

Effects of a Constitution on Taxation: The Role of Constitutional Review in the Development of Tax Laws in Estonia

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ABSTRACT

This paper examines the role of constitutional review in the development of tax laws in Estonia. The case study of Estonia is used for testing the theoretical propositions derived from the existing literature on constitutional politics with regard to the willingness of the constitutional court to pass judgements that are costly for the budget and the likely reactions of the legislature to such costly judgements. The Estonian case demonstrates that the Constitutional Review Chamber has been repeatedly willing to go ahead with costly rulings on tax laws, and the legislature has, for most part, deferred to the court in these decisions. The case study indicates that although the strategic interaction models employed by the existing literature can provide some insights into the decision strategies of courts and legislatures in the constitutional review of tax laws, a more complete explanation should pay attention to the symbolic role attached to constitutional review by the actors involved and to path dependencies that specific rulings can create.

Key words: constitutional law and economics; constitutional politics; constitutional review; taxation; post-communist transition

1. Introduction

Constitution has been "brought back in" to economics in recent years, as witnessed by a large number of studies exploring the effects of constitutions and constitutional features on economic indicators, like economic growth, public deficits, spending mix and tax mix (see, inter alia, Boix 2001; Sakamoto 2001; Persson and Tabellini 2003, 2004a, 2004b; Woo 2003; Gerring, Thacker and Moreno 2005; Blume et al. 2009).¹ Although most of these studies have focused on constitutional features like presidentialism versus parliamentarism, proportional versus majoritarian electoral systems, another important feature of the constitutional system – the

¹ For an extensive overview of the literature, see Raudla (2010a).

judiciary – has also received some attention. While most of these inquiries have concentrated on the effects of the characteristics of the judiciary on indicators like economic growth (see, for example, Henisz 2000; Feld and Voigt 2003, 2006), a handful of studies have also explored the effects of judicial characteristics on public finances (Padovano, Sgarra and Fiorino 2003; Maskin and Tirole 2004; Tridimas 2005; Eslava 2006).

It is striking, however, that there have only been two studies explicitly exploring the influence of *constitutional* courts and constitutional review on budgetary outcomes, like fiscal discipline and tax revenues. Eslava (2006) examines the impacts of judicial activism on fiscal adjustments in Latin America and finds that the degree of courts' involvement in fiscal policy is "a key determinant of the level of deficit" (29).² Tridimas (2005) investigates how judicial review and judicial independence affect the relative share of tax revenues in GDP. He predicts that the relative share of tax revenues decreases as the judicial independence and powers of judicial review increase, since an independent judiciary can overturn redistributive tax measures.³ Such a lacuna of studies is especially puzzling, given the emergence of constitutional courts as potentially powerful actors in the policy-making arena (Stone Sweet 2000). Indeed, one can speak of a particular stream of literature – constitutional politics – that focuses on the increasing policy-making role played by constitutional courts in many countries. At the same time, none of the studies in constitutional politics have explicitly traced the influence of constitutional review on the development of tax laws in a particular polity.

This article seeks to fill these gaps and bring the two hitherto disparate streams of literature – constitutional economics and constitutional politics – together. It employs an exploratory case study for examining the impacts of the constitutional review procedure on the development of tax laws in one particular country – Estonia. In order to structure the empirical analysis, this study draws on the theoretical propositions of constitutional politics literature and examines whether the theoretical basis of this literature – which draws heavily on the rational choice model advocated in the methodology of orthodox economics – is sufficient for capturing the effects that constitutional review can have in a polity. The study assumes that in order to understand the impacts of the constitutional court's rulings on the development of laws, it would be insufficient to focus on constitutional courts alone: it is also necessary to analyse the interactions taking place between the constitutional courts and other major political institutions, like the legislature and the executive, whose reactions to constitutional review decisions mediate the effects that the rulings can have on a particular substantive policy area.

Estonia is a particularly useful case for exploring the role of constitutional review in the development of tax laws. Given their potentially important roles as

² As Eslava (2006) explains, undertaking lasting fiscal adjustments usually requires spending cuts on items such as transfers, social security contributions and wage payments; thus, fiscal adjustments often impose costs that fall disproportionately on specific groups of the population. When these transfers are viewed as having acquired the nature of rights of the corresponding recipients, the constitutional courts are likely to interpret such cuts as unconstitutional.

³ Tridimas (2005) tests these predictions in a cross-section sample of 52 countries and shows that more extensive judicial review is indeed associated with a smaller relative share of taxes in the economy.

focal points in a situation where the entire legal system is in flux, constitutions in transition countries can provide a useful testing ground for finding out whether the ambitious role that constitutional economics attributes to constitutions actually holds. As in other transition countries, the tax system in Estonia has gone through major changes since the 1990s and hence, there were several windows of influence for constitutional review decisions to shape the course of the tax laws. Since the constitutional review model employed by Estonia is very “restrictive” with regard to the circle of actors who can initiate constitutional review proceedings (Sadurski 2005), it can be expected that if constitutional review has played an important role in the development of tax laws in Estonia, it is likely to have played an even greater role in other transition countries, where a wider circle of actors – including legislative opposition – has a recourse to constitutional review.

