, the United Kingdom and Ireland, however there are no figures that reveal the whole picture or truth. Most of the emigrants in the service industry are through hiring out of workers, postings or self-employment. In Sweden and Finland there are no numbers available of the posted workers (Dølvik & Eldring, 2006). The emigration "is drastically shaping the Baltic labour market, since masses of skilled labour are leaving their home countries, making it difficult for firms to maintain their skills base" (Sippola, 2011, p.11).

There are both 'pull' and 'push' factors that are determining the decisions for leaving the country. Estonia's accession to the European Union in 2004 gave a large impulse for their workers to seek jobs abroad,

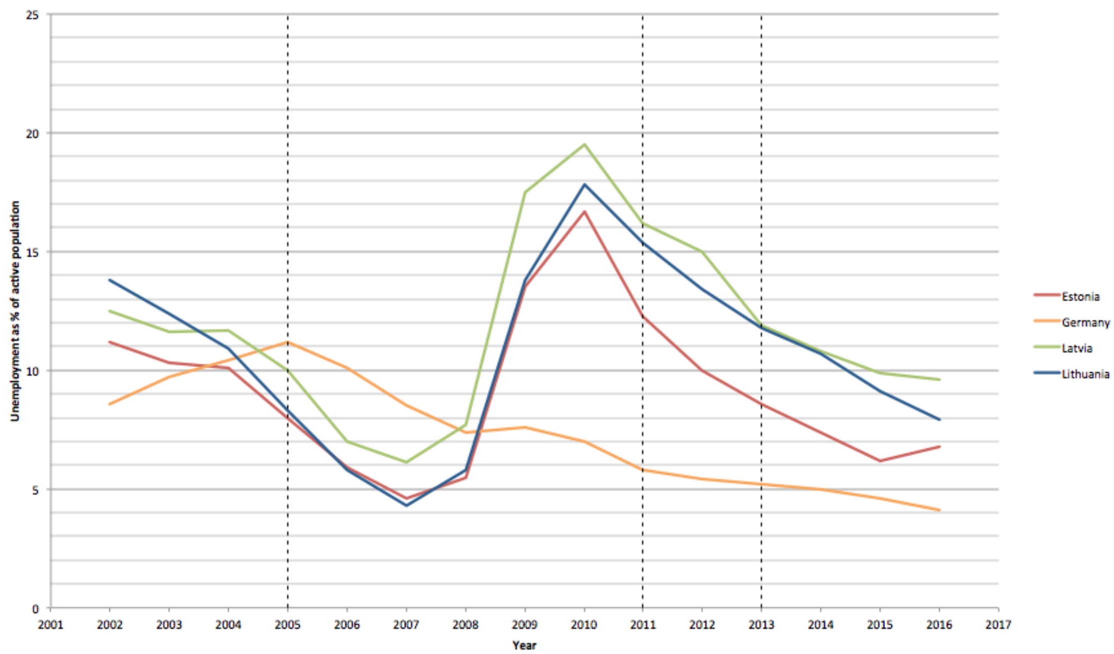


Figure 2: The development of the unemployment in the Baltic States between 2002-2016
Source: (Eurostat, 2017e)

and Finland, the neighbouring country of Estonia, abolished all restrictions related the free movement of labour two years after Estonia joined the EU, which widened the possibilities for working abroad. In Latvia most of the emigration focussed to Ireland and Britain, which can "partly be explained by the fact that the minimum wage in Latvia is the lowest among EU countries, while the cost of living and economic growth have increased greatly" (Sippola, 2011, p.12). Also Lithuania is dealing with several 'push' factors that increase the desire to emigrate. The World Bank report for Lithuania in 2005 notes that there is anecdotal evidence that "Lithuanians preferred moving to Ireland or any promising foreign country than to any location in Lithuania" (Sippola, 2011, p.12). In sum, there are four main reasons for emigrants to leave the Baltic States:

- "Better paid jobs in other EU countries;
- Better working conditions: relations between employer and employee, better protection of workers' rights;
- Social security and stability in the host country;
- Better opportunities for education and employment" (Sippola, 2011, p.12).

In response to the emigration of workers, the labour markets tightened. Rather than trying "to improve the labour conditions of domestic workers, employers have encouraged the import of foreign workers from Belarus and Ukraine" (Woolfson, 2007). While the trade union movements have been discussed in relation to the wages, there are no differences that can be noted when discussing the trade union action and the level of unemployment, with the exception for Latvia. Each country will shortly be discussed, noting the biggest differences that are happening in the countries itself related to the level of unemployment.

5.1.3.1 Estonia

It should be noted in the beginning that the fiscal consolidation measures taken by Estonia in 2009 were not a direct reaction to the rising unemployment or the economic and financial crisis (Staehr, 2013). After Estonia joined the European Union the authorities wanted to get their country part of the Eurozone as soon as possible. When focussing on the emigration statistics in 2000s around 14% to 19% of the total workforce is estimated to work abroad. However, in 2009 only 2.8% of the total workforce is working abroad. This "means that a considerable proportion of the workers have opted for a temporary job abroad - in most cases in Finland. A survey that is conducted in 2009 among Estonian emigrants evidenced that while a quarter of the respondents wished for returning back to Estonia, 45% of them intended to stay in the destination country" (Sippola, 2011, p.9). There is also anecdotal evidence that the desire to work abroad is closely connected with the poor work and salary prospects that most workers have in Estonia. This argument is supported by a survey conducted in 2010 among Estonians, the survey concluded that 40% of the working-age population was afraid for dismissals, and 49% of them were not satisfied with their promotion and developmental prospects when considering their work and career (Kõre, 2011).

5.1.3.2 Lithuania

Lithuania's economy has suffered over the past years from an uneven economic development, which had a detrimental effect on the levels of employment and unemployment. The number of unemployed people in the age-group from 15-64 increased during the crisis and in 2010 reached the point it was more than four times the level of unemployment from 2007. With this rapid increase in the unemployment levels, also the level of long-term unemployed (those who did not have a job for more than 1 year) as well as their share in the total unemployment levels rose. The economic and financial crisis "had a particularly negative impact on the countryside. The rate of employed among residents of rural regions aged 15-64 plunged sharply, standing at only 49% in 2010, whereas the corresponding figure for urban residents in the same age-group was 62%" (European Economic and Social Committee, 2013b). This negative trend is even worse when focussing on the net migration levels. In the previous years, more citizens are leaving Lithuania than immigrated there. Their emigration rate is the highest of the EU.

5.1.3.3 Latvia

In Latvia "one of the most painful consequences of the recession was to push a large number of economically active young people into leaving the country to find better working and living conditions abroad" (European Economic and Social Committee, 2013a). As the government decided on the internal devaluation policy, which included wage reductions, cut the public spending and the number of workers; many Latvians were finding themselves without income or work and set-off emigrating to different countries, especially in Western Europe. Since most of the Western European labour markets already opened up for migrant workers, with the exception of Germany, which they opened up later.

At the "time of the recession, the main forum in Latvia for hosting tripartite social dialogue at national level between the government, employers and workers (the Latvian Confederation of Free Trades Unions, or LBAS) was the National Council for Tripartite Cooperation (NTSP), which continues its work today. It contains eight internal sub-councils covering (i) tripartite cooperation on labour issues, (ii) social security, (iii) tripartite cooperation on vocational training and employment, (iv) the health care sector, (v) tripartite cooperation on transport and communications, (vi) tripartite cooperation on environmental protection, (vii) tripartite cooperation for regional development and (viii) public safety" (European Economic and Social Committee, 2013a). The NTSP did not get any official recognition, the government often avoided to discuss major issues with the NTSP in the economically good times, and although a case is discussed and following a compromise position adopted, both the parliament and government are not bound by it.

To improve the social dialogue and to guarantee the involvement of the social partners in the national decision-making in case of a crisis, the Latvian prime minister decided in 2009 to set-up a new steering committee that deals with reforms, which includes several trade unions, including the LBAS. The committee's main task was preparing the draft of the national budget for 2010, and for the long-term, the national budget for 2012, whereby the deficit should not exceed the 3% of GDP. In making this decision for the set-up of a steering committee the prime minister wanted "to win support of the social partners for the austerity measures proposed by the government and calm public opinion by showing that discussions and consultations had taken place" (European Economic and Social Committee, 2013a). However, more often the working group was dealing with strengthening of the national budget and putting structural reforms of the priorities.

On several occasions during the economic and financial crisis starting in 2008, employers urged the LBAS, as being a social partner, to waive the section 110 of the Latvian Labour Code, "which provides protection for unionised workers by guaranteeing that they cannot be dismissed without prior consent of their union except in special circumstances, such as the consumption of alcohol during working hours. The Labour Code states that the dismissal of an employee without the approval of their union is allowed only by court order" (European Economic and Social Committee, 2013a). On the employers' side there have been several attempts to violate the social guarantees that are provided for in the collective agreements that were concluded previously. Also from the government has there been calls for a non-compliance with obligations that are laid down in the collective agreements.

5.1.4 Current Account

When moving to the theory section, there are two potential outcomes expected from the analysis of the current account. When dealing with the Macroeconomic Policy Ideas, it is expected that the government will focus on the export versus demand question broadly. While following the Interest Group Politics section the government will indeed focus on the export versus demand, but there are trade unions from employers and businesses that deal with the question of for example competition in the sectors and government support for the sector or industry.

