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**The financial crisis and the Baltic States: Effects on governance
arrangements in the context of the European Structural Funds**

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Since their accession to the EU in 2004 the Baltic States have been integrated into the multi-level system of the EU. A common assumption is that the inclusion of unitary states into the EU structure increases regionalisation or at least decentralisation. However, in the case of the Baltic countries, membership seemed to have strengthened the central states, thus exhibiting only minimal regionalisation and decentralisation. Explanatory factors include the lack of historical roots and the absence of domestic veto-players who may have been able to promote stronger regionalisation within the states. Moreover, the shortage in co-financing funds prevented Regional Policy from being structurally effective.

The Baltic States belong to the group of Member States most heavily affected by the latest economic crisis. For the year 2009, the GDP in the EU 27 receded on average by 4.25 percent: in Estonia by 14.1 percent, Lithuania 15 percent and in Latvia even by 18 percent. These numbers are even more shocking when one considers that in the years prior to the economic downturn, the Baltic States exhibited the most growth within the EU. In 2006, Lithuania's GDP grew by 7.8 percent, Estonia's by 10 percent and Latvia's by 12.2 percent. Growth exceeding the EU average has been documented since the turn of the century (Eurostat 2010c). Against the backdrop of this massive growth and economic development, the Baltic States had come to be called the "Baltic Tigers" in reference to the Tiger States of South-East Asia (Andersen 2009a). Similar to how the Asian crisis impacted the Tiger States at the end of the 1990s, the global economic crisis 10 years later has had a dramatic effect on the Baltic States. Yet it is not merely the economies which have been affected. The governments of all three states have been confronted with sinking national budgets and have had to adopt measures to protect their states from bankruptcy. Thus the question: Has the major concern for the erosion of budgetary and financial policy caused by the financial crisis affected policy-making in the multi-level system? The financial crisis is conceived here as an external factor that can influence the Baltic States within the multilevel system. In order to explore such effects, this study uses the Structural Funds and Regional Policy as classical fields of multi-level governance. Analysis will focus on the extent to which the economic crisis has strengthened the central tendencies already present in the Baltic States.

To address the question above, this paper is divided into two sections: The first will illustrate how the accession to the EU has resulted in regionalisation in the Baltic States. The second section focuses on the effects of the reactions of the EU and individual governments of the

Baltic States to the crisis on multilevel governance. Here, special attention is given to ‘path dependency’ as a potential factor, i.e. to what extent the economic crisis strengthened previously embedded tendencies. The Baltic States are particularly valuable for the analysis of the effects of the financial crisis on sub-national governance arrangements as on the one hand they exhibit numerous general parallels regarding size, population, and EU accession date, the degree that they were hit - though to different degrees - by the crisis. Yet on the other hand and despite these similarities they adopted different coping methods.

1. The Baltic States in the Multilevel System: Limited regionalisation as a result of Europeanisation

For the past several years, Europeanisation has been used as an explanatory concept for changes in national governance attributed to EU Membership. Radaelli’s conceptualization has proven especially valuable. It acknowledges a process for the construction, diffusion and institutionalisation of rules, paradigms and procedures that “are first defined and consolidated in the EU policy process and then incorporated in the logic of domestic (national and subnational) discourse, political structures and public policies” (Radaelli 2004). Most notably in the new EU member states membership processes led to a strong “reorientation” of national actors towards the EU-level as well as the “incorporation” of values, norms and rules consolidated at the EU level into national policy-making (Urdze/Knodt 2006). Literature on Europeanisation often assumes that the effect of the EU on respective Member States must be greater the more the State’s organization, decision-making structures and normative orientation diverge from those of the EU: in other words, in the case of “misfit” states. Moreover, it is expected that the implementation of EU requirements, especially in the area of Regional Policy (for example due to the Partnership Principle¹), would clearly result in the inclusion of a regional level and promote processes of regionalisation. In turn, significant institutional change is predicted with respect to the regionalisation of unitary states through Europeanisation. Recent studies have shown that the adaptation process – namely through the adoption of the *acquis* – does not in all cases exhibit regionalisation tendencies but rather

¹ Since the structural fund reforms in 1988 and their revision in 1999, the partnership principle is intended to promote and guarantee cooperation between the Commission and Member States, as well as “regional and local authorities, the economic and social partners, any other relevant competent bodies within this framework” (Council of the European Union 1999). According to the legal ordinance of the Council from 1999 that determines the general conditions for the Structural Funds between 2000-2006, the “partnership shall cover the preparation, financing, monitoring and evaluation of assistance. Member States shall ensure the association of the relevant partners at the different stages of programming, taking account of the time limit for each stage” (Council of the European Union 1999). This structure has been maintained until today, being continuously broadened, and it includes the current 2007-2013 programme period (European Union 2007: 27; see also Council of the European Union 2006).

merely establish “statistical units for the purpose of administrating the allocation of Structural Funds” (Sedelmeier 2006: 16). New domestic factors have also been revealed such as veto-players and ‘path dependency’ (Urdze/Knodt 2006; Urdze/Knodt forthcoming). Also diverging from the positions commonly found in literature, EU policies are not merely conceptualized as static, but instead take into account the learning-processes experienced by the Commission. This can lead to changes in the pressure for Europeanization processes by the European level. To illustrate these effects, focus is given to the polity and politics dimensions. In turn, the establishment of an administrative level for the processing of European Structural Funds, and thus the adjustments made to meet European requirements, will be examined. This paper will also illustrate to what extent the restriction of regionalisation or decentralization processes can be attributed to adjustments made in the polity area and/or to the inclusion in the European Structural Funds and decision-making processes. In doing so, focus will be given to local level as well (Urdze/Knodt forthcoming).