The paper is structured as follows. Section 2 gives an overview of the theoretical propositions from the constitutional-politics literature and outlines the conjectures pertaining to the strategies of constitutional courts and legislatures in constitutional review of tax laws. Section 3 gives an overview of how constitutional review has shaped the development of major tax laws in Estonia – Taxation Act, Income Tax Act, Social Tax Act and Value Added Tax Act. Section 4 discusses the findings in light of the existing theoretical literature and proposes how the analytical frameworks can be extended. Section 5 concludes.

2. Constitutional Review and Tax Laws: Theoretical Propositions

The constitution can shape tax laws through the official process of constitutional review,⁴ in which the constitutional court (or an equivalent) assesses the constitutionality of the contested provisions, strikes down unconstitutional legislation and indicates how the law should be changed in order to be in compliance with the constitution. This effect is called the “downstream” or “remedial” effect by Favoreu (1988, 103) and “immediate, direct, or formal” effect by Stone Sweet (2000, 63).

To what extent the *potential* effects of constitutional review are translated into *actual* effects – that is, whether the legislature defers to the court and revises the law according to the court’s interpretation – has received increasing attention in the literature. Among other factors, the willingness of the legislature to comply with the decisions of the court is influenced by public support for constitutional “rules of the game” in general and for constitutional courts in particular (see Caldeira 1986; Murphy and Tanenhaus 1990; Weingast 1997). As Vanberg (2001, 347) emphasises, in democracies where the constitutional court enjoys a high degree of public support, “a legislative decision not to comply with judicial rulings may result in a negative public backlash and the fear of such a backlash may be a powerful inducement for legislative majorities to respect judicial decisions.” The prevailing assessment of the scholars investigating the relations between legislatures and constitutional courts in

⁴ Though earlier literature used to distinguish between “judicial review” (which characterised the American model) and “constitutional review” (which referred to the European model) then, by now, these terms are used interchangeably (McWhinney 1986).

Western democracies is that, on the whole, legislatures follow the decisions of the constitutional court and open confrontations are rare (see Rubio Llorente 1988; von Brünneck 1988). Still, reversals and more subtle modifications of the constitutional review decisions by the legislature can take place and have been discussed in a number of studies. Fisher (1990), for example, has shown that in the case of the US, the Court's rulings have "hardly been the last word": Congress has repeatedly attempted to override the Supreme Court decisions and often succeeded.⁵

To what extent the potential *threat of an override*, in turn, influences the decision of the constitutional court has also received extensive attention in the literature, especially by scholars focusing on the US Supreme Court. A strand of research following the rational-choice tradition has emphasised strategic interactions between the legislature and the judiciary, implying that the court might be subject to stronger external constraints than the attitudinal model (Segal 1997) postulates.⁶ Pickerill summarises the assumptions of this approach as follows: "Justices make decisions to maximise their policy preferences while minimising the likelihood that Congress will enact legislation to 'override' the judicial decision" (2004, 18-19).⁷ Drawing on the existing theoretical literature, Hansford and Damore (2000) emphasise the necessity to combine the attitudinal and rational choice models into more elaborate models that would bring out under what conditions the constitutional court would be constrained by legislative preferences.⁸ They argue that justices would be constrained by congressional preferences only when the legislature "poses a credible threat". Hansford and Damore hypothesise that previous legislative overrides in an issue area and case-level interest group activity are likely to be important factors in influencing whether the court perceives the potential override as a credible threat. They explain that the number of recent overrides in a specific issue area (e.g. in taxation) offer a clear cue about the willingness of the legislature to override legislation in that specific area (495). Epstein, Knight and Shvetsova (2001) predict, based on a game-theoretical model involving the court, the executive and a bicameral legislature, that a court that wishes to strengthen itself (which is especially the case with the courts in CEE countries), both in the short-term and long-term perspectives, has to take decisions that lie in the overlap of the other players' tolerance interval concerning the particular case; otherwise, the other players will override the decision of the court.⁹ In addition, they argue that the court would be motivated to abstain from intense

⁵ Meernik and Ignagni (1997, 463) find that between 1954 and 1990, the Congress attempted to reverse the judgement of the Supreme Court in 22 per cent of the cases and succeeded in 33 per cent of the attempts. For a discussion of factors behind the US Congress's attempts to reverse the decisions of the Supreme Court, see Ignagni and Meernik (1994), Meernik and Ignagni (1997), Eskridge (1991), Rogers (2001) and Segal (1997), among others.

⁶ See, for example, Spiller and Gely (1992), Gely and Spiller (1992), Epstein and Knight (1998), Epstein and Walker (1995). An overview of the literature taking the rational-choice perspective for analysing the Supreme Court-Congress interactions has been given by Pickerill (2004).

⁷ "Likewise, they assume that members of Congress are goal-oriented, rational actors who have incentives to inform themselves of Supreme Court decisions and tailor the language of statutes as to minimise the likelihood of adverse Court decisions." (Pickerill 2004, 19)

⁸ As Hansford and Damore (2000, 491) underline, the rational-choice models postulate unrealistically high levels of external constraint, whereas the attitudinal model underestimates the extent to which judicial behaviour can be influenced by other political actors.