Figure 3: The development of the current account in the Baltic States between 2005-2016
Source: (Eurostat, 2016b)

The current account balances of Estonia, Latvia, and Lithuania all dropped till 2007, and reached their peak in 2009 after which their current account balances dropped till 2011 for Lithuania and till 2012 for

Estonia and Latvia, this is shown in figure 3. Since 2012 the current account balances for Estonia and Latvia are increasing again, even though for Latvia the figures remain negative. The current account balances for Lithuania increased from 2011 till 2014, but showed a steep drop between 2014 to 2015. What should be noted furthermore is that when focussing on 2014 to 2015 the current account balance increased for Germany with 1%, Estonia this increase was 1.3%, and Latvia the increase was 1.2% (even though the current account balance remained negative for 2015).

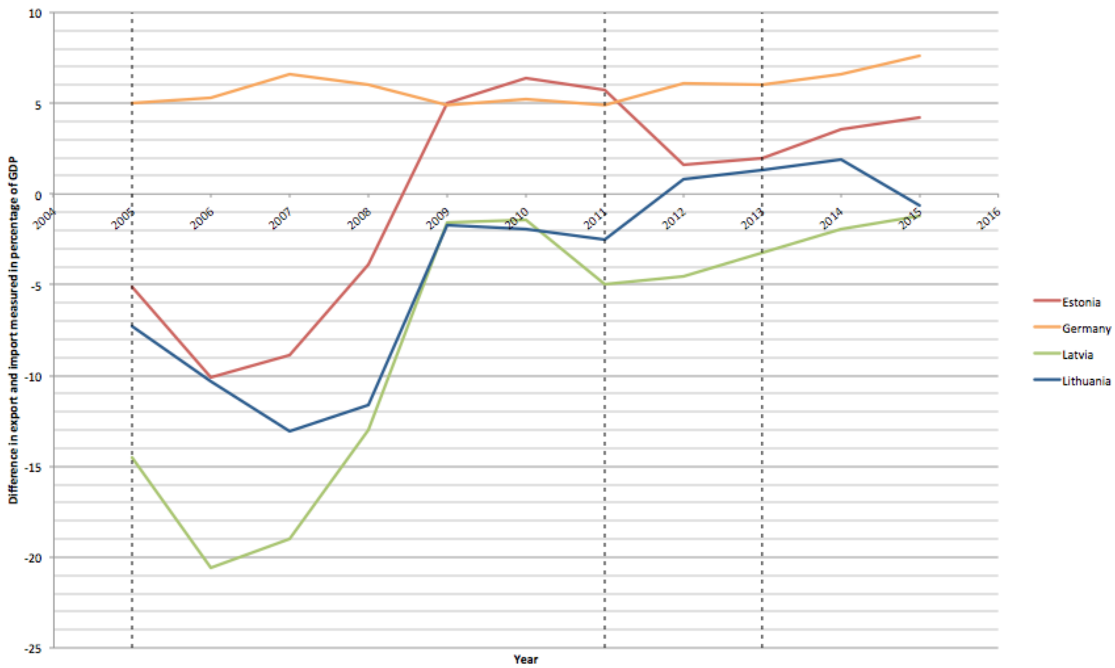


Figure 4: The development of the trade in the Baltic States between 2005-2016
Source: (Eurostat, 2016d)

Since the trade makes up the largest part of the current account, this point will be heighted to determine the influence of this point on the current account of the four selected countries, figure 4. The data for the export and import of goods and services is coming from Eurostat. The export is measured as “the indicator is the value of exports of goods and services divided by the GDP in current prices” (Eurostat, 2016c), while the import is measured as “the indicator is the value of import of goods and services divided by the GDP in current prices” (Eurostat, 2016c). Exports are occurring when goods and/or services are sold abroad. Imports are occurring when the goods or services are bought abroad (Eurostat, 2016d). Trade is finally measured when subtracting for each year the value for imports from the value for exports.

In the first decade “of their independencies Lithuania, Latvia, and Estonia became signatories of the General Agreement to Tariff and Trade (GATT) and after ratifying the World Trade Organization (WTO) arrangements, became members of the WTO” (Masteikienė & Šliburytė, 2010). The WTO membership gave the three countries reliability and stability in their trade relations - factors that are important for both trade partners and investors. Since the trade with third countries became more transparent, predictable, and liberal; the three Baltic States themselves became more attractive for foreign investment. Their WTO membership has a big influence on the export promotion, and also improving the business environment. Policies of export development promotion and the economic integration to the European Union, Estonia, Latvia, and Lithuania significantly opened themselves in economic terms to external trade. Unfortunately, with the start of the economic and financial crisis the situation changed.

The start of the financial and economic crisis in 2008 was also the start for a sudden stop in the capital flows of the three Baltic States, shown in the pronounced current account change between 2007-2009. Before the crisis the Baltic States already had a structural weakness in that their "foreign investments did not flow into the export sector but mainly into companies operating in financial or construction service area" (Mező & Bagi, 2012). This is not contributing towards the modernization of the manufacturing nor to the improvement of the balance of trade. All the three Baltic States implemented internal devaluations since they were supportive of the exchange rate peg, even though the exporters in the three countries are hurt by "the devaluations of currencies in the surrounding markets such as Poland, Russia, and Ukraine" (Kuokštis & Vilpišauskas, 2013, p.9).

Besides did the export demand collapsed, which was affecting the Baltic States hard and disproportionately, "as their economies are very open and have large export sectors integrated into Western European supply chains" (Staehr, 2013, p.296). The pace and magnitude of the decline in output of the three Baltic States were reflecting for a large part the pre-existing vulnerabilities. Empirical studies found that when countries had large current account deficits, large foreign debt stock, and a high share of exports before the crisis, they would experience the largest declines in output after the economic and financial crisis started. Consistent with these findings is that Estonia and Latvia were experiencing larger declined in output than Lithuania.

The return to growth was mainly driven by the strong export performance, whereby export volumes were reached from 40% or more between 2009-2013. These large increases in export are not however an indication of a successful policy, driven by austerity and internal devaluations policy. First of all, the "rapid export growth in 2009 took place against the background of an extraordinarily deep contraction in exports, thus some rebound was to be expected" (Staehr, 2013, p.301). Secondly, the exports picked up while at the same time the unit labour costs were at or above their level from 2007. Empirical studies have found that typically "the short-term export price elasticities are relatively small and subject to time lags (the j-curve effect)" (Staehr, 2013, p.301). The final argument is that the sudden decline in the domestic demand could have led to an excess capacity and therefore compelled producers to increase their exports.

The Baltic States export evolved gradually from "products produced in low-skilled sectors to products produced in medium-skilled sectors during the 1990s" (Staehr, 2015). Even so, the high-tech products are only a relatively small share of the total exports compared to countries as Hungary or the Czech Republic. Most of the high-tech products in the Baltic States are there only to be assembled and often add only little domestic value. The "relatively unsophisticated export structure of the Baltic States seems to have remained after the global financial crisis" (Staehr, 2015).

Another common feature of the Baltic States is that they all three have neo-liberal governments. The governments emphasised minimal government intervention. Even though the "economic results in the beginning indicated that what did indeed start out as a standard export-led recovery has led to accelerating real-wage and income increases, not just a bubble for the local and global wealthy" (Dizard, 2016). Much of the growth that happened in the service sector, for example banking, and along "with the construction sector, is due to an unsustainable influx of flight capital from Russia and other former Soviet States" (Dizard, 2016). The domestic market flexibility combined with the openness of the Baltics economies are key to recovery and reduced the adverse effects of the internal devaluation policy on the domestic demand (Masteikienė & Klyviene, 2012).

Common in the three Baltic States was that they had an export-led recovery. The Baltic "economies are very open and the exports as a percentage of GDP are as high as 60% for Latvia, above 80% for Lithuania and above 90% for Estonia" (Maslauskaite & Zorgenfreija, 2013). It is not surprising therefore that the key driver for the GDP revival in the post-crisis period were the exports. The reasons for the exceptional growth after the crisis is generally twofold. Firstly, "it is important to recognise that the countries' main export partners managed to survive the crisis comparatively well (Poland) or recover quickly (Scandinavian countries, Russia, and all the three Baltic States, who are among each other's main trading partners)" (Maslauskaite & Zorgenfreija, 2013). This is also reflected when focussing on the foreign demand, that shows a sharp rebound from 2010. This leads to the conclusion that the Baltic States and favourable external conditions and were disposed to profit from their open economies. Secondly, "the developments in the external competitiveness are of key importance for the export performance" (Maslauskaite & Zorgenfreija, 2013). In the post-crisis period the counties experienced increases in competitiveness, while the REER fell sharply, while the shares of the export market increased.

The economic and financial crisis from 2008 in the Baltic States "proved to be an opportunity for Russian investments, or at least has made it possible to increase Russian influence in these countries in energy and media as well as the recovering real estate market, in transport and in logistics" (Dudzińska, 2013). Nevertheless, due to the structure of the import/export in the Baltic States, the importance of Russia is almost unchanged. According to official statistics of the three Baltic States it appears that Latvia has the strongest links to Russia. It is though hard to prove that all of the ties between the politics on the one side and the economy on the other. The crucial angle seems to be the Russian investments that were made in the energy sector of the Baltic States, this is significant considering that the Baltics have the obligation to implement the 'Third Energy Package'. However, with the start of the economic and financial crisis the interests of the Baltic States in a stronger cooperation with Russia increased, due to economic benefits, such as foreign investment.

To some extent led also the internal devaluation policy advocated by the Baltic States to improvements. Though none of the three countries was experiencing a significant deflation, there was a reduction in the wages that is coupled with gains in the labour productivity. Most of the points related to the export versus demand are already discussed, but there is some differences in the way the three Baltic States were dealing with the current account and export problems. These are discussed separately for each country below.