Changes in formal organisation through negotiations for EU Membership

The examination of the current local and regional arrangements in the Baltic States clearly shows that the local levels in all three States continue to have only a limited amount of independence *vis-à-vis* the central governments. This may be surprising considering that the reform of local and regional arrangements began to take place shortly following the reestablishment of independence in 1990 – especially with sights already set on EU membership. Initially, these processes were aimed at the consolidation and democratisation of political institutions and public administration (Vanags/ Vilka 2006). Despite strong advocacy for local self-governance by local political elites, the local level remained dominated by the central level (Pūķis/Začesta 2003: 6f): In Estonia, although local authorities are anchored in the Constitution (§154-§169), their power is limited as they remain financially dependent on the central government and responsibilities are not clearly divided between the two levels (Tatar 2009). The position of local authorities in Latvia is comparable to Estonia, despite not being constitutionally guaranteed (Latvijas Republikas Saeima 2010; The Ministry of Regional Development and Local Government 2010). The weakness of its local authorities in comparison to the central government was made clear during the most recent administrative-territorial reforms. While the local authorities were included in the reforms of 2000 more so than ever before, the central government did not completely abstain from exerting pressure throughout the restructuring processes (Vanags 2005: 19f; Začesta/Pūķis 2005). Like in Estonia, the local authorities in Lithuania are protected by the constitution (Republic of

Lithuania 1992). An independent law regulates the division of responsibilities and clearly reveals that the local level is heavily influenced by the central government (Burbulyte 2004).

The regional level has revealed even less development potential than the local level. There are currently only a very limited amount of autonomous regional arrangements that operate independently from central government regulation or may exert veto power in support of a regionalised structure. In Estonia, regions are directly subordinate to the central government and their governors are appointed by the national Ministerial Cabinet (Council of Europe 2000; Riigikogu 2002). The planning regions in Latvia also lack independent legitimation and are subordinate to the central government (Saeima 2008; Saeima 2009). Finally, Lithuania is divided into ten regions that are also directly subordinate to the national governments and are thus part of the central administration (Open Society Institute 2005). Due to EU accession, the Baltic States were obligated to adapt its structures according to the NUTS²; however, these adjustments do not completely correspond with the regional structures illustrated above. Latvia for example exhibits little territorial differences between both types of structures (Vilka 2004: 20), suggesting that the adoption of the NUTS structure within the framework of EU membership was exclusively formal.

Overall it can be concluded that there is no tendency within the polity dimension towards regionalisation associated with potential EU membership. In turn, the following questions arise: Why are the regionalising effects of Europeanisation not present in the Baltic States as they are in numerous other states? How have the central governments been able to maintain their strong positions despite the changes and restructuring made?

First it must be noted that, from the beginning, the regionalisation and decentralisation processes in all three countries were hampered by the lack of financial means. National budgets did not contain means for Regional Policy (Pūķis/Začesta 2003: 6f). Yet it also must be noted that the motivation for regionalisation and decentralisation was low despite the initiation of reforms, as will be shown. Indications for this include the procrastination of reform procedures, the blocking of measures, the retraction of steps already taken, and the reluctance shown in making adjustments under the pressure of the EU. Furthermore, both the inconsistent position of the Commission and its expansion of the candidate countries' area of activity are explanatory factors that have not yet been recognized or not addressed in the analysis of Europeanisation.

² Since 1988, Eurostat has used the NUTS (Nomenclature of Territorial Units for Statistics) classification to guarantee the consistent compilation of regional statistics (European Commission 2010b).

Discussions about the restructuring of self-governance began in Lithuania in 1991, with new laws being adopted in 1995 (Beksta/Petkevicius 2000: 169ff). Although the necessity for further reforms was emphasized, there was no direct effort mobilise them (Beksta/Petkevicius 2000: 201). In general, the Lithuanian central government exhibited little interest in carrying out reforms that would transfer powers to the regional and local authorities (Vanags/Vilka 2006: 625).

In 1993, the Ministerial Cabinet in Latvia passed the general conditions for self-governance reforms (Vanags 2005: 15). A distinguishing element in Latvia's reform process is that laws adopted between 1990 and 1992 supported decentralisation, while as of 1994, the laws were regressive, meaning that they contained unitary tendencies (Vanags/Vilka: 122). Similar to Latvia, Estonia was under constant reform during the 1990s (Mäeltsemees 2000: 66). According to a law passed in 1994, Regional Policy was carried out under the leadership of the central government (Ristkok/Jauhiainen 1999: 69).

Parallel to these self-initiated processes, reforms were also taking place as a result of the approaching possibility for EU membership. In accordance with Chapter 21 of the Commission's routine reports on accession progress, these reforms aimed to establish autonomous regional policies. Adaptations to the organisation of regional and local self-governance were also required in order to be eligible for funding for membership preparation (PHARE, ISPA and SAPARD³) and/or for the European Structural Funds. However, it is clearly visible that the Baltic States approached these reforms with reluctance. Steps were frequently taken at the last minute or in response to reminders from the Commission. Yet it should also be stated that the EU provisions permitted a centralised approach to the development of Regional Policy: a factor that has been neglected by Europeanisation literature to date.