⁹ Epstein, Knight and Shvetsova (2001) demonstrate the applicability of this model in the case of Russia.

political conflict and contentious political issues – especially with regard to the controversies concerning institutional prerogatives of the other branches.

Subscribing to the interactive perspective, Vanberg (2005) discusses how the anticipated legislative reactions to constitutional review decisions influence decision-making in the court. Vanberg (2005, 169-170) argues that although most of the literature on constitutional courts views the courts as unconstrained actors capable of imposing their preferences on other policy-makers, the courts' decisions are in fact shaped by the political environment. Vanberg concurs that the courts must usually rely on the majority of the legislature to implement their decision (by revising the statutes) and the main "enforcement mechanism" the courts have in such a situation is public support for the constitutional court and the fear – by the members of parliament – of public disdain (with its possible electoral consequences), were the legislature not to follow the rulings of the court.¹⁰ (14, 170) Given the importance of public support as a venue for ensuring compliance – thus constituting an important "judicial resource" – judges are likely to be concerned with public support for their decisions, assuming that, over time, "specific support" for concrete decisions can be transformed into "diffuse support" for the court as a whole (14, 51-52).¹¹ Alongside the satisfaction of the public with the specific substance of the decisions, "Public support for courts is likely to be a function of courts' ability to convey the image of impartial, apolitical legal body." (52)¹²

Based on these considerations, Vanberg (2005, 57) puts forth a number of hypotheses, including the following ones:

Hypothesis 1: Judges are motivated by a concern to maintain public support and are sensitive to prevailing public opinion.

Hypothesis 2: Judges are sensitive to the interests of governing majorities.

Hypothesis 3: The potential for public backlash is an important consideration for legislators in deciding how to respond to a judicial ruling.

Further, Vanberg argues that since legislative majorities are inclined to resist a ruling that imposes financial costs, the courts (anticipating the likely evasion) would be more deferential to the parliament in cases where the judicial decision would have

¹⁰ The importance of public support in guaranteeing compliance has also been discussed by Canon and Johnson (1999), Gibson, Caldeira and Baird (1998), Murphy and Tanenhaus (1990) and Caldeira (1986).

¹¹ Vanberg borrows the distinction between "diffused" and "specific" support from Easton (1975). Vanberg (2005, 50-51) points to several studies concluding that specific support influences diffuse the support for a court in the sense that "substantive evaluations of particular court decisions do affect the level of public support for a court" (e.g. Grosskopf and Mondak 1998; Franklin and Kosaki 1995; Marshall 1989). See also Durr, Martin and Wolbrecht (2000) and Mondak and Smiley (1997). At the same time, Vanberg notes, "This does not imply that a constitutional court will act as a 'preference barometer' and decide cases on the basis of opinion polls. Nor does it imply that judges cannot, on occasion, get away with an unpopular decision. But judges are likely to be aware that the support they enjoy is a valuable resource that can be 'spent' too quickly if too many unpopular decisions convince too many citizens that the court exercises an undesirable influence on the direction of policy" (Vanberg 2005, 51).

¹² See also Capelletti (1989), Gibson (1989, 1991), Schwartz (2000), Shapiro (1981) and Tyler and Raskinski (1991).

budgetary impacts, in terms of demanding additional expenditures or reducing available revenues (130-132).¹³

With regard to the question of whether the courts in CEE countries are likely to impose costs on the legislature, the prediction could go both ways. On the one hand, given tighter financial constraints in these countries, the constitutional court could anticipate the difficulties that the parliaments would have with such decisions and would hence be unwilling to impose large costs with its decisions. On the other hand, since the public support for the court depends on its reputation of being an impartial mediator, the court should be willing to take decisions that impose costs on the legislature, when the merits of the case require so. Further, given the need to build up the support of the general public, a constitutional court in a CEE country would have incentives to favour the rights and positions of taxpayers *vis-à-vis* the state in constitutional disputes.

Drawing on the hypotheses offered by Vanberg, one can put forward a number of competing conjectures about the behaviour of political actors in the context of extensive political and economic transition (like the transition process in CEE countries).¹⁴

Conjecture 1: Given the need to build up public support, constitutional courts in transition countries will favour taxpayers in their decisions (even if these decisions would have budgetary implications).

Conjecture 2: Given the need to build up the reputation as a neutral arbiter, constitutional courts in transition countries will adopt decisions that bring about high budgetary costs (if the merits of the case require so).

Conjecture 3: Given the need to build up the support for other political institutions, the constitutional courts will not adopt decisions that have costly budgetary consequences.

Conjecture 4: Given stringent fiscal constraints faced by the governments in the countries in transition, constitutional courts will not adopt decisions that would imply high budgetary costs.

With regard to the behaviour of the legislatures, the competing pressures and incentives would lead to competing conjectures as well:

Conjecture 5: Given stringent fiscal constraints, parliaments in transition countries will not defer to the constitutional court in cases with costly budgetary implications.