5.1.4.1 Estonia

The GDP of Estonia fell in the last quarter of 2008 by nearly 10% and for the first quarter of 2009 by about 15%, when compared to the previous years corresponding period. The foreign and domestic demand declined and the revenues of companies were decreased by at least 20%. The volume of the foreign trade of Estonia with its key partners shrank with 30% or more (Kaasik, 2009). In 2009 there was a decline in the export and imports, but the latter was to a greater extend, and therefore turned the balance of trade for Estonia positive, the last time this was the case was in 2003 (UNCTAD, 2012). When focussing on the high-tech industries, Estonia is the most competitive compared to Latvia and Lithuania (Ozoliņa, 2016).

To achieve "a balanced fiscal position, the Estonian government offset the previous increase in its spending (between 2007 and 2009) with the reduction of expenditure and with the revenue increases, as well" (Mező & Bagi, 2012). The most important measures taken were: to skip the sick pay; raising of the retirement age; increase VAT and decreased the income tax. The government was focusing on economic stimulus measures. In the beginning of 2009 "360 million euro credit line was approved for various goals: to increase the small and medium enterprises' accession to credit and to maintain their exports; to finance tourism and research and development; as well as for job creation and for social programs" (Mező & Bagi, 2012). The government also signed a loan agreement worth 700 million euro with the European Investment Bank. The aim of the loan and credit line was to stimulate the economy.

5.1.4.2 Latvia

After Latvia joined the European Union the wage-increase was surpassing the productivity growth and together with the inflation, were both weakening the export competitiveness. For this reason, "a huge trade deficit emerged and resulted current account deficit from year to year" (Mező & Bagi, 2012). This nadir lasted between 2006 and 2007, just before the crisis. The neo-liberal governments were supporting the growth through "pro-cyclical economic policy, and sought for internal demand-based growth instead of increasing the competitiveness of the productive sector" (Mező & Bagi, 2012). The property prices reached their maximum just before the crisis and declined by 29% in 2008. The loan-to-value ratio also diminished quickly, and the economic growth was declining starting in 2008. To offset these processes, the central bank and government tried to adopt measures that would throttle the consumption. Though the domestic consumption did slow down, these efforts did not immediately mean to be a solution.

Although the Latvian government adopted several measures to combat the crisis, they did not influence the import or export. Most measures were focused on increasing the revenue and reducing the expenditures.

Some of these measures are: “severances and reducing wages in the public sector, reduction of pensions and maternity benefits, increase taxes, and the introduction of new taxes” (Mező & Bagi, 2012). The situation in the country was still critical at the start of 2010, since the unemployment rate was above 20% and the growing taxation burdens affected the entire population. Since the government already rejected a devaluation of the Lat, the growth of export was discontinued and all of the important economic sectors declined.

5.1.4.3 Lithuania

After the “democratic transformation, the country’s performance was outstanding in may ways: economic growth, GDP per capita, external debt and - until 2007 - inflation rate was all favourable” (Mező & Bagi, 2012). The privatization, foreign trade and price liberalization reached the level of a well-functioning market economy by 2009. The selected growth path was based on the conservative economic policy, which was the main driver of the domestic consumption and export. The rapidly expanding credits, the assistance of the EU as well as the appearance of foreign banks (often Scandinavian) also played an important role in the growth of the Lithuanian economy (Lengyel & Fejes, 2016).

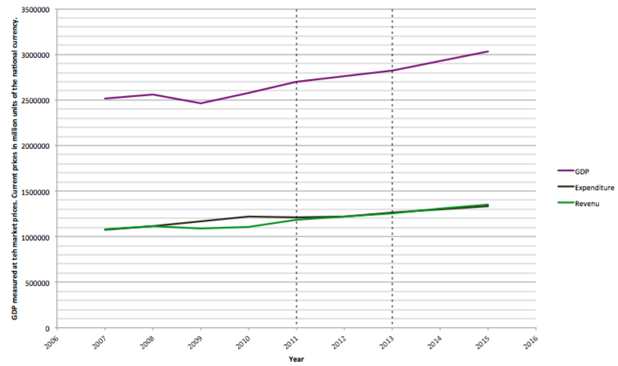
At the start of the economic and financial crisis the situation in Lithuania did not seem to be as bad as in Estonia or Latvia, since the country’s GDP expanded in 2008, however with a GDP increase of 2.8% it was the lowest since 2000. In 2009 Lithuania’s GDP almost decreased by 15%, mainly due to declining investment and foreign trade, consumption, and increasing unemployment. It became clear that Lithuania was not able to “‘swim with’ the crisis as easily as initially had hoped. The economic slowed down mainly by the net exports” (Mező & Bagi, 2012). The economic downturn the country experienced was mainly slowing down the net exports.

The new Lithuanian government took office in 2008, which made crisis management the most important task of this new government. Although the country was affected hard by the crisis, there was no immediate need for the IMF loan in 2008. In order to “avoid the need of borrowing from external organizations in the future, the government adopted the first elements of its saving program, which included strengthening of the financial sector, the increase of VAT rates and reducing public spending and the wages in the public sector” (Mező & Bagi, 2012). The government did not execute a devaluation of the Litas, which would be disadvantageous for the exporters. This also resulted in high interest rates that made the loans more expensive. Therefore in the beginning of 2009, the financial funds of the state were expanded to counteract this. These funds were providing “preferential loans to enterprises, especially exporting small and medium enterprises, thus helping their survival in order to maintain jobs and restrain the fall in exports” (Mező & Bagi, 2012).

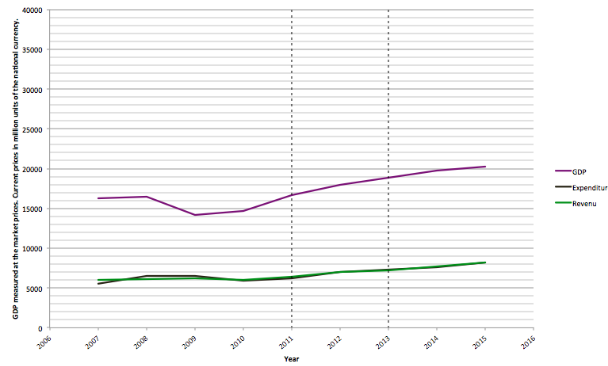
It should be noted that the Lithuanian government was attaching a large importance to attracting the foreign direct investments to Lithuania. It therefore tried to create an economic and legal environment that was favourable for foreign investments, built on advanced infrastructure and high qualification level, mostly in the service sector. Through these measures the Lithuanian economy stabilized in 2009: in “2010 the domestic demand gradually revived, the real estate market seemed to grow stronger, exports nearly reached the two years before peak, and the GDP also increased again” (Mező & Bagi, 2012). It was important for Lithuania, like for Latvia as well, to fulfil the Maastricht criteria and being able to join the Eurozone as soon as they could (Zabuliene, 2011). Analysis is showing that Lithuania is the more competitive of the three Baltic States in broad terms, since it has the largest share of the three countries in the global market (Ozoliņa, 2016).

5.1.5 Fiscal Restraint

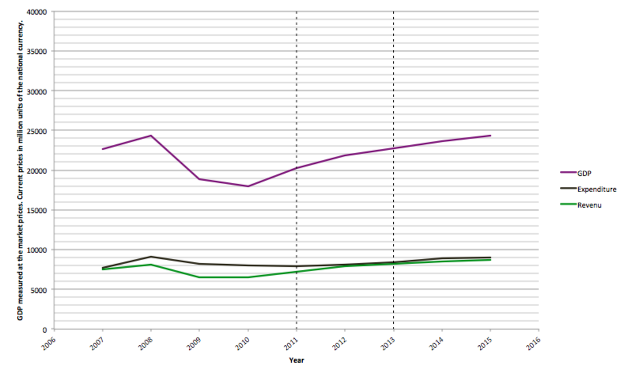
When considering fiscal restraint there will be looked at the budget to GDP figures. The definition of GDP is “the monetary value of all finished goods and services produced within a country’s borders in a specific time period” (Organisation for Economic Co-operation and Development, 2016). Also the definition of budget should be made more specific, because these can slightly differ for each author. A budget is “an estimation of the revenue and expenses over a specified future period of time and is compiled and re-evaluated on a periodic



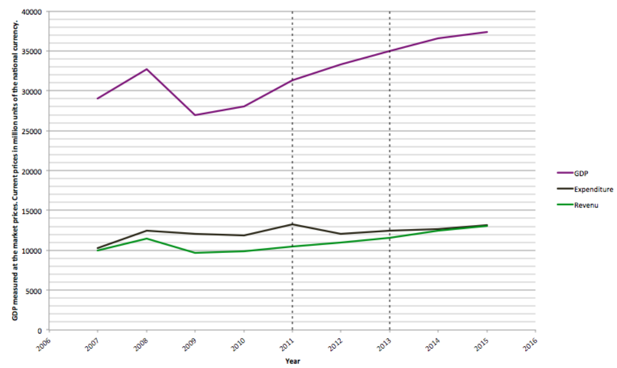
(a) Germany



(b) Estonia



(c) Latvia



(d) Lithuania

Figure 5: The government expenditure and revenue, and the GDP (measured at the market prices, current prices in million units of the national currency) for Germany, Estonia, Latvia, and Lithuania (note the different scale for the Baltic States and Germany).
Source: (Eurostat, 2017b)

basis" (n.d., 2017). When there is a surplus budget, there is anticipated on profits, a deficit budget however is when the expenses are exceeding the revenues. A balanced budget the expenses equals the revenues.

There was anticipated in the methodology that the data for the fiscal restraint is coming from the Alert Mechanism Report from the European Commission, however when evaluating the data it seemed that the data was not complete for all Eurozone members. Therefore will the data come from Eurostat for both the data for the GDP and budget. First will the data for the budget be considered and than for the GDP.