In the case of Lithuania, a relationship is revealed between the pressure from the EU to make adjustments according to its requirements and the resulting centralised development of Regional Policy, as will be illustrated. In 1997, a report by the EU Commission determined that there had been no development of a Regional Policy in Lithuania. The potential Member State immediately responded by adopting directives on Regional Policy in 1998 (Pūķis/Začesta 2003; Nakrošis 2008). In 2000, these directives were adopted as law, thus

³ PHARE was initially an instrument for economic development in Poland and Hungary (Council of the European Communities 1989). It was eventually expanded to cover all Central and Eastern European membership candidates (European Union 2007). Projects in the areas of transportation and environment are financed by ISPA, while SAPARD supports measures in the areas of agriculture and rural development (European Commission 2008).

making the necessary adjustments within the framework of administrative and national support of Regional Policy. Regional Policy became a “self-sustainable vertical policy of an intervention character” (Cepaitiene/Zitkus 2003: 116). Similarly, European funding for membership preparation – PHARE, ISPA and SAPARD – was also made available to Lithuania as of 2000. This access enabled the country to undertake the required administrative adjustments and develop the necessary legal regulations for the utilisation of the actual Structural Funds. Pressure to adapt was especially intensified by the Commission’s announcement that no financial support would be offered as long as the adjustments contained in the directives had not been implemented (Cepaitiene/Zitkus 2003: 118f). Also in 2001, responsibility for regionalisation policy was transferred to the Ministry of Finance from the Ministry for the Reform of Public Administration and Local Self-Government which had become part of the Ministry of the Interior. This caused stronger centralisation in the implementation of cohesion policy (Nakrošis 2008). Despite its slow approach to reforms in the area of Regional Policy, Lithuania was one of the first membership candidates to fulfil the requirements of the appropriate chapter in the *acquis*. The main reason for this rapid progress is claimed to be the refusal of the central government to transfer powers to the regions in order to establish Regional Policy. From the start, the task of Regional Policy formulation was delegated to the National Ministry of Finance (Nakrošis 2008: 4f). The majority of adjustments can be traced back to recommendations and demands made by the Commission. These are however not assessed as consistent. At times, the Commission called for the development of independent Regional Policy under the authority of the regions, but at other times encouraged this policy to be integrated with the policy of the central government (Nakrošis 2008: 3). Another example of such inconsistency is the implementation of PHARE: “It was decided to concentrate financial assistance from the PHARE Economic and Social Cohesion 2000 component in three Lithuanian ‘target’ regions [...]. this decision was made after consultation with the Commission, which insisted on designating Utena county as a ‘target’ region. However, after PHARE 2000 Review the Commission proposed introducing more of a sectoral approach similar to Objective 1 of the Structural Funds [...]. Thus, financial assistance from subsequent PHARE programmes was concentrated primarily in a sectoral manner on the development of business and human resources. Because of this change, the county administrations gradually lost their administrative capacity, which had been set up for the management of PHARE 2000 assistance” (Nakrošis 2008: 4).

In all three countries it is clear that the pressure to adapt in the context of EU accession led to extensive formal changes. EU requirements also resulted in the establishment of a Regional

Policy that did not previously exist, although this mostly took place centrally as opposed to regionally. Thus, it has been determined that in all three Baltic States the demand for Regional Policy development resulted paradoxically in the strengthening of centralisation tendencies. No veto actors were established at the regional or local levels that may have been able to impede the central implementation of Regional Policy. Moreover, the enormous time pressure to adopt the “*acquis*” combined with the attempt to gain access to financial support, also resulted in a centralised approach that afforded regional, local and societal actors even less acknowledgment than usual in the area of EU Regional Policy (Urdze/Knodt 2006; Jauhiainen 2000: 198; Kungla 2005: 329). This is similarly the case in the politics dimension.

Regionalisation and decentralisation through inclusion in Regional Policy and Structural Funds?

The implementation of the Structural Funds in the three Baltic States is characterised by coordination and organisation carried out by the central government. The Ministry of Finance plays a central role (Ministry of Finance of the Republic of Latvia 2007: 94; Republic of Estonia 2007, Government of the Republic of Lithuania 2007). No strict usage of the partnership principle can be determined as the inclusion of regional and local actors has merely been formal. This contrasts the organisation of federal states in which Ministries merely frame the procedure while the implementation of Structural Funds is carried out by regional Ministries and agencies in terms of the partnership principle. The “National General Strategy” for implementation in Lithuania explicitly points to the size of the country as a reason for central organisation: “[h]aving regard to a small area of the country and limited potential of administrative capacities, an efficient administration of all operational programmes will be guaranteed by a common national management and control system of EU structural assistance [...]” (Government of the Republic of Lithuania 2007: 53).

Regardless, all three states have committed themselves to complying with the partnership principle, as required by the EU stipulations contained in their respective framework documents: those of Latvia and Lithuania contain specific sections addressing this topic. In Latvia’s “National Strategic Reference Frameworks” (NSRF) it is stated that, “Latvia acknowledge [!] the partnership principle as one of the core principles in preparation and implementation of NSRF and OPs [operational programmes]. Latvia’s objective was to involve all the relevant parties, including socio-economic partners, regional partners (planning regions, local municipalities and their associations) and respective NGOs in the formulation of the NSRF and OPs, thus ensuring the transparency of the process, as well as respecting the