Conjecture 6: Given the need to build up public support for the institution, parliaments in countries of transition will be deferential to the court's deci-

¹³ The German case study conducted by Vanberg confirmed this conjecture (131-137). The interviews indicated that "There was a unanimous agreement that a ruling is likely to be ignored or compliance with it delayed if it imposes considerable additional expenses or leads to a shortfall in revenue" (131) and that the court will be more deferential in such cases.

¹⁴ Since they are only tentative and exploratory, this paper refrains from calling these conjectures "hypotheses", yet. Of course, in their nature these propositions are akin to hypotheses and can be used as guiding hypotheses in future empirical studies.

sions in cases that favour taxpayers' rights (even if they have costly budgetary implications).

Which of these configurations of incentives would dominate and which of the outcomes would prevail in transitional contexts is difficult to say a priori and would have to be tested empirically. Among the factors that can influence the incentives of the actors involved in constitutional review, the independence of the constitutional court from the legislative and executive branches (and guarantees of autonomy provided by the constitution) can certainly be expected to play an important role. Indeed, when the constitutional judges are politically appointed for a limited term (and need the approval of the legislature to be re-elected), the court is more likely to be more deferential in its judgements than is the case with judges who are appointed for life. Also, the professional background of the judges sitting in the constitutional court can be considered an important factor: if the judges have a political – rather than a legal or scholarly – background, the court can be expected to be more attentive to the preferences of the executive and legislative branches in constitutional disputes. Given these considerations, one would expect the Estonian constitutional court – which stands out among CEE countries for its independence, guarantees of autonomy and professional standing (see Sadurski 2002, 2005; Schwartz 2000) – to be able and willing to go against the preferences of the other branches of government.¹⁵

In addition to the factors revolving around the independence of the constitutional judges, it can be argued that a constitutional court would be more willing (and also more able) to deviate from the preferences of the other branches in issue areas that are governed by international standards and endorsed by international (or supranational) bodies (Maveety and Grosskopf 2004). As Maveety and Grosskopf (2004, 467) argue, in such issue areas, the constitutional courts would be less constrained by national institutions, since the “international standards have the potential to liberate constitutional courts from some national constraints.” With regard to tax legislation, one can hence expect that the constitutional courts would be more able to exert their influence on those issues that are reflected in some international agreements. Unlike issue areas like minority rights (discussed by Maveety and Grosskopf 2004), the area of tax policy is not so “densely populated” with international obligations, which may make it more difficult for the constitutional court to appeal to specific international standards (alongside the generally accepted constitutional principles like the rule of law), except in tax disputes concerning relations between the local governments and the national government (which is covered by the European Charter of Local Self-Government, for example).

¹⁵ Also, as one of the reviewers for this article pointed out, since the judges in the Estonian Constitutional Review Chamber are in parallel also members of the civil, criminal and administrative chamber, such a model favours “judicial work culture”, which should further contribute to the “independent-mindedness” of the constitutional court and its detachment from other branches of government.

3. Constitutional Review of Tax Laws in Estonia

The Estonian 1992 Constitution provides for four different venues of constitutional review: 1) the president when proclaiming laws; 2) the Legal Chancellor when reviewing the consistency of legislation with the Constitution; 3) the courts that review the constitutionality of legislation when applying it to the adjudication of specific cases; 4) the Supreme Court when resolving constitutional review decisions of the president, the legal chancellor and courts.¹⁶ Roosma (1998, 36) has noted that although in a narrow sense, the exercise of “constitutional review” refers to the authoritative determination of whether a legal act contradicts the Constitution or not – which is only carried out by the Supreme Court – then, in a broader sense, one can say that the president, the legal chancellor and lower courts also exercise “constitutional review” when they evaluate the conformity of legal acts with the Constitution and undertake certain steps when they find a conflict between the Constitution and other legal acts.

3.1. The 1994 Taxation Act

Already the first Taxation Act of the independent period, which sets out the main principles of taxation in Estonia, (and was passed by the *Riigikogu* on 25 August 1993, enacted on 1 January 1994) gave rise to extensive discussions pertaining to the constitutionality of several provisions. The President refused to promulgate the Taxation Act on the grounds of unconstitutionality and returned it to the *Riigikogu* for a new reading and decision (Resolution No. 177, from 8 September 1993). When the President’s resolution was discussed in the *Riigikogu*, the participants in the debate – in particular the chairmen of the Constitutional Committee and Finance Committee – argued that all these aspects pointed out by the President could be interpreted differently and there was no violation of constitutional norms; thus, there was no reason to change the Taxation Act (*Riigikogu* Verbatim Record, 28 September 1993).¹⁷ On 28 September 1993, the *Riigikogu* passed the Taxation Act unamended, and the President requested the Supreme Court to declare the law unconstitutional.

In its Judgement No. III-4/1-4/93 (of 4 November 1993), the Constitutional Review Chamber agreed with the President and declared the Taxation Act unconstitutional. First, the CRC pointed out that the authority delegated to the Minister of

¹⁶ For more detailed discussions on the set-up of constitutional review in Estonia, see Maruste and Schneider (1996, 1998), Roosma (1998, 2001) and Pettai (2000). The effects of constitutional review of legislation in Estonia have been examined in Maveety and Grosskopf (2004), Maveety and Pettai (2005), and Annus (2007). For an analysis of how the provisions in the Constitution of Estonia came about, see Raudla (2010b).