When moving to the theory section, there are two potential outcomes expected from the analysis of the fiscal restraint. When focussing on the Macroeconomic policy Ideas, it is expected that the government expenditure and revenue as the country's GDP will be influenced by the governmental policies. However, focussing on the Interest Group Politics, it is expected that only specific groups are affected by the governmental policies. These and/or other groups might have a strong trade unions that are able to affect their position, i.e. when it comes to cuts in the government expenditure through internal devaluation policy, some sectors might be influenced harder than others.

During the economic crisis all four countries had a decrease in their GDP, see figure 5. For Germany the government expenditure increased between 2007-2010, and showed, especially between 2008-2010 a gab with the government revenue. This was expected since the economic and financial crisis hit the country, and had to increase its government expenditure. While from 2011 onwards the government expenditure and revenue are closely connected. Estonia also increased its government expenditure from 2007-2008, however from 2008-2010 its government expenditure decreased. While its revenue continued to remain relatively stable, Estonia's GDP decreased largely in 2008-2009. However from 2009 onwards the country shows a GDP increase and a government expenditure and revenue that are closely connected.

Latvia experienced a fall in its GDP between 2008-2010, while its government expenditure and revenue remained almost the same for 2007, from 2008 to 2012 the country has a higher government expenditure than revenue, from 2012 onwards the government expenditure remains higher than the government revenue, although the differences are smaller. Lithuania experienced, as for Germany and Estonia, a fall in its GDP from 2008-2009. The government expenditure and revenue were both increasing for 2008, while from 2008 to 2010 the government expenditure decreased, however remained higher then the government revenue. In 2011 the government expenditure increases a lot more than the government revenue, but from 2012 onwards the differences in government expenditure and government revenue are decreasing.

When focussing on the data and measures taken by the national governments, there are two main options the governments can take, a 'pro-cyclical fiscal policy' and a 'countercyclical fiscal policy'. When a government decides to increase its public spending and reduce the taxes in case of an economic boom, but is reducing its public spending and increasing taxes during a recession, the government opted for a 'pro-cyclical fiscal policy'. When the government opts for a 'countercyclical fiscal policy' there is referred to the opposite approach: in case of a boom period the spending is reduced and taxes are raised, while during a recession the spending is increased and the taxes are cut.

After the turn of the Millennium the Baltic States had carefully planned their fiscal policy. From the "EU-accession to 2007 (in other words before the crisis) all three states' budget deficits were below the 3% of GDP required by the Maastricht criteria" (Mező & Bagi, 2012), but in 2008 for Estonia, Latvia, and Lithuania experienced highly increasing government deficits. Latvia and Lithuania already experienced a deficit previously, however in 2008 also the budget of Estonia turned into deficit. The budgetary expenditures from Estonia and Latvia in 2008 were raised by 9% to 16%, while the revenues did not change much compared to 2007. In Lithuania the revenue stagnated in 2008, while the government spending only increased a bit.

Even though each of the three Baltic States governments took different measures as part of their internal devaluation policy, the goal of the three countries was to keep their currency pegged to the euro and join the Eurozone as soon as possible. There were "muted and sporadic protests organized by various trade unions and citizens interest groups throughout 2009 in al three countries, however their impact remained limited" (Kattel & Raudla, 2013, p.441). These mild reactions towards the governments' measures can be explained though several factors. Important is that the majority of the populations in each of the three countries were favourable towards keeping the currency pegs, "which made it easier for the government to 'sell' the measures necessary for internal devaluation" (Kattel & Raudla, 2013, p.441). The next section will consider each country in detail, the measures the governments took and the reactions of the populations on these measures.

5.1.5.1 Estonia

With the start of a new Millennium, the economic growth rate of Estonia was "one of the highest among the emerging transition countries, associated with low inflation until 2005" (Mező & Bagi, 2012). After the country joined the European Union, the domestic demand was mainly fuelled by a real estate boom. The constructions prosperity was resulting from the "expectations of income growth, the cheap (floating rate, foreign currency denominated) loans with related tax allowance and the large amount of capital inflows" (Mező & Bagi, 2012). Therefore were the housing market and financial sector linked with many threads. Due to the financial crisis both sectors were facing difficulties: borrowing options narrowed, property prices fell and so did the domestic demand also declined gradually starting in the second half of 2008. Since the majority of the credits were financed by "foreign parent banks' loans, the Estonian national bank had to expand its cooperation with its Nordic partners in the fields of crisis management and bank supervision" (Mező & Bagi, 2012).

The pro-cyclical fiscal policy from Estonia was worsening the crisis situation, the government had reduced the tax rates and increased its spending in the boom years. The government was unable to prevent the indebtedness of the private sector, even though the public debt remained below the Maastricht criteria and even far below the average of the EU Member States in the years of crisis.

Among the Baltic States it appeared that the position of Estonia was the most stable. The country did not need an IMF loan in 2008, but in the beginning of 2009 the Estonian government "brought a budget amendment connected to a vote of confidence before the legislature" (Mező & Bagi, 2012). Thee vote was confirming the government and the austerity package was accepted, the main elements were: a 10% cut in public expenditure, cuts in the public sector wages and employees (Meisel, 2009). Thus the government was able to adopt the euro and therefore avoided the bankruptcies of the financial institutions due "to the termination of the exchange rate risk" (Mező & Bagi, 2012). In order to get a balanced fiscal position the government was offsetting the previous increases in spending (the government spending between 2007 and 2009) with a reduction of the expenditures and increases of revenue. The most important measures that were taken by the government were:

- "In 2009, excise tax of some products was raised and the VAT rate was increased from 18% to 20%;
- The personal income tax rate was reduced (from 26% to 21%), while the lower limit of compulsory social insurance contribution was raised;
- Sick pay was taken away;
- Tax exemption for student loans was eliminated;
- Government allocated funds to local authorities were reduced;
- Transfers to the private pension funds were suspended for two years from July 2009;
- Raise of the retirement age from 2017 was decided" (Mező & Bagi, 2012).

Since Estonia does not have any major domestic financial institution, the government did not have to bail out the financial sector (98% of the banking sector in Estonia is owned by foreigners). The Scandinavian parent banks were making the crisis management steps. The government "accumulated reserves in good times, and this provided the necessary room for manoeuver to contribute to stabilizing the financial system" (Mező & Bagi, 2012). Although it is a temporarily solution, the reserves enabled the government for financing the budget deficit without the need to obtaining funds from the market. The Estonian government "had to strengthen its fiscal position in order to revive and maintain the markets trust in the economy" (Mező & Bagi, 2012).

In light of the public protests the population "in Estonia accepted the austerity measures quietly (or even supportively)"[1] (Kattel & Raudla, 2013, p.441). A key reason that the population remained mild was the particularly successful communicative 'crisis discourse' that was constructed by the Estonian government. The discourse pointed to three key elements: "we cannot abandon the peg, we have to adopt the euro; hence we have to adjust the budget" (Kattel & Raudla, 2013, p.441), the message was coherent, simple, and persuasive.

The country would be able to join the Eurozone on January 2011, whereby the common currency would "eliminate the exchange rate risk, reduces transaction costs, and attracts foreign investors, who are primarily interested in metal and engineering industry, chemical industry, business services and information technology" (Mező & Bagi, 2012).

[1]In the Estonian context, "the mass protests as a venue of expressing discontent had been strongly stigmatised in spring 2007, when, as a reaction to relocating the statue of a bronze soldier (commemorating the Soviet victory over Nazi Germany) from the city centre of Tallinn (the capital of Estonia), Russian-speaking youths reacted with riots and looting. Thus, as argued by Kattel (2010) and Raun (2010), the members of the Estonian public feared that if mass protests were organised in reaction to government's austerity measures, they would be likened to the rioters and looters during the Bronze Soldier events" (Kattel & Raudla, 2013, p.441).

5.1.5.2 Latvia

Latvia was seen as the most emblematic countries during the economic and financial crisis, since the recession was severe already by the end of 2008. Though, and also somewhat paradoxically, the government realized to have an annual GDP growth with double digits between 2005 and 2007 - unique in the European Union. The main driving forces of this GDP growth were the cheap loans and FDI inflow (Blanchard, Das, & Faruqee, 2010; Lengyel & Fejes, 2016).

The severity of the economic and financial crisis was partly due to the high inflation rates. After the country joined the European Union the Lat became pegged on the euro, and the inflation rate that was previously stable started to soar. The increase in price is traceable to the housing bubble and consumption boom, as well as the sharp increase in the financial loans. The annual growth rate of these loans between 2005 and 2007 was more than 50%. Foreign (mostly Swedish) banks "multiplied in the country in the past years, thus by the end of 2007, foreign currency debt rose to 86% of total loans and Latvia has become increasingly exposed to external shocks" (Mező & Bagi, 2012). The private sector's loans were amounting to 100% of GDP for 2007.

The growth of the public debt increased largely during 2009, with several factors to account for. The high government deficit as well as the IMF loan, but also the bank consolidation was important. The "nationalization of the Parex Bank and the provided liquidity and guarantees overall took 9.5% of GDP" (Mező & Bagi, 2012). Not only the inflation criteria, also the public debt Maastricht criteria was threatened.

The Latvian government requested in 2008 for an aid package, which it got from the IMF, World Bank, the EU and the Nordic countries, making pooled 7.5 billion euro. This amount meant serious help when compared to the country's GDP. In order to "be allowed to drawdown the loan, the Latvian government had to take various stabilization measures, such as tightening its fiscal policy by about 7% of GDP. However, the loan was not sufficient for defending the fixed exchange rate, so the Bank of Latvia had to use nearly one fifth of its reserves for this purpose" (Mező & Bagi, 2012).