interests of partners and potential beneficiaries of the EU funds“ (Ministry of Finance of the Republic of Latvia 2007: 100). The following section describes in detail how the partnership principle was viewed during the planning phases of the NSRF and OPs. Regional partners, municipalities, unions, industrial associations, and NGOs were included in various phases (Ministry of Finance of the Republic of Latvia 2007: 100). Furthermore, public discussions took place about these documents. Regional aspects were especially valued in the formulation of the OPs through the organisation of public discussions in the various planning regions. Regional and non-governmental partners also play a central role through the monitoring committee. It seems that the partnership principle, despite the numerous central tendencies determined in the area of Regional Policy, was formatively effective in the implementation of the Structural Funds, even beyond its intended scope. In other words, that the EU intention to increase legitimacy through the inclusion of societal actors was adopted in the form of the partnership principle. In turn, it appears that the formulation of the decision-making processes can be considered as the adoption of a legitimate European norm – the norm of partnership. However, interviews performed with partners included show that this adoption was mostly superficial. Neither the representatives of the regional nor local administrations feel adequately included by the central government. They admitted that their recommendations were significantly more difficult to implement than those of the central government. Although the regional and local actors adopted the role of lobbyists, they did not participate in EU Regional Policy as integrated partners. An additional problem is posed by the limited ability of partners to substantially contribute to formulation. In turn, the adoption of the partnership principle only had a minimal effect on the central character of the administration and implementation of the EU Structural Funds in the Baltic States. The politics dimension also exhibits paradoxical results: while the EU aims for the strengthening of regional and local structures, the requirements within the Structural Fund framework promote the strengthening of centralized forms of governance, for which means of weakening have at least been occasionally available (Knodt/Urdze 2009). Pūķis and Začesta also reach a similar conclusion: “The implementation of the EU Structural Funds is accompanied by processes of concentration and centralisation” (Pūķis/Začesta 2003: 14).

Yet Europeanisation did slightly increase influence, though exclusively for the local level. As previously explained, the regional levels introduced to the Baltic States through EU accession have remained mostly insignificant. One argument for the lacking independence of the regions is the absence of historical roots. Unlike in other Soviet republics, the Baltic States did not contain precursors to the present regions with individual identities or aspirations to

increase independence (Matsuzato 2007: 395f). The weakness of the regional level causes the local level to carry more responsibility, especially in respect to the Structural Funds. This is confirmed by expert interviews carried out in Latvia and Lithuania by the authors and is further supported by the results of a similar study on Estonia (Tatar 2009). The majority of those interviewed not only emphasized the significance of the local authorities in the allocation of the funds, but also, when answering questions related to regional aspects, often referred to the local as opposed to the regional level. The higher significance of the local level is also supported by the results of a study carried out in Latvia prior to the most recent administrative-territorial government reform. In its evaluation, this study mostly refers to the results of local actors. In general, its results showed that the significance of the two levels is approximately equal in respect to Regional Policy (Popelis et al. 2006).

2. The Structural Funds during the Economic Crisis

The objective of the Structural Funds is the harmonisation of living standards within the EU. For the 2007-2013 funding period, the EU has allotted more than a third of its budget for this purpose. In pursuit of the goals of convergence and European territorial cooperation, the Baltic States are entitled to apply for support from the Structural Funds, thus being able to access, amongst others, the Cohesion Fund (European Union 2007: 11ff). In total, Estonia will receive € 2.456 billion, Latvia € 4.620 billion, and Lithuania € 6.885 billion (European Commission 2007). Likewise, these numbers approximately reflect the different populations of the Baltic States (European Commission 2010c).

The present economic crisis has already exacerbated existing differences in economic development within the EU. The average GDP across the EU sank by 4.2 percent and in the Eurozone by 4.1 percent. Only Poland's GDP grew, namely by 1.7 percent. The Baltic States have been especially impacted by the economic crisis, being the only EU Member States with a recession value in the double-digits. Estonia's GDP sank by 14.1 percent, Lithuania's by 15 percent and Latvia's by 18 percent (Eurostat 2010c). These economic downturns seem even more dramatic when one considers that prior to the crisis, the GDP growth rates in these "Baltic Tigers" (Andersen 2009a; Rizga 2009) were in the double-digits (Eurostat 2010c). In turn, it must be questioned (a) how the organisation of the EU Structural Funds reacted to the exacerbation of the differences in living standards; (b) how the effects of the economic crisis in the Baltic States could be effectively addressed by the Structural Funds; and (c) in this context what effects can be identified in relation to decentralisation and regionalisation. First, the next section will illustrate the course of the economic crisis in the individual Baltic States

in order to clarify existing problem patterns that affect the implementation of the Structural Funds.

The course and affects of the economic crisis in the Baltic States

The overview offered in the following table illustrates to what degree the Baltic States and their people have been affected by the economic crisis.

	Estonia	Latvia	Lithuania	EU27-Average
Real GDP growth rate 2006*	10.0 %	12.2 %	7.8 %	3.2 %
Real GDP growth rate 2009*	-14.1 %	- 18.0 %	- 15 %	- 4.2 %
Real GDP growth rate 2010 (Prognosis)*	-0.1 %	- 4.0 %	- 3.9 %	0.7 %
Harmonised unemployment rates – September ⁴ 2005**	7.0 %	8.4 %	7.2 %	8.7 %
Harmonised unemployment rates – September 2009**	14.6 %	19.4 %	13.8 %	9.1 %

Sources: *Eurostat 2010c, **Eurostat 2010a, ***Eurostat 2010b

This table clearly reveals two aspects: First, the economic crisis affected the Baltic States to different degrees. Latvia exhibits the most effects, and Estonia the least. However, it can be assumed that all three Baltic States have already withstood the worst in respect to GDP development. Second, the values of the unemployment rates reveal that the economic crisis has had a strong impact in this respect. As the states were significantly affected, so were living standards – the core of the Structural Funds. The following section will briefly illustrate the course of the economic crisis in the individual Baltic States, beginning with Latvia as the most strongly affected country.