¹⁷ A question that arises here is: why did the parliament not react to the President’s review in 1993? One possible explanation is that the parliament wished to enact the law as fast as possible, hoping that the President would also appreciate the urgency of having the Act passed and not turn to the Supreme Court. This was the second time for the *Riigikogu* to pass the law unamended after the President’s veto. In the previous case, the President had taken the law to the CRC but had lost the dispute. Another factor was that the parliament wanted to exert some stubborn independence *vis-à-vis* the President: it was the seventh law that the President had sent back since 1992, and there were some signs of annoyance among the legislators about such active intervention by the President.

Finance to establish the nature of local taxes and the requirement to have the local taxes approved and registered by the Minister of Finance before they could be enacted by the local councils was unconstitutional, since it violated the right of the local governments to levy and collect taxes (Article 157 of the Constitution). According to the CRC, since under the Constitution, local governments conduct their activities in accordance with the *laws*, the *Riigikogu* had no authority to *delegate* its legislative powers regarding the regulation of the activities of local governments. Second, the Court argued that the provisions in the Taxation Act according to which a tax inspector was authorised to inspect the property and buildings of enterprises without a prior warning or special authorisation, to set up measurements on containers, storage areas and equipment and to place cameras were unconstitutional, since all those activities required entry into another's property, and the provisions in the Act did not require the owner's or possessor's consent, which went against the constitutional principles governing the inviolability of ownership. In addition, the Court pointed out that giving a tax inspector the right to conduct a needed inspection on a court order, if he has reason to believe that a delay in inspection would lead to tax evasion was unconstitutional, since the inviolability of living spaces, possessions or places of business as provided by Article 33 of the Constitution may not be restricted on the basis of the tax inspector's *belief* that a delay in inspection would result in tax evasion. Third, the Court stated that the Taxation Act did not specify whether the placement of surveillance cameras mentioned in the Act also included the use of cameras for secret surveillance. The Court added that when cameras are intended for secret surveillance, they are so-called "special means", but according to existing laws, tax inspectors did not belong to the group of persons who can use "special means". Fourth, the CRC stated that the requirement to exhaust an administrative procedure before gaining access to the courts violated Article 15 of the Constitution, which establishes that every person whose rights have been violated has access to the courts.¹⁸

As a result of the Court's decision, the *Riigikogu* changed the controversial provisions in the Taxation Act. The discussions on the Taxation Act (after it had been returned to the parliament) indicated that the legislators were primarily interested in getting the Taxation Act passed as fast as possible (before the end of the year 1993), since many tax laws were to come into force at the beginning of 1994; having the Taxation Act (which was the framework law for the other tax laws) suspended would have complicated the implementation of these laws (*Riigikogu* Verbatim Record, 7 December 1993). Thus, the *Riigikogu* sought to remove the contradictions with the Constitution indicated by the Constitutional Review Chamber. The new version of the Taxation Act stipulated that local taxes would be established by law (and would by implication not be controlled and registered by the Minister of Finance). Although the first draft of the new Act stipulated that the use of cameras would be foreseen for collecting the gambling tax, by the second reading, the

¹⁸ Further, the CRC argued that the pre-trial procedure outlined in the Taxation Act did not meet the requirement of Article 13 Section 2 of the Constitution (according to which everyone must be protected by law against arbitrary treatment by government), since the jurisdiction to decide a dispute had been given to an administrative agency whose action was being complained about.

Finance Committee of the *Riigikogu* decided to leave it out, arguing that the revenues from the gambling tax were so small that it would not be worth fighting another constitutional debate for that issue (*Riigikogu* Verbatim Record, 16 December 1993). In addition, the new version of the Act established that tax inspectors can only enter the premises after receiving consent from the owner of the territory or building. Also, the new version stipulated that in any phase of a tax dispute, the taxpayer had the right to turn to the court.

Thus, as a result of the constitutional review disputes, the Taxation Act was significantly changed: it constrained the rights of local governments and taxpayers considerably less than the original version of the Taxation Act would have done.

3.2. The Interest Rates Case

The biggest constitutional controversy regarding the Taxation Act took place in 2002-2003, following the Judgement No. 3-4-1-8-02 of the Constitutional Review Chamber (of 5 November 2002). It concerned the question of whether establishing the interest rate on tax arrears can be delegated to the executive power (the Minister of Finance) or not. Since this case turned out to be one of the paradigmatic cases in the Estonian constitutional discourse, it is worth looking at the decision, the arguments presented, and the parliament's reaction in detail.¹⁹

The 1994 Taxation Act had delegated the right to establish the interest rates charged on tax arrears to the Minister of Finance, and only with changes made to the Act coming into force on 1 July 2002 were the interest rates established in the Taxation Act itself.²⁰ Constitutional review in this issue was initiated by the Administrative Court (on the basis of a tax dispute), which argued that since the interest paid on tax debt is in nature similar to taxes, the interest rate should be stipulated by law (since Article 113 of the Constitution states that “State taxes, duties, fees, fines and compulsory insurance payments shall be provided by law”); otherwise, the principles of legal certainty and separation of powers would be violated.