Political consequences of the crisis were occurring quickly: at the start of 2009 the prime minister had to resign and a new government was formed soon after. Its first action would include developing a coherent and stronger crisis management program that would focus primarily on the restraining of expenditures - as was prescribed by the IMF. Since there were almost no resources to stimulate the economy, only certain sectors were given priority (such as the pharmaceuticals, conversion of timber and some heavy industry) by the government.

The main measures taken by the government to reduce the expenditures were: "severances and reducing wages in the public sector, cuts in the health and education system, reduction of pensions and maternity benefits. The revenue-raising measures were more considerable:

- Increase the rate of the personal income tax from 23% to 26%;
- Increase the VAT rate from 18% to 21%;
- Increase the excise duties on alcohol, tobacco and energy;
- Increase the property tax and vehicle taxes;
- Introduction of new taxes" (Mező & Bagi, 2012).

The population of Latvia, in comparison to Estonia, did not accept the austerity measures quietly and some protests were visible. In Latvia there were one-day riots in January 2009 that seemed to have a much more political background than economically.

5.1.5.3 Lithuania

Similar to Estonia and Latvia, the Lithuanian domestic consumption was exaggerated, thus the private sector's indebtedness, inflation, and current account deficit went out of control even before the crisis started: the internal and external imbalances occurred around 2007 (Lengyel & Fejes, 2016). In 2009, the country did not need an IMF loan, but it agreed with the European Central Bank in March of 2009 on a 1.132 billion euro loan for the co-financed projects from the EU. An additional external resource was the Eurobond worth of "500 million euro issued on the international financial markets" (Mező & Bagi, 2012).

In July 2009 there was an excessive deficit procedure launched by the EU against Lithuania. For this reason, the Lithuanian government "sought to fiscal balance as soon as possible: public expenditures were intended to be reduced by 2% annual between 2010 and 2012". As the first step, the public sector wages were reduced by 5%, and then 8% in August 2009. In 2010 this tendency continued: the salaries of public employees and public officials fell further, as well as the decrease in salaries of managers' and politicians' (Palócz, 2010). In spring of 2009 there were modifications introduced in the tax system to tighten the austerity measures:

- "Reduction of personal income tax by 9% to 15%;
- Increase the corporate profit tax by 5%;
- Increase the VAT rate by 1% to 19% in the beginning of 2009, then to 21% in September 2009;
- Increase the excise duties" (Mező & Bagi, 2012).

In contrast to Latvia, Lithuania had resources left to stimulate the economy, following some sectors of the Lithuanian economy to grow by the end of 2009. The situation in the construction industry was normalized and the trade revived. Also was the position of the Lithuanian banks satisfactory. However, at the end of 2009 the inflation was surging and reached 4.2% - the second highest in the EU after Romania. The Lithuanian politicians "thought that the main instrument for cutting government expenditure is the simplifying of public administration and public services. This program causes much lower social tensions than the drastic Latvian package, but it is still not easy to implement such a measure" (Mező & Bagi, 2012). Therefore was started in 2009 with an institutional reform to promote transparency of the budget. This reform was "supposed to build institutional guarantees into the budgetary system, which aimed at enhancing budget planning, implementation, monitoring and transparency" (Mező & Bagi, 2012).

In comparison to Estonia and Latvia the trade unions in Lithuania managed via protests "to make their voices heard: although initially, when devising the austerity measures at the end of 2008, the government totally avoided social dialogue, it was forced to engage in it - at least to a certain extent - in the course of 2009" (Kattel & Raudla, 2013, p.441). In the end of 2009 there was a national agreement or 'social pact' concluded in Lithuania, "endorsed by the trade union confederations, employers' unions and the government; according to the 'national agreement' the trade unions promised to suspend social protests in exchange for government's promise to protect the living standards and to engage in social dialogue"[2] (Kattel & Raudla, 2013, p.441).

5.2 The positions of the Baltic States governments during the SGP negotiations

The Baltic States are staunch supporters of a deeper economic integration, along with Germany (Zaborowski, 2011) and adopted the euro in different years. Estonia adopted the euro as first of the three Baltic States in 2011, Latvia in 2014, and Lithuania soon after in 2015. The adoption of the euro also gave the new Eurozone members new responsibilities and tasks. Estonia was the 17th member of the Eurozone and its President T.H. Ilves noted that "Estonia was ready to play its part in helping the countries who have fared less well during the recent crisis [...] even though it is small and comparatively poor" (Spiegel, 2011). In addition:

> "The poorer countries that are fiscally responsible end up paying out richer countries that are not. This would be even ok except for the occasional arrogance and haughtiness of the rich countries towards us poor east Europeans. You can't be haughty towards us because we're not

[2] As an example "in summer 2009 the Lithuanian trade union confederation protested against the government plan to cut basic monthly salary in the public sector (which would have primarily affected the lowest paid employees) by organizing a hunger strike in front of the parliament. As a result of the protest, the government amended the plan and introduced more progressive salary cuts, whereby higher cuts were imposed on the better paid employees" (Masso & Krillo, 2011, Appendix 3)

> so rich, and at the same time [argue] it's time to bail them out. Ultimately, let's face it: Being richer wasn't based on being more productive. It was based on bigger loans. Wealth based on loans is not wealth." (Spiegel, 2011)

This section is focussing on the four decisions made under the Stability and Growth Pact. It analyses the position of the governments of the countries before, during and after the negotiations. The first decision is the 'SGP amendment', adopted in 2005. The second decisions considered is the 'six-pack' that is adopted in 2011. The third and fourth decision are both adopted in 2013 and are respectively the 'Fiscal Compact' and the 'two-pack'. In the following sections each year will be discussed separately, and start with a short focus on the four observable moments for that year, followed by the analysis of government positions for the SGP decision.

5.2.1 The 2005 'SGP amendment'

When focussing on the four observable moments, there is unfortunately no data available for 2005 for the wage development and fiscal restraint. When focusing on the unemployment levels, for the year 2005, there unemployment levels are continuing to decrease. While for Germany the years 2002-2005 show an increase in unemployment but from 2005 onwards a decline again in the unemployment levels. When focussing on the current account levels, the Baltic States show a decrease in their current account balance from 2005 to 2006, while Germany on the other hand showed a slight increase. This is also reflected in the levels of trade. The Baltic States showed negative trade balance for 2005, Germany showed a positive balance.

The SGP is aiming to safeguard the EMU and policy stability as well as securing sound financial management of the national budgets. However, there were critical voices that noted that the procedures to implement these objectives were long winded and might not be effective. Not least "the dependency on the political will of the Member States hampers the effective enforcement of the SGP, as they themselves may be subjected to the procedure and are thus not neutral to the process" (Dutzler & Hable, 2005). The SGP is often questioned if it is suitable for achieving fiscal discipline and the national budgetary policy discipline. These questions were confirmed when the deficit procedures were started against France and Germany.

At the end of 2003 the Council did not follow the Commissions recommendations and decided not to proceed with a deficit procedure against France and Germany, and only decided to adopt 'political conclusions'. At this moment in time, both France and Germany had gone through most of the steps of the multi-level procedure. When the Council would have adopted the proposed recommendations, this would have marked the final step before imposing sanctions. To that moment in time had never a Member State got a sanction imposed; "this, and not the differences regarding the scope and nature of the measures that Germany and France should take, was the main reason for the contested step taken by the Council" (Dutzler & Hable, 2005).

When the Member States agreed and signed on the binding sanction mechanism from the SGP, they had shown the courage to be constraint. However, when "it became clear that the sanctions might actually be employed for the first time, the majority of the Council shied away from such interference in national sovereignty. According to the Commission, the credibility and effective enforcement of the SGP was thereby put at risk" (Dutzler & Hable, 2005). The EU finance ministers "concurred with the Commission that further steps against France and Germany as regards their deficits are not necessary at this stage. However, it did not let Greece and Hungary of the hook" (n.d., 2005). The matter was taken to the European Court of Justice. In 2005 the 'SGP amendment' was adopted, whereby the SGP was amended to allow it for better consideration of the national individual circumstances (European Commission, 2016b). There were changes made to both the preventive and corrective arm. The main changes that are made are:
To "the preventive arm:

- The new Pact has introduced differentiated 'medium-term objectives' (or MTOs). Whereas the old Pact merely stated that Member States should maintain medium-term budgetary positions that are 'close to balance or in surplus', under the new Pact each Member State will present its own country-specific MTO.

- The reformed Pact also introduces new provisions concerning the adjustment effort that should be made in order to reach the MTO. This adjustment should be equal to 0.5% of GDP per year, as a benchmark, with more effort in good times, and possibly less in bad times.
- Both the MTOs and the adjustment path towards them will be measured in cyclically adjusted terms, net of one-off and temporary measures.
- In addition, the budgetary implications of major structural reforms are to be taken into account.

Turning to the corrective arm, there are also a number of important changes here:

- The first of these concerns the so-called 'exceptional circumstances' clause. Under the Pact, a deficit above 3% of GDP is not necessarily considered excessive if it can be shown that the breach is 'exceptional and temporary'.
- The second change concerns the so-called 'other relevant factors' to be taken into account when assessing whether a deficit above 3% of GDP is excessive. The new Pact provides an explicit and relatively long list of 'other relevant factors' that have to be taken into account when assessing deficit developments in the context of the excessive deficit procedure.
- The third significant change to the corrective arm concerns the deadlines for correcting excessive deficits. The default deadline for the correction of an excessive deficit remains the 'year after its identification, unless there are special circumstances'. But whereas 'special circumstances' were hitherto undefined, the list of other relevant factors will now serve as the basis for deciding whether special circumstances exist" (González-Páramo, 2005).