At the beginning of 2009, an article referred to Latvia as “Europe’s Sickest Country” (Parry 2009). Since then, in Latvia partially relief has been expressed that it was less affected by the economic crisis than Iceland (Jemberga 2010). The real estate boom at the beginning of the 2000s is considered to be the main reason for the strong impact on Latvia. In immediate

⁴ Because the January value was not available for Lithuania, the September value for the unemployment rate in September must be taken as a basis, unlike for the other data.

response to the crisis, real estate prices began to drop, thus pushing the country's entire economy into a downturn (Vanags/Hansen 2008). Finally, the government also ended up in a dramatic budgetary situation. Even prior to the crisis, Latvia's economy was not considered healthy. One major problem was the high inflation rate – one of the highest in the EU. Although a crisis to such a degree was not expected, stagflation had already been predicated (Vanags/Hansen 2008). As a consequence, a plea was made to the International Monetary Fund (IMF) for € 5 billion in credit (Dombrovsky 2008, Dombrovsky 2009, Ījabs 2009). Additional financial aid came from the European Commission, the IMF, and the Swedish Government (Åslund 2008, Hansen 2009). A reason why these benefit payments were granted was that the creditors feared that the national bankruptcy of Latvia would damage the other Baltic and Eastern European states. In turn, this may have caused massive loss for Swedish banks, which had acted as substantial creditors for Baltic States (Anwar 2009).

In order to receive credit, Latvia had to assure its creditors – the IWF, the EU, and the Swedish government – that severe budget cuts would be made. Yet it was also stated that the social sector should remain particularly protected (Anon. 2009; Andersen 2009b). Despite appropriate planning, the Latvian government failed to avoid major budget cuts, thus causing significant change in the living standards of much of the population. The government perceived these cuts to be even more necessary following the IMF refusal of additional benefit payments in February 2009, citing insufficient budget cuts as the reason (McIntosh 2009). By the beginning of 2009, wages in the public sector had been reduced by up to 15 percent, and then again by up to 20 percent (Steuer 2009; Wolff 2009). Moreover, the Government and Parliament decided to reduce pensions by 10 percent, and by 70 percent for pensioners who were simultaneously employed. Likewise, government employee salaries decreased by a fifth (DW-World.de 2009). The Ministry for Health was especially hard-hit, as well as the health system budget cut by 30 percent (Jolly 2009). Hospitals had to dismiss much of their staff and revert to out-patient-treatment. The budget of Riga's first hospital was reduced by 70 percent and it was forced, as a result, to let go of 570 employees in September 2009 (Hurley et al. 2010: 11). Another sector heavily affected by cuts was education; the salaries of educators were reduced by nearly a third (The Baltic Times 2009a). Yet despite all of these measures the IMF and the European Commission insisted that more must ensue. It was demanded that the budget for 2010 had to contain additional cutbacks (Sherwood/Molin 2009; BBC News 2009). At the beginning of 2010, a strict policy of austerity was called for, as well as further savings measures (Diena 2010b, Zālīte 2010, Rutule 2010).

In comparison to Latvia, Estonia has been significantly less affected by the economic crisis. A newspaper article from January 2010 even revealed that Estonia would offer Latvia € 100 million in credit by the end of the year (Diena 2010a). Yet, Estonia, too, had been strongly impacted by the crisis. As in the other Baltic States, the crisis was considered a result of the easy access credit granted upon successful EU accession. Estonia had also experienced a real estate boom. It was under these conditions that Estonia also ended up in crisis. However, Estonia was better prepared than Latvia as it had accumulated budgetary surpluses throughout the economically successful years. Also, reactions to the first signs of crisis were prompt. When the Lehmann Brothers collapsed in September 2008, Estonia was taking part in budget consultations and, in premeditation of potential consequences, budget cuts had already been planned for 2009. As a result of all these factors, it seemed that by the end of 2009 Estonia had already survived the worst of the crisis (Andersen 2009a; Lamine 2009). At the beginning of March 2010, the Statistical Office of Estonia confirmed that the last quarter of 2009 had in fact seen economic growth (Magone 2010). Due to less impact and better preparations, the budget cuts in Estonia were less detrimental than in Latvia. However, because the nation was in fact more affected than originally expected at the end of 2008, spending was to be even more restricted. All Ministries submitted new budget proposals including cutbacks in their respective sectors. In turn, the budget was reduced by 3.5 percent. Cutbacks included a 7 percent salary decrease for federally financed institutions. At the same time, an amendment to labour contract law was made that enabled private employers to decrease wages by 7 percent *ex parte* (The Baltic Times 2009b; Lutz 2009). The Estonian health system also underwent a 9 percent cutback in 2009, with an additional 6 percent planned for 2010 (Karapetyan 2009, Moynihan 2009). Although Estonia partially suffered major cutbacks that affected its population, in comparison to Latvia, these can be considered minor. Additional measures made the already flexible labour market even more adaptable while parallel efforts were made to identify and create new opportunities for the unemployed. Moreover, Estonia did not solely implement cutbacks, but simultaneously established an investment programme for future investment projects (Allikivi 2009).

The causes of the economic crisis in Latvia are comparable to those in its neighbouring states. It should be emphasized that both Lithuania and Latvia fell into crisis with budget deficits, unlike Estonia, which was able to rely on its surpluses (Eurostat 2009). The course of the crisis in Lithuania also has more in common with Latvia than Estonia. An important difference is that Latvia's foreign debt in relation to its GDP was nearly twice as high as Lithuania's. Also, the crisis hit Lithuania later than Latvia (Åslund 2009). However, all three

Baltic States strictly refused currency devaluation. As a way to rescue national finances, Lithuania suggested an increase in value-added-tax and an application for credit from the European Investment Bank (Herrmann 2009b, International Monetary Fund 2009b). Yet instead of requesting support payments from the IMF, Lithuania's government sold Eurobonds in June 2009 in order to secure extra funding (International Monetary Fund 2009b). Regardless, Lithuania was not able to avoid cutbacks in the social sector. It did, however, try to protect particularly vulnerable groups by grading cuts according to social criteria and precise monitoring of actual needs (International Monetary Fund 2009a). In comparison to Latvia, salary decreases were moderate: for example in the public service sector approx. 5-10 percent (EUbusiness 2009). Economic predictions in Lithuania suggest that through the dramatic cutbacks and securing of additional finances, the worst of the crisis has been overcome and Lithuania no longer runs the risk of bankruptcy (Hermann 2009a).