At the discussion of the case in the Constitutional Review Chamber, the views of the judiciary on the one hand and the executive and the legislature on the other hand clearly clashed. The legislature and the executive sought to argue for the constitutionality of the delegation provision in the Taxation Act in their statements submitted to the Court. The Finance Committee of the parliament explained that the delegation of the right to establish interest rates had been motivated by the desire to give the Minister of Finance a simpler possibility to *lower* the interest rates. It pointed out that the Minister of Finance had repeatedly lowered the interest rate and had not abused the power vested in him. The Finance Committee also found that an

¹⁹ As the Chairman of the Constitutional Committee of the *Riigikogu* noted, “This is not an ordinary constitutional debate, its dimension and meaning is unique for the Estonian public law.” (Protocol of the Constitutional Committee of the *Riigikogu*, 17 April 2003)

²⁰ The interest rates on tax arrears had been 0.15 per cent per day until the end of 1996, 0.07 per cent in 1997, 0.035 per cent in 1998, 0.07 per cent from the beginning of 1999 to June 2002, and 0.06 per cent from July 2002 onwards.

interest was not a tax but an obligation accessory to a tax, and the conditions for imposing a tax and an interest need not be the same. The Minister of Finance pointed out that the financial obligations in public law, referred to in Article 113 of the Constitution, are unilateral (in the sense that the state imposes an obligation and persons have to fulfil it), whereas the contested article did not establish an obligation only to taxable persons but also to the state: the interest was also calculated for the benefit of the taxpayer, when the taxpayer had paid a greater amount of tax than was actually due. Therefore, the Minister of Finance noted, the interest on arrears cannot be regarded as a tax; otherwise, one could come to the conclusion that there are also “taxes” that the state pays to the taxpayer.

Notwithstanding the explanations offered by the legislature and the executive, the Constitutional Review Chamber of the Supreme Court decided that such a delegation was unconstitutional and that interest rates on tax arrears should be established by law and not by regulation. The Court argued that although Article 113 of the Constitution does not refer to an interest or a fine for delay, the protected area of the provision is broader and does not include only the financial obligations listed therein but “all financial obligations in public law”. The judgement stated that the purpose of Article 113 of the Constitution is to achieve a situation where “all financial obligations in public law” are established solely by the Acts passed by the *Riigikogu* (as had been outlined in the Judgement No. 3-4-1-10-2000 of the Supreme Court *en banc*, of 22 December 2000).²¹ The Court emphasised that interest on a tax as an accessory obligation to tax liability constitutes a financial obligation in public law which, pursuant to Article 113 of the Constitution, should be provided by law.²² Thus, the CRC decided that a delegation norm authorising the Minister of Finance to establish interest rates on tax arrears and the regulations issued on the basis thereof were in conflict with Article 113 of the Constitution.

This judgement provoked an extensive debate between the political institutions, involving the Court, the *Riigikogu*, the Legal Chancellor, the Tax Board, the Ministry of Finance, the Taxpayers Association, the Chamber of Commerce and tax lawyers.

²¹ The case concerned unreturnable participation fees charged from participants of an auction of land, established by a Government regulation. The Supreme Court *en banc* stated in its decision that since such fees are in essence taxes (as they are not only used for covering the costs of a specific auction), these fees should be established by law, as required by Article 113 of the Constitution. According to the Court, the sphere of protection of Article 113 is much wider than the literal interpretation would allow: the listing of state taxes, duties, fees, fines and compulsory insurance payments indicates that this provision attempts to enumerate all financial obligations of public law. Thus, the Court underlined that “all financial obligations of public law, irrespective of how these are named in different pieces of legislation are within the sphere of protection of Article 113” and this article “is aimed at achieving a situation where all financial obligations of public law are imposed by legislation adopted only by the *Riigikogu* in the form of parliamentary Acts.” In other words, the aim of Article 113 is “to allow only the legislator to restrict fundamental rights of person by imposing an obligation to pay state taxes.” The Court decided that the Government had, by establishing such a fee, exceeded the delegation norm, since the Land Reform Act had not provided for a participation fee.

²² The Court admitted that under certain conditions it would be possible to establish the minimum and maximum levels of interest on a tax by law and to delegate the right to establish a concrete interest rate to the executive (as had been pointed out in Judgement No. 3-4-1-2-98 of the Constitutional Review Chamber of the Supreme Court (from 23 March 1998)), but in the case at hand, the legislator had left the interest rate in its entirety to be imposed by the executive power.