The flexibility of the Stability and Growth Pact was widely discussed during its reform in 2005. Whereby a number of countries, for example Italy, Greece, France, and Germany, want to exclude specific categories from the 3% deficit ceiling from the SGP (including area's as investment, infrastructure spending, and R&D). There are broadly three camps. The first group comprises those countries that favour a strict interpretation, whereby there is hold onto the 3% deficit ceiling. The second group is allowing for "some flexibility if the excess spending is intended for certain types of reform that would have a beneficial impact on the medium- or long-term finances of the country. The third group would like such expenditure as R&D and investment to be considered as structural reform expenditure and therefore to be excluded from the calculation of the deficit" (n.d., 2005).

The European Central Bank expressed 'serious concerns' about the changes made to the SGP and the German Bundesbank notes that the new rules have weakened the pact (n.d., 2006). Also the Eurogroup, which consists of the finance ministers of the Eurozone members were not in favour of the relaxation of the SGP rules.

The Baltic States joined the European Union in 2004, shortly before the new 'SGP amendment' would be adopted and right after the incident with the Council, the Commission, Germany, and France. The countries also accepted the convergence requirements for the Exchange Rate Mechanism II, since the Baltic States wanted to adopt the Euro as soon as possible (Tuma, 2007). According to Caio Koch-Weser in 2005 - an influential deputy finance minister from Germany - "six countries [Estonia, Latvia, Lithuania, Slovakia, Cyprus and Malta] are in the waiting room for euro accession. Although I prefer to call it the 'exercise room' as the countries shave to undergo strenuous policy programmes to get their house in order before joining the euro" (Williamson & Parker, 2005).

One year after the accession to the European Union, the three governments were asked to deal with the 'SGP amendment'. In Latvia the then-President Vike Freiberga considered the then recent EU referendum as binding, since the Latvians had already approved the substance of the 'SGP amendment' (National Forum on Europe, 2012). There was no protest voiced against this decision, not by the parliamentarians, nor by the citizens. The ratification of the amendment was neither problematic in any way for the governments of Estonia and Lithuania. This would have been possible since the 'SGP amendment' changes also a condition of the ERM II, whereby the Baltic States now should aim "for an annual structural adjustment in line with the benchmark of 0.5% of GDP" (EUR-lex, 2006).

5.2.2 The 2011 'Six-pack'

When focussing on the four observable moments for 2011, the wages are continuing to increase for both the three Baltic States as well as for Germany. The unemployment levels are decreasing for the four countries, which showed to be remarkably high when the financial and economic crisis hit the three Baltic States. The unemployment levels for Germany are showing an increase during the economic and financial crisis, but not as big as for the three Baltic States. Also for Germany is the unemployment level for 2011 decreasing. When focussing on the current account, the current account balance is increasing for Germany 2011, but decreasing for Estonia, Latvia, and Lithuania. From 2011 to 2012 also Lithuania's (together with Germany) current account balance is increasing, but remains negative.

When focussing on the trade levels in the countries, both Germany and Estonia have a positive trade balance, although for both countries slightly less than for 2010. Latvia and Lithuania have a negative trade balance, and show a decrease in their trade balance compared to 2010. From 2011 to 2012 the trade balance is decreasing even more for Estonia, but increases for Germany, Latvia and Lithuania. Focussing on the fourth indicator the fiscal restraint. The government revenue and expenditure are closely connected for Germany and Estonia and increasing, as is the German and Estonian GDP. The government expenditure is slightly higher for Latvia than its government revenue, but it shows an increase in its GDP. For Lithuania the government and expenditure are less connected with a higher government expenditure than revenue. The Lithuanian GDP is increasing.

The SGP is "made more comprehensive and predictable with a major enhancement of the EU's economic governance rules through a collection of new laws, know as the 'six pack"' (European Commission, 2016b). There are four regulations adopted in the area of fiscal policy and two related to macroeconomic imbalances. Relating to the fiscal policy area, the regulations adopted are:

1. Regulation 1175/2011 amending Regulation 1466/97 "on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies" (EUR-lex, 2011d);

2. Regulation 1177/2011 amending Regulation 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure" (EUR-lex, 2011f);

3. Regulation 1173/2011 "on the effective enforcement of budgetary surveillance in the euro area" (EUR-lex, 2011b);

4. Directive 2011/85/EU "on requirements for budgetary frameworks of the Member States. The directive is laying down rules related to the national budget. These are put into place to ensure that Member State governments are respecting the requirements of the EMU and are not running excessive deficits" (EUR-lex, 2011a).

And to overcome macroeconomic imbalances the following two regulations are adopted:

5. Regulation 1176/2011 "on the prevention and correction of macroeconomic imbalances" (EUR-lex, 2011e);

6. Regulation 1174/2011 "on enforcement measures to correct excessive macroeconomic imbalances in the euro area" (EUR-lex, 2011c).

Estonia is supporting a stronger integration of the European Union and the Eurozone (Wagstyl, 2012), as well as "introducing new cooperation formats in order to foster the competitiveness, growth and financial stability of the euro area" (Estonian Government Office, 2011). The government of Estonia wanted a strong and stable euro, and it should be built on several variables. The first is a strict fiscal policy in the Member States. Secondly, the factors that are influencing budgetary decisions of the respective Member States have to be reinforced, examples of these factors are: the effective functioning of financial markets. Thirdly, "EFSF and ESM mechanisms created or to be created to ensure the financial stability of the euro area must guarantee the emergency support to Member States in major crisis so as to enable any state concerned to implement the reforms necessary to stabilise its economy and budget. Fourthly, the European Central Bank guarantees the stability of monetary policy and price stability in the euro area" (Estonian Government Office, 2011). In order to achieve these principals the Estonian government set-up several steps that need to be met for the Member States.

While a government document was explicitly referring to the Euro-Plus-Pact, "it follows that, in accordance with the founding Treaties, the Estonian government was willing to take additional steps in coordinating economic policies between the Eurozone countries and countries outside the Eurozone" (Laatsit, 2014, p.14). The government also focuses on the 'six pack' and notes a supportive view towards the automatic sanctioning. There were no difficulties encountered nationally with the adoption of the 'six pack', only with the implementation there was questioned "in the parliamentary debate as to a possible infringement of the principle of separation of powers by a provision of the State Budget Bill" (Laatsit, 2014, p.16). In the end of 2011 the Auditor General Alar Karis would submit an opinion on the case and there were proposals made to separate the provisions on the budgetary balance from the other amendments in order to resolve the conflict (Riigikogu, 2015).

When focussing on Latvia, the government did not experience serious problems or difficulties when adopting the 'six-pack', however some discussions arose during the process for approving the national position. When starting with the initial position in June 2010, "there were discussions in the Parliamentary Committee for European Affairs (PCEA)[3] concerning the question whether Latvia should agree that in the name of greater financial stability the Member States should submit their budgets for evaluation in the EU even before their adoption in national parliaments" (Rasnača, 2014, p.43). The chairwomen of the PCEA who was in a coalition government, member of the party Pilsoniskā Savienība, PS, Vaira Paegle argued that it would help disciplining the Member States whereby big budget deficits could not be created anymore, while on the other hand the question emerged whether this would comply with the Lisbon Treaty and if it would limit the sovereignty of the Member States. Gundars Bērziņš, also a member of the coalition government and member of the Union of Greens and Farmers party, was stressing that these changes at the EU level would indicate the Latvian budgetary principals compared to the other Member States. However, he sceptically evaluated the "possibility of financial sanctions for failing to comply with the Stability and Growth Pact and argued that a ban on access to cohesion funds for these Member States would only worsen their situation" (Rasnača, 2014, p.43). While other members of the PCEA (Dzintars Rasnačs and Nacionālā Apvienība) stressed the importance:

> "This is a question concerning the sovereignty of Latvia, and it can be taken only after broad discussions among experts and politicians. This could be a step towards a federal Europe and, thus, could limit the sovereignty of Latvia." (Rasnača, 2014)

In October 2010 an agreement was reached for the position of Latvia, which included that it would support stronger macroeconomic and fiscal surveillance at the level of the European Union. The national position also stated that "for defiance of fiscal discipline effective sanctions should be enforced - these should concern not only cohesion funds but all categories of EU budget expenditure" (Rasnača, 2014, p.44). This position was approved for the European Council. During the ECOFIN meeting in February 2011 the general national position was still in place, however the Latvian government position emphasized that "the position supported the proposal but expressed an opinion that the levels of indicators in the macroeconomic imbalances procedure for non-euro countries have to differ from the Eurozone countries (due to the necessity to catch up). This was kept as an objection in the position because it was not considered to be enough to mention this in the preamble and, instead, the position argued that this has to be included in the main body of the measure" (Rasnača, 2014, p.44).

[3]The Parliamentary Committee for European Affairs (PCEA) is one of the largest committees of the Saeima. The European Affairs Committee is considering and approving the national positions that are prepared by the government before it will be submitted to the Council of the European Union. The minister "who represents Latvia in the relevant Council of the European Union has to inform the Committee on the government's position regarding all significant decisions before they are presented to the Council of the European Union. The relevant minister is authorised to present Latvia's position to the Council only when it has been approved by the Committee. If the Committee rejects the position approved by the government, the relevant ministry must amend the position in accordance with the recommendations of the Committee before presenting it to the Council" (Saeima, 2015).

The next meeting would be the ECOFIN meeting in March 2011, whereby the initial position presented was not approved. Through the not-approved position the Latvian government had to compromise on the support that penalty payments that had to be made under the sanction mechanism to avoid macroeconomic imbalances in the Eurozone would be going to the ESM. However, the main doubts remained concerning that the payments for the penalty would go to a fund whereby the rule-breakers will be able to receive aid from. The position did support amendments to the Regulation No. 1466/97. In the meeting a discussion arose concerning the allocation of penalty payments, however the main discussion would focus on the sovereignty. Parliamentarian J. Dombrava, who is part of the opposition "asked why Latvia should lose a part of its sovereignty by adopting all these instruments and why we should limit our operations in favour to supranational organisations. The Government representative expressed the opinion that the essence of the six-pack is that it is hard to create a united market, to have a united currency, if the fiscal policy is not united. He argued that some sort of sovereignty has to be given up in order to create a level playing field for economic processes and that budgetary deficit ceilings are meant for normal and not extreme situations" (Rasnača, 2014, p.45). Other members of the parliament, from the opposition expressed concerns for a too powerful EU and that the measures would worsen the Latvian position after the crisis.