The next section of this paper explores the effects of the economic crisis on the policies of the Baltic States in the context of the EU. It also examines to what extent the States are able to utilise such support in overcoming the economic crisis. Finally, the changes in the utilisation of Structural Funds in the Baltic States due to the economic crisis will be explained.

Changes in Structural Fund policy through the EU as a result of the economic crisis

Approximately six weeks after the insolvency of the Lehmann Brothers in September 2008, a turning-point for financial markets and the EU, the Commission published a report titled "From financial crisis to recovery: A European framework for action" (Commission of the European Communities 2008b). This report focused mostly on the stabilisation of financial markets, with recommendations remaining rather vague. It was emphasized that the EU-dimension would help overcome the crisis and protect the Members' economies from being too overwhelmed. This should be achieved through the aid of increased investments, improved labour market flexibility, freeing up businesses, and a shift to "green" economy. Because these recommendations were the initial reaction to the crisis, rather the objectives themselves were described instead of concrete measures. Commission's recommendation in respect to Cohesion Policy were far more concrete: to "explore with Member States the scope for accelerating investment projects and for bringing forward payments to Member States" (Commission of the European Communities 2008b: 6). To protect the already weaker groups of society, the possibility of "reprogramming funds under the European Social Fund to support measures to quickly reintegrate unemployed into the labour market" (Commission of

the European Communities 2008b: 7) was proposed. Possibilities for this were plausible through the “European Globalisation Adjustment Fund” (EGF) – a fund established in 2007 as an instrument for relieving the pressures of globalisation (European Commission for Employment and Social Affairs 2009: 18) through supporting the entrepreneurship of the unemployed and offering temporary subsidy measures (Commission of the European Communities 2008b: 7). One month following this initial Commission Communication on the potential options for dealing with the crisis, the Commission published another report detailing its new “European Economic Recovery Plan” (Commission of the European Communities 2009), which was adopted by the Council of the EU in December (Bundesministerium der Finanzen 2009). The main objective of the Recovery Plan was “to help those most in need” (Commission of the European Communities 2009: 3), primarily through the creation and securing of employment opportunities. The Plan’s structure was based on two pillars: the first was intended to mobilise a “major injection of purchasing power into the economy” (Commission of the European Communities 2009: 2). For this, Member States and the EU were to contribute extra funds reaching the amount of 1.5 percent of the EU GDP. The second pillar was “a comprehensive programme to direct action to ‘smart’ investment” (Commission of the European Communities 2009: 2). Further details of the Recovery Plan are not of interest here. Instead we will focus on the changes in Structural Fund policy resulting from this plan. In this context it is the main document as it contains the legal foundation for the various changes made to the Structural Fund policy. Specifically:

- a simplification of support terms within the framework of the European Social Fund (ESF) and, as of 2009, an acceleration in the advance payments for projects financed by this fund. The main objective is the promotion of low-skilled and economically weakest in order to (re)employ them as quickly as possible;
- the expansion of the European Globalisation Adjustment Fund (EGF) to address the consequences of the economic crisis (as explained above);
- an acceleration of Structural Fund implementation, including additional pre-financing by the Commission, so that Member States are able to speed-up the financing of projects and other measures recommended by the Commission;
- a realignment of the Member States’ Operational Programmes, in which additional means for energy efficiency are made available (Commission of the European Communities 2009: 11ff; European Union 2009).

What all these points have in common is that the Commission emphasized the urgency of each of these measures.

Only about three weeks after the Recovery Plan was published, the Commission released yet another Communication, this time especially addressing Cohesion Policy within the context of the economic crisis (Commission of the European Communities 2008a). It highlighted the role of the Cohesion Policy within the framework of the Recovery Plan as this policy area is the most essential for investment made by the Community in real economy. The Communication also contained concrete adjustments for Cohesion Policy, assigning them either to the jurisdiction of the Member States or the Commission. The jurisdiction of the Member States includes, for example (Commission of the European Communities 2008a):

- promotion of flexicurity and especially affected groups;
- promotion of access to finance;
- special attention to the needs of small and medium-sized enterprises (SME);
- action in the areas of energy conservation, research, and development;
- prompt allocation of funds, also by using the option of pre-financing.

Furthermore Member States are encouraged to make additional recommendations for the adjustments of programmes and goals through strategic reports expected until the end of 2009 (Commission of the European Communities 2008a).

The jurisdiction of the Commission includes:

- the facilitation of easier access to financial instruments;
- in certain cases, an increase in financing;
- where necessary, further required adjustments;
- prompt assessment of requests for short extensions from the previous 2000-2006 programme period (Commission of European Communities 2008a).

In addition to these general formulations, the following two examples illustrate a more concrete picture of the changes made to Cohesion Policy: the ESF and the EGF. The latter, though not actually part of the EGF, was broadened in order to pursue objectives resulting from the economic crisis.