In particular, it was discussed what the budgetary implications of the judgement would be. The costs for the budget could arise from three main sources. First, the Tax Board had to annul the precepts pertaining to charges of interest on tax arrears (accumulated between 1 January 1994 and 1 July 2002) for which there were pending court cases or for which the deadline for dispute had not yet lapsed. The Tax Board assessed the sum of annulled interests to be around 2.5 billion kroons (about 160 million euro) (Reinap 2002b).²³ Second, tax offices could not, in their *further* work, issue precepts that would charge interests on tax arrears accumulated before 1 July 2002. Third, budgetary costs could arise from future court cases where taxpayers who had already paid the interests on tax arrears would demand them back. According to the Tax Board, the sum of interests that taxpayers had paid between 1994 and 2002 was 970 million kroons (about 62 million euro) (Reinap 2002b). Different actors had different conceptions of the conditions under which persons would be entitled to demand back the paid interests. The head of the Supreme Court stated that in his opinion, the judgement of the CRC would not bring about a large number of cases claiming back the paid interest, because this had been a formal violation (Reinap 2002a). The Legal Chancellor pointed out in his opinion to the CRC that this judgement implies that only those taxpayers who had disputed the calculation and demand of interests or in regard of whose complaints a judgement of an administrative court had not yet already entered into force could demand the paid interests back (Reinap 2002c). Some tax lawyers, however, argued that the implication of this judgement was that those taxpayers who had paid the unconstitutionally stipulated interests in 1994-2002 and had contested the tax payment in the court on *some grounds* had a right to claim them back from the state (Reinap 2002c; Mereste 2003). The Tax Board conjectured, however, that those taxpayers who had already paid the interests and who had not disputed the payments had no grounds to claim them back. The worst-case scenario (suggested by some members of parliament) was that *all* taxpayers who had paid interests on tax arrears until July 2002 would have the right to demand the paid interests back.²⁴

Against the background of these discussions, the *Riigikogu* introduced a provision in the Taxation Act in December 2002, according to which interest could still be demanded from the tax arrears accumulated before 30 June 2002. The provision retrospectively stipulated the different interest rates that would be charged for different time periods in the past; these rates were the same that had been established by the Minister of Finance with his regulations.²⁵ Already during the debates on this amendment in parliament, a majority of the discussions focused on the question of whether such a provision would be constitutional. Minister of Finance Harri Õunapuu, when presenting the Act in parliament, explained that the amendment allowing the charging of interest for the tax arrears accumulated before 1 July 2002 was necessary in order to ensure equality before the law. He stated that the obligation

²³ Head of the Tax Board Aivar Sõerd noted, however, that 90 per cent of the cases were anyway hopeless, implying that the actual direct costs of the judgement would be lower than the potential costs (Reinap 2002b).

²⁴ For a discussion on the legal validity of these different possibilities, see Pilving (2002).

²⁵ That is, 0.15 per cent per day until the end of 1996, 0.07 per cent in 1997, 0.035 per cent in 1998, 0.07 per cent from the beginning of 1999 to June 2002.

to pay interest on arrears had existed since 1989, and taxpayers had never had the grounds to say that they did not have to pay the interest. He argued that if such a provision were not introduced, it would imply the declaration of tax amnesty. This position was endorsed by Chairman of the Finance Committee Meelis Atonen, who stated that if the interest on arrears were not demanded from those who had not yet paid them, it would mean that those who had paid the interests would be treated unequally. Olev Raju argued that if one were to interpret the judgement of the Supreme Court literally, it would mean bankruptcy for the Estonian state, since all the interests on tax arrears that had been paid to the state would have to be paid back. Uno Mereste also argued that the Finance Committee had found a good solution to the situation that could otherwise endanger the economy of Estonia. He pointed out that Article 113 of the Constitution is a comprehensive list, and it does not mention interest on arrears; thus, interest rates on arrears can be established with a lower-level act. (*Riigikogu* Verbatim Record, 11 December 2002)

There were, however, some MPs who warned against the implications of overriding the Supreme Court's ruling. Kalle Jürgenson noted that the judgement of the Supreme Court "is a phenomenon on its own and has put the parliament and the state on the whole in an embarrassing situation", but he emphasised that by retrospectively establishing the interest rates in the Taxation Act, the parliament would go against the decision of the Supreme Court – this would establish a dangerous precedent and undermine the principle of the balance of powers. He argued that the judgement of the Supreme Court was very unpleasant for the state, but the damage the parliament would do by overriding the decision of the Court would be even greater than the cost of the Court's judgement. Mihkel Pärnoja pointed out that the interest rate that had been charged on the basis of the regulation had meant an annual interest of 21.9 per cent, which was clearly higher than the market interest rate; thus, the arrears did have a punitive nature (rather than being just a measure of coercion) and retroactive imposition of a punishment would be problematic. (*Riigikogu* Verbatim Record, 11 December 2002) Notwithstanding these warnings, the parliament passed the amendment and stipulated the interest rates charged on tax arrears retrospectively.