In the ECOFIN meeting in October 2011, the Latvian government agreed with the 'six-pack', even though there were still voices from the opposition. Parliamentarian J. Dombrava questioned why the Latvian government would support the measures that could endanger the Latvian economy in the long-term. The government "representative answered the 'six-pack' is containing a long-term view and is not a reaction to the crisis; the states will have to obey fiscal discipline in both good and bad times. Latvia supported the compromise version because it would contribute to strengthening of the fiscal discipline in the EU. In general, Latvia supported stricter coordination of the EU economic policy, since that would promote a practice of more responsible fiscal and macroeconomic policy in the Member States which, according to the position, is a precondition for the stability of the Eurozone and the economic and financial stability of the whole EU" (Rasnača, 2014, p.47).

The position of Lithuania is hardly discussed, however most of the articles assume that the Lithuanian government did not raise any serious concerns regarding the implementation and implications of the 'six-pack'. Lithuania was supportive towards the proposal to impose "financial sanctions on the Eurozone Member States which fail to ensure budgetary discipline as prescribed by the SGP" (Šaltinytė, 2015, p.32).

5.2.3 The 2013 'Fiscal Compact' and 'Two-pack'

When focussing on the four observable moments for 2013, the wages are continuing to increase for both the three Baltic States as well as for Germany. While the unemployment levels are continuing to decrease. The current account balance and the level of trade for Germany is positive, however are slightly decreasing for 2013. The current account balances for Latvia and Estonia are both increasing, but remain negative. Lithuania has a positive current account balance for 2011 that is increasing compared to the previous year. The level of trade is positive and increasing for Estonia and Lithuania. While for Latvia the trade balance is negative but steadily increasing. When focussing on the fiscal restraint, for all the four countries the GDP's are increasing. Germany, Estonia, and Latvia show a closely connected government expenditure and revenue, while the Lithuanian government expenditure is still above the government revenue.

Under the SGP's preventive arm there are budgetary targets that can be set and these are strengthened through a law, this law is known as the fiscal compact. This law is part of the Treaty on Stability, Coordination and Governance (TSCG). The second measure is the 'two-pack', to strengthen the adherence of the SGP. It thereby reinforces the economic coordination between the Member States and is introducing new tools for monitoring. The 'two-pack' consists of two regulations, which are:

1. Regulation 472/2013 "on strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability" (EUR-lex, 2013a);

2. Regulation 473/2013 "on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area" (EUR-lex, 2013b).

The Estonian government laid down a framework document ‘Estonia’s European Union Policy 2011-2015’. The position of the government of Estonia is based largely on this framework, which sets out that the euro needs to be strengthened as well as concluding the new fiscal compact treaty. The framework document sets out that Estonia is “open to the deepening of the EU’s competences along with the strengthening of the Community method” (Laatsit, 2014, p.30). A well-functioning and strong Eurozone is identified as necessary for securing the Estonian economic development and security. The government is highly in favour of a speedy introduction of “the fiscal compact treaty into the EU legal framework, including primary law” (Laatsit, 2014, p.30).

The government also indicated that it is supporting the adoption of a balanced budget rule for all the EU Member States. The government “wishes that the margin of allowed structural deficit of 5% of the GDP were interpreted as a maximum. In addition, Estonia supports fixing sovereign debt level to 60% and setting a more ambitious debt reduction rate to countries with a higher level of debt. Besides, does the government prefer that the balanced budget requirement to be inserted in the base legislation on national budgets that is binding and of a stable nature” (Laatsit, 2014, p.30). While in 2010 a proposal was made by the coalition party Res Publica Union and Pro Partria to include a budgetary balance requirement to be set into the Constitution, the Reform Party, the other coalition party, was preferring a solution whereby the balanced budget rule was inserted into the State Budget Act.

The situation was different in Latvia. The government was in favour of the Fiscal Compact, although the meeting with the Parliamentary Committee of European Affairs in January 2012 showed a better picture of the Latvian government position. During the meeting E. Rinkēvičs, which was the minister of Foreign Affairs, informed that the position of the Latvian government was supportive of the closer coordination of the economy and fiscal discipline between the Member States to prevent excessive budgetary deficits that are creating instability in the financial markets in Europe. He noted that a stable environment of the financial and economic markets is a necessary condition to ensure a stable and sustainable economic development. The position “favourably appreciated the initiative to involve EU institutions in the implementation of Fiscal Compact provisions, ensuring the supremacy of EU law and the determination to incorporate the provisions of this Treaty in EU primary law when possible” (Rasnača, 2014, p.65).

However, the statement on the position continued and “insisted that the involvement of EU institutions is appropriate only insofar as the founding Treaties allow this and the Fiscal Compact cannot serve as a legal basis for adoption of EU legislation. It was emphasized that it is important to clearly define in what way the Court of Justice of the European Union (CJEU) competence under this Treaty is compatible with the TFEU, especially Article 126(10) TFEU” (Rasnača, 2014, p.65). The position did also not support the extension of the competences of the CJEU more than necessary to be able to achieve the aims for the fiscal compact. The position did also not support the possibility that the CJEU gained control over national constitutions. The tasks of the national courts and the interactions between the CJEU and the national courts must be clearly formulated. The CJEU’s supervisory powers only concerned the legally defined obligations as well as the scope of its competences should be in compliance with the set competences for the EU (Latvijas Republikas Ārlietu Ministrija, 2017).

The position was also stressing the importance of transparency and information exchange, as well as that non-euro countries should be able to participate in the Euro summits with an observer status. The final point that can be added to the Latvian government position is that the Maastricht criteria should be left untouched by the fiscal compact (Delfi, 2012a).

In the national parliament there were voiced noted that points were unclear or another point was that the importance of the fiscal compact is considered, each article should be dealt with separately and not as a whole (raised by S. Dolgopolovs who was in the opposition for the Saskanas Centrs party). Another concern that was raised was that the fiscal compact would significantly alter the competences of the CJEU, and thereby breach the founding Treaties (expressed by B. Cilevičs who was in the opposition for the Saskanas Centrs party). There was also a suggestion made that the position should be voted for in parliament (and thereby not remaining in the power of the PCEA). The votes in the Committee on this issue were divided - 8 in favour and 9 against - thereby was the suggestion rejected. To this conclusion the members of the Saskanas Centrs (SC) party (opposition) were leaving the meeting. Following, “the position proposed by the Government concerning the Fiscal Compact was approved (10 in favour, none against)" (Rasnača, 2014, p.66).

The Latvian Prime Minister singed the fiscal compact, however the ratification was left in the hands of the Latvian parliament. In accordance with article 68(2) of the Latvian Constitution "determines the procedure for ratification of international treaties which delegate part of the state institution competence, a quorum of two-thirds of the votes was needed in a sitting when it is put on the vote with at least two-thirds of the MPs being present" (Rasnača, 2014, p.67). Due to the need to gain a two-third majority so the fiscal compact could be ratified, the coalition had to seek support from the opposition. The Union of Greens and Farmers promised the government to support the initiatives to strengthen the financial discipline, but it wanted two minister positions in return in the coalition. The coalition parties refused and the Union of Greens and Farmers (ZZS) promise was retreated (Delfi, 2012b; n.d., 2012). However, the Union of Greens and Farmers "came up with a suggestion that if it received a written promise from the PM about defending the Latvian position in the talks concerning direct payments to farmers and division of cohesion funding, ZZS would vote in favour of the fiscal discipline instruments" (Rasnača, 2014, p.67). This led to the two-thirds support needed for the ratification of the fiscal compact.

The Lithuanian government position was for most of the parts of the fiscal compact and the 'two-pack' in favour. During parliamentary negotiations the idea that the Eurozone has to enhance its coordination of economic policy was supported. This enhancing of the coordination would be done through encouraging the economic competitiveness and growth. Lithuania was in 2013 not yet part of the Eurozone (it would join the Eurozone in 2015) and it "had reservations on the provisions of the program of economic partnership which may imply a huge administrative/political burden on the country at the very start of the excessive deficit procedure" (Šaltinytė, 2015).

It was supportive of the idea that non-Eurozone members would be able to join the European summits as well as the flexible formulation to include a provision dealing with balanced budget or surplus budget in the Constitution. These provisions, that are part of the fiscal compact, were seen by the Lithuanian government to be in their own interests, since "they imposed on the governments of the Member States a duty to conduct a responsible and sustainable fiscal policy. The Treaty was presented in Lithuania as one which does not encroach on national sovereignty, and is merely a logical conclusion to the earlier agreements on stricter financial discipline, which introduces sanctions for countries' failure to comply with substantive rules and expands the competence of the CJEU" (Šaltinytė, 2015). The position that the Lithuanian government took was maintained throughout the negotiations.

6 Discussion

This chapter consolidates the work presented in the previous chapters and discusses the positions of the governments of the Baltic States under the Stability and Growth Pact. The author decided to focus on the economic interests and selected four indicators to show a broad picture of the national economy, the national legislation adopted in relation to these four indicators, and the government position during the SGP decisions. This leaves room for discussion. The first section is dedicated to dealing with the question: why is the focus on economic interests? While the second part of the discussion is focussing on the observable moments, and data collection.