It has already been mentioned that the Commission had adopted the intention to accelerate the assessment of requests for funding extending beyond the original 2000-2006 programme period. Within the framework of the ESF, this financing refers to approx. 10 percent of the 2000-2006 period – in numbers, approx. € 7 billion. In order for applications to be made quickly, extensions were limited to June 2009. Through strengthened pre-financing by the EU, as mentioned above, financing was nearly doubled in the year 2009. For the complete financing of projects by the EU, a regulation was introduced that did not eliminate the required co-financing through the Member States, but called for repayment by the end of the programme period in 2013. For the short-term, complete financing by the EU allowed Member States with significant budgetary issues to access co-financing, thus enabling the Recovery Plan to be effective in struggling states. By decreasing administrative costs and efforts, the ESF, which also promotes smaller projects, can expect more applications from new groups; before this, administrative efforts seemed too high in relationship to potential small projects (European Commission 2009b). The second example, the EGF, also exhibits an increase in applications due to its expansion to include consequences of the economic crisis. While in 2007 only ten applications for financial aid were made to the EGF, and in 2008 only five, as of the expansion in April 2009 it saw 28 applications. Of the Baltic States, Lithuania was especially active in this context (European Commission 2010a).

In addition to the changes made to the Structural Funds, it can be concluded that the prompt reactions considered necessary – especially by the Commission – to gain control over the effects of the economic crisis on heavily impacted states and regions led to the limitation of the partnership principle. Shortened timelines did not allow for lengthy discussions about potential adjustments and their implementation, in other words, discussions with Member States were reduced to a minimum. That the Commission's recommendations are mostly 'nodded through' by the Member States is one characteristic exhibited by the adaptation processes (European Union 2009). The 2009 strategic reports were the first explicitly named possible means to give feedback on the experiences of the Member States as well as for making additional recommendations for the revision of programmes (Commission of the European Communities 2008a: 11). This type of (non)implementation of the partnership principle – in which Member States are merely included as an afterthought and other partners may only provide limited feedback – contradicts the original intention to strengthen the principle for the present funding period. According to the original plan, "The principle of partnership is widened, which is to say that any appropriate organization representing civil society, environmental partners, non-governmental organisations and organisations

responsible for promoting equality between men and women can participate in negotiations concerning the use of Structural Funds. It not only participates in management but is involved at every programming stage (setting up, follow-up and evaluation)” (European Union 2007: 27; also Council of the European Union 2006). However, such limitation of the partnership principle corresponds with the strengthened coordination considered necessary by the EU for the management of the crisis (European Commission 2009a).

To complement the illustration of the impact of the economic crisis on each of the Baltic States and the related changes made to the EU-dimension of Cohesion Policy, the next section will explore how the effects of the crisis changed how the Structural Funds are utilised in the Baltic States and whether the previously existing centralisation / decentralisation tendencies were affected.

Effects on centralisation/decentralisation tendencies in the Baltic States through changes in the general conditions of the Structural Funds

In a study released by the DG for Economic and Monetary Affairs on the EU reactions to the crisis, it was emphasized that in addition to all the adjustments made to the Structural Funds, it is also necessary to acknowledge the unique conditions of the individual Member States as different approaches or focuses may prove effective in different States (European Commission 2009b: 44). Especially in respect to the Baltic States, the way in which Structural Funds were utilised largely corresponds with the aforementioned limitations and approaches within these States. Likewise, it has been determined that, in spite of receiving additional financial support, Latvia experienced difficulties in the pre- and co-financing of projects as a result of major budgetary issues. The slow implementation of projects that resulted is, in the case of Latvia, endangering the 2009 and 2010 objectives (European Commission 2009b: 23, 73). This is especially true for large-scale infrastructure projects (European Commission 2009b: 70). This means that as a result of its budgetary difficulties, Latvia is barely able to stimulate its economy through an investment programme. In respect to the economy and development, the country has had less money in 2009 and 2010 than it did before the crisis (European Commission 2009b: 50, 66, 69). In consideration of the previously described budgetary situation in Latvia that has led to massive cutbacks, the additional possibilities for pre-financing and the extended access to funding in association with the Cohesion Fund have not been sufficient to boost the economy as hoped. Moreover, it must be emphasized that Latvia is faced with two contradicting demands: for one, the contribution of additional investment within the framework of the Cohesion Policy, and for the other, the

implementation of major budgetary cutbacks, as required by the Commission. In other words, additional investments could only be obtained through the reconfiguration of the budget; however, this would result in even larger cutbacks in the social sector – cutbacks that have already led to massive protests in Latvia. At this point, the sole plausible solution would be for the EU to completely take over project financing. However, because repayment is required by the end of the 2007-2013 programming period, this option can be considered as only minimally attractive as it would require the government to deliver a higher amount of co-financing in the remaining three years meaning additional financial means for this area in the national budget. Considering the urgency of the implemented cutbacks – even in health care services alone – this does not seem as a realistic course of action.

In comparison to Latvia, Estonia and Lithuania faced fewer problems in the utilisation of extra support already provided by the Structural Funds. In this context, as opposed to the general context of the effects of the economic crisis, there are greater similarities between Estonia and Lithuania than there are between Lithuania and Latvia. The study released by the European Commission offers no indication that Estonia and Lithuania faced any serious difficulties in generating either pre- or co-financing for the implementation of the Structural Funds. Accordingly, the implementation of objectives is significantly less endangered than in Latvia. In contrast, the Commission emphasizes that Estonia and Lithuania have partially planned for the pre-financing of projects prior to the Commission's approval; thus, they are willing to risk the possibility of carry costs independently (European Commission 2009b: 23, 54). Yet it must be noted that the implementation problems faced by Lithuania are greater than in Estonia due to the increased need for budgetary cuts; Lithuania has committed itself to a 10 percent reduction in public investment (European Commission 2009b: 50). The examples of Estonia and Lithuania demonstrate that adjustments made to the Cohesion Funds by the EU could be effective in certain cases. In contrast, Latvia shows that this is only possible in the absence of extreme budgetary problems. Therefore, it should be examined whether the economic crisis could lead to a regrouping in the analysis of states within the framework of the Cohesion Policy. According to this logic, it could be assumed that Latvia will eventually have more in common with extremely hard-hit Greece than with either of its Baltic neighbours.