The thesis is focussing on four SGP decisions and four national variables. This decision is taken in order to determine the economic position for each Member State and determine if there is a correlation between the national economy and the position of the Member State. There are different ways to determine this, for example by not focussing on four variables but the broader picture of each of the national economies. This is also a suggestion for further research, and can determine if a combination or several economic variables together can influence the government position or that the government is acting separately from its economic position.

As noted previously the focus is placed on economic interests, and for example not on political interests. The EMU can be seen as the result of progressive economic integration in the European Union. Some Member States were afraid that countries could free-ride once they were part of the EMU. Therefore, under the SGP, "member states that violate the rules to keep their public debt and budgetary deficit low can be penalized, and may have to pay a fine" (Cini & Pérez-Solórzano Borragán, 2016). Other Member States wanted to increase the level of economic integration by adopting the Euro. While "a single monetary policy is set by the European Central Bank (ECB) and is complemented by harmonised fiscal and coordinated economic policies, within the EMU there is no single institution responsible for economic policy" (European Parliament, 2016). Instead, the responsibility is divided between various EU institutions and the Member States.

The focus is placed on economic interests, since the EMU and SGP are influential to a certain extent for the economic policies from the Member States. Another option would be to focus on political interests, since from previous research it appeared that the Baltic States were supporting Germany in the SGP decision-making. Adding both the political and economic interests could make the thesis potentially too broad and complex, and only one variable was selected. The political interests would be a good alternative for the economic interests, however the EMU and SGP are focussing on the economy of the Member States and, are able to place sanctions on the Member States. These sanctions are first focussing on recommendations and targets for the Member State to meet, but can also result in a financial sanction. Through the possibility of financial sanctions and the focus on the economy of the Member States, the economic interests were considered to be most interesting and relevant for the thesis.

Suggestions for further research would be to focus on the political interests. The analysis is showing that the macroeconomic policy ideas are prevailing in the Baltic States. This can even be extended, towards the minimal influence of the economic interests. For the selected SGP decisions the economies in the Baltic States were for most criteria doing reasonable to good (also in comparison with Germany) and therefore can the influence of the economic interests be only minimal. The government showed to be having a leading role without, or only minimal, external influences. A more in-debt analysis of the political interests could show a better picture of how it is possible that the macroeconomic policy ideas are prevailing.

A different choice that was made was the option of including ideas as a variable in the research question, thereby focussing on the importance of ideas versus interests. For the thesis the author decided to leave the focus on the economic interests. However, the economic interests are not able to a complete extent potentially to explain the government's positions in the SGP decision-making. While all the three Baltic States opted for stricter SGP rules, which not always were necessarily better for them, since they could also benefitted from a looser application of these rules. The governments of the countries nevertheless opted not too choose for this option and labelled it as nothing but populism (Greeley, 2012; Grybauskaitė, 2010). The Baltic States suffered from high unemployment levels, low wages (although increasing, they remain below the EU-average), and negative current account balances.

This leaves some room to discuss the potential influence of ideas. The Baltic States suffered from large current account deficits, even before the economic and financial crisis hit them, as well as had double-digit contraction were seen for the three economies in 2008. However, the governments remained keen on prioritizing low level of national debts and all three implemented an internal devaluation policy to overcome the crisis. What first seemed to be a mainly national matter, gained European importance when "those small countries advocated that approach for all other European countries, too. Austerity poster child Estonia, one of the few countries that did not violate the SGP during the crisis, frequently made references to the pains it had gone through to justify austerity programmes in other countries" (Spielberger, 2016). The Baltic States also blamed the crisis countries that were violating the SGP rules, which idea was never questioned.

In line with the ideas approach is that the Baltic States governments have a neo-liberal policy that played an important role in the set-up of their economies. Also did they "unquestioningly observed the Stability and Growth Pact before the crisis as part of their Euro adoption agendas. Hence their belief that austerity, ideally enforced through technocrats rather than political decisions would bring back stability to the Eurozone" (Spielberger, 2016). Another point on the influence of ideas is that the creation of the initial SGP and the Euro were inspired by ideas that the decision makers had on how the economic governance could function. The reform of the SGP could be influenced by shared economic ideas and therefore to achieve significant reforms over time.

Part of the internal devaluations section there were four identified observable moments selected, these are: wages, unemployment, current account, and fiscal restraint. These four observable moments were selected for specific reasons as noted in the methods section, but also to measure the level of economic interest. When focussing on these four indicators there leaves some room that cannot be explained by only the economic interests, as indicated earlier. This also leaves room for the option that there are observable moments missing to provide a more complete picture. Indicators as Foreign Direct Investment (FDI), labour productivity, and competitiveness were not selected, since these do not relate in a straightforward way to Eurozone-related economic interests or can be used to deduce objective economic interests. Since the influence of the interest groups on the government decisions was only little, as well as the influence of the interest groups themselves was small, the level of protest or intervention from interest groups was only small.

A suggestion for further research would be to focus on indicators that can be to some extent controlled by the European Union or by the national governments. Another point for further research would be to focus not only on the decisions made under the SGP, but also, or solely, on the SGP review and the SGP flexibility. These two decisions were not taken into consideration for this paper since they do not include any decision-making from the MS themselves. However, since the MS are still affected by these decisions it can be worthwhile to discuss these in further research.

This also introduces a different issue faced during the analysis, since it was difficult to gather the government positions before, during, and after the SGP decisions for the three Baltic States. The main difficulties were that the information was often incomplete or only small - remaining one or two sentences about the topic and than addressing a new topic. Therefore, a lot of different sources had to be used from different authors. A different problem is that often the information remains incomplete in the way as for the decision for the 'SGP amendment' in 2005, where there is a broad conceptual view given for the three Baltic States, however the independent positions remain vague. Also were the Lithuanian government positions often not publically available, neither via their governmental site. Therefore, only newspaper articles or scientific articles could be used. Also the national parliamentary sittings are documented for, for example Latvia, but the documents related to what was discussed are not available for 2005 anymore.

The position of the three countries governments were often added together into one single view, although each government had different issues when proposing the new SGP decisions in their national parliament. Another problem was the language; since most of the governmental documents from Estonia, Latvia, and Lithuania were in the country's national language, translation tools were necessary. The reliability of these tools can differ. Even though the conclusion that the macroeconomic policy ideas are prevailing is strong, there is rather room for mobility towards more tolerance for the interest group politics theory, keeping in mind the previously discussed weaknesses.

7 Conclusion

The Baltic States are small countries and had to undergo drastic measures in order to combat the economic and financial crisis. To research question that was addressed in the beginning of the paper:

> What determines the positions of the new Member States of the Eurozone for the decision-making under the Stability and Growth Pact?

The focus was placed on the economic interests and the theory section focused on the question: how do economic interests determine the position of the national government. There were two main answers considered. The first option would be when the question is answered with a 'yes' in that case the interest groups are influential when the national government is making its decision - the Interest Group Politics. The second option is that the question is answered with a 'no', in this case the government is leading and the interest groups do not have much or any influence in the outcome - the Macroeconomic Policy Ideas.

The methods section focused on which of the countries would be used for the analysis, these are the Baltic States, but also focused more on how the analysis would be conducted. The analysis was divided into two main parts. The first part is focussing on the internal devaluations all the three Baltic States underwent. There were four identified observable moments selected that are of potential influence for shaping the government actors, these were: wages, unemployment, current account, and fiscal policy. For each of these observable moments the government decisions are considered and the actual movement of the trade unions; for example labour, employers, business trade unions. It could be concluded that these economic indicators only to a certain extent are able to influence the government position.

Another point that can be added is that the government often decides without or only little influence of trade unions or government opposition. Demonstrations remain an uncommon form of protest, when for example focussing on Latvia, the majority of the population prefers to migrate and show a silent form of protest with the government position. The trade unions are trying to gain some influence on the government decisions. However only a small part of the working population is a member of a trade union, and since a large part of the Lithuanian population shares the opinion that when people initiate or when they are actively participating in industrial action they may lose their jobs; the influence of trade unions in the Baltic States in the near future remains questionable. The population of the Baltic States remained to have a positive view regarding the European Union and the Eurozone rules throughout the economic and financial crisis and the internal devaluation policy.

The second part of the analysis focused on if the position of the national governmental actors is influenced in the SGP decision-making process. This can be influenced by for example trade unions, or national opposition members that do not support the government position on the SGP decision. It can be concluded that the positions of the national governments of the Baltic States hardly changed in the negotiation process of the SGP, and especially in the case for Latvia, even though the national opposition did not always immediately supported the government.

This leaves open the main research question to be answered. The three governments of the Baltic States had the idea to implement an internal devaluation policy, but also the domestic political economy and the general public opinion in favour to transform this idea into actual results. This is strengthening their policy commitment even further. What follows from the analysis is that the trade unions hardly have any influence and are often not supported by the population of the Baltic States. And, even though the government opposition did questioned the policies on European and national level, the national governments kept their position during the SGP negotiations.

There are exceptions to this statement, for example since the Latvian government was not completely immune for the protests, in 2009 the Latvian prime minister wanted to improve the social dialogue and guarantee the involvement of the social partners in the national decision-making in the case of a crisis. A steering committee was set into place. Also during the negotiations of the 'six-pack' in 2011 the initial position of the Latvian government was not approved. The Latvian government had to compromise on the support that penalty payments that had to be made under the sanction mechanism to avoid macroeconomic imbalances in the Eurozone would be going to the ESM.

Nevertheless can be concluded that the Macroeconomic Policy Ideas stream is having an important influence in the Baltic States when it comes to the decision-making on a national and European level under the Stability and Growth Pact. The Interest Group Politics did show to have some influence, for example in Latvia, although it remains remarkably little.

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