Moreover, it must be stated that the Baltic States also take advantage of the opportunity to make adjustments to the Operational Programmes. It has been established that focus is shifting from the improvement of public service infrastructure, to research and development.

Furthermore, support is also being improved for businesses and increased energy efficiency in buildings (European Commission 2009b: 73).

Interviews carried out in autumn 2009 also support the assumption that the financial crisis strongly affected how Structural Funds were utilised in the Baltic States, as well as strengthened the pre-existing centralisation tendencies. In all three countries, the problem of lacking resources for co-financing was often mentioned in the interviews. This refers to all levels at which projects were to be concretely implemented: neither the regions or local authorities, nor private partners such as NGOs had constant access to sufficient resources for the financing of projects. At the time, the situation was such that sometimes even contracts for previously approved projects were not being signed and thus, could not be executed. In order to carry out a project at all, frequently aid had to be requested from the central government – although national budgets were not always able to deliver. This corresponds with the aforementioned problem that complete pre-financing by the Commission was not sufficient for the actual implementation of all eligible projects. Yet sufficient data is not available to determine to what extent Latvia has been more affected by this problem in relation to its two neighbours. However, in accordance with the prior observations, it can be assumed that this was an especially relevant problem in Latvia (Knodt/Urdze 2009). As stated before, it can be concluded that all contributions by the central state were reduced to a minimum and to those areas without which the state would no longer have been able to function – and in all three Baltic States, Regional Policy does not belong to these areas. In turn, due to the strengthened coordination of budgetary policy by the central government, as well as the necessary national co-financing, and (though less directly) cutbacks in the areas of Regional Policy that were implemented without EU financial aid, Regional Policy suffered a loss in significance and the tendency towards central governance was reinforced. Particularly in the case of Latvia, this development was strengthened because the necessity for budgetary cutbacks substantiated the coordinating function of the central government. The assumption made here, is that such cutbacks would not have been successful if implemented by a decentralized organisation. This was especially true in the case of Latvia as the nation was under enormous pressure to obtain credit quickly. Accordingly, the economic crisis decreased the importance of Regional Policy, while strengthening tendencies towards central governance. This resulted (1) directly from the strengthened coordination of budgetary policy by the central government, (2) the necessity for co-financing; and (3) indirectly from cutbacks in those areas of Regional Policy that operated without the financial support of the EU.

Conclusion

The objective of this paper was to examine the effects on policy-making in the multilevel system caused by the heavy impact of the financial crisis on the Baltic States. In order to determine the effects of the financial crisis on pre-existing central tendencies, the examples of the Structural Funds and Regional Policy were analysed as classical policies of multilevel governance.

The initial step of our analysis determined the existence of such central tendencies based on Europeanisation processes taking place in the Baltic States within the context of EU accession. It was revealed that at the beginning of their independence, efforts to develop a Regional Policy were clearly present in the Baltic States. However, once these self-initiated efforts ceased, it was the pressure exerted by the EU to adapt that led to the further development of Regional Policy. One characteristic of the development in the Baltic States is the paradoxical centralised implementation of the required adjustments, for which the deadline for adaptation processes can be held responsible. Furthermore, once Membership was attained, the role of regional actors was not strengthened through the principle of partnership rooted in the Structural Funds. This is due to the fact that the independent regional authorities lacked historical roots. In turn, according to 'path-dependency' tendencies, no independent actors were established at the regional level.

Further analysis revealed that the economic crisis reinforced the central tendencies in the Baltic States and thus further impaired the already weak system of multilevel governance. This, too, is clearly illustrated by the Structural Funds policy. As a reaction to the economic crisis, the Commission made short-term adjustments in order to create additional opportunities for the Member States to confront effects with flexibility. However, in contrast to the partnership principle central to this policy field, adjustments were made (also at EU level) without sufficient inclusion of the Member States or the other partners. This can be explained, for one, by the enormous time pressure under which changes were to take place, as well as by the strengthened coordination considered necessary by the EU to successfully address the crisis. In the Baltic States, a concrete increase in central tendencies can be observed as a result of the economic crisis. Accordingly, there is an apparent connection between the impact of the economic crisis and the increase in central tendencies: Because Latvia, the most heavily impacted of the Baltic States, was desperate to receive credit from the Commission in order to avoid bankruptcy, it was forced to make major budgetary cutbacks. Therefore, due to the co-financing requirement, it was not able to profit from the

additional possibilities offered by the Structural Funds. In turn, the significance of Regional Policy in Latvia has suffered a major loss. Furthermore, time pressure caused several conditions under which multilevel governance seemed to be a less effective option for policy-making than a more centralised approach. Moreover, the regions in all three Baltic States did not have the possibility to establish themselves as competent partners for the development of solutions. In contrast, Estonia and Lithuania, the less impacted Baltic States, had more of an opportunity to profit from the possibilities resulting from the adjustments made by the Commission to the Structural Funds. Because the general conditions for the implementation of the Structural Funds have essentially remained the same, it can be assumed that the partnership principle is better observed in Estonia and Lithuania than in Latvia, where Regional Policy has inevitably lost relevance. In summary, it can be stated that the financial crisis – at least in the cases of the Baltic States, and especially Latvia – led to a major reduction of multilevel governance and thus caused a relapse to a system of governance resembling the 1990s.

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