Immediately, the Taxpayers Association criticised this provision. In their opinion, this amendment made the Supreme Court's decision meaningless, and by doing that, the *Riigikogu* had abused its powers, since the judgement of the Supreme Court on the constitutionality of an act should be finite. Further, the Association considered this provision to be retroactive, hence violating the most basic values of the Constitution (ETA 2002; Protocol of the meeting of the Constitutional Committee of the *Riigikogu*, 17 April 2003). Similar arguments – appealing to the principle of legal certainty and to the principle of separation of powers – were pointed out by the Chamber of Commerce. The Taxpayers Association turned to the President with the request not to promulgate the amended Taxation Act on the grounds of unconstitutionality. The President still promulgated it. In the media, both the *Riigikogu*'s amendment and the resolution of the President to promulgate it had predominantly negative repercussions. The Taxpayers Association viewed the legislative override as a tyranny of the parliament, turning the administration of justice into a "farce" (ETA 2002). The secretary general of the Taxpayers Association stated that for the Estonian

constitutional order, the actions of the parliament and the President were equivalent to “murder” (Mereste 2003).

After the promulgation of the Act, the Taxpayers Association turned to the Legal Chancellor with the plea to initiate constitutional review of the retrospective provisions introduced to the Taxation Act. Legal Chancellor Allar Jõks initiated a constitutional review procedure and argued in his plea to the *Riigikogu* that the amendment passed by the *Riigikogu* had disregarded the ruling of the Supreme Court. He stated that the provision establishing interest on tax arrears retroactively was unconstitutional: it violated the right to property (Article 32 of the Constitution) and the principle of legal certainty (expressed in Article 10 of the Constitution). He emphasised that the state cannot change the rules of the game retrospectively in a way that is disadvantageous to persons. He admitted that in extreme cases, retrospective provisions are allowed but there have to be very weighty grounds for that; since the Constitution absolutely forbids the imposition of punishments retroactively, it would be hard to find cogent enough arguments for retroactive imposition of interest. In his opinion, securing the finances of the state could certainly not be one such ground. He emphasised that if the contested provision in the Taxation Act remained, it would strongly undermine the principle of the rule of law and send a very negative signal about Estonia. (*Riigikogu* Verbatim Record, 30 April 2003) The debate that took place between the Legal Chancellor and the members of parliament at the plenary session focused on the costs of the Court’s judgement, in terms of financial costs (this time the sum mentioned was 970 million kroons, about 62 million euro) and also in terms of creating disincentives to pay taxes by treating dishonest taxpayers favourably (see questions and speeches by Männik, Opmann and Kallas). Several MPs contested the argument that the parliament had established the interests retroactively, since in essence they had existed already before (*Riigikogu* Verbatim Record, 30 April 2003). The Finance Committee and the Constitutional Committee as a whole, however, supported the plea of the Legal Chancellor, and despite many arguments to the contrary, the *Riigikogu* decided to agree with the Legal Chancellor and annulled the amendment made to the Taxation Act.

3.3. The Division of Income Tax Revenues

There has been only one case in the Constitutional Review Chamber concerning the substance of the Income Tax Act itself. The 1993 Income Tax Act stipulated that the Minister of Finance was to formulate the implementing regulation of the Act concerning the division of income tax revenues between the central government and local governments. The regulation approved by the Minister of Finance stipulated that 48 per cent of the income tax revenue would be transferred to the state budget and 52 per cent to the budgets of local governments. The Legal Chancellor initiated constitutional review and pointed out that this authority should not be delegated to the Minister of Finance. The Constitutional Review Chamber agreed with the Legal Chancellor and argued in its Judgement No. III-4/1-9/94 (of 7 December 1994) that a provision for such a division of income tax revenues between budgets of the state and local governments had no legal ground. There was no delegation norm in the Income Tax Act or other laws commissioning the Minister to decide on the division

of the revenues between state and local governments.²⁶ As a result of the Court's ruling, the division of the income tax revenues was established in the Income Tax Act itself.

3.4. The 50,000 Kroons Judgements

The two judgements passed by CRC on Value Added Tax Act in 2002 – Judgement No. 3-4-1-1-02 (of 6 March 2002) and Judgement No. 3-4-1-6-02 (of 12 June 2002) – were of relatively minor importance and did not give rise to considerable constitutional debates. Both cases concerned the question of whether the deduction of VAT should depend on whether the transaction was made in cash or not. An amendment to the VAT Act (passed on 17 November 1999 and enacted on 1 January 2000) stipulated that if the taxable value of goods or services purchased for money in Estonia exceeds 50,000 kroons (ca. 3,200 euro) per transaction, deduction was permitted in case the payment for the goods or services had been carried out in full through a credit institution either by bank transfer or a cash payment made to the bank account of the seller. In both cases, the CRC found that such interference with the freedom to engage in enterprise was not a proportionate measure for the prevention of tax fraud.

3.5. Value Added Tax and Cultural Events

The most significant constitutional debate regarding the VAT concerned the issue of the VAT rates applying to cultural events. The main controversy focused on the question of whether cultural events should be taxed with a lower VAT rate (than the usual rate of 18 per cent) and to what kind of cultural events the lower rate would apply.

According to the Value Added Tax Act adopted on 10 December 2003 and enacted on 1 May 2004, a reduced rate of value added tax (5 per cent) was to be applied to the “organisation of performances or concerts by a state, municipal or private performing arts institution or the national opera on the condition that the funds received by the organiser of the performance or concert from the state, rural municipality or city budget or the Cultural Endowment of Estonia amount to at least 10 per cent of its budget revenue for the calendar year.”²⁷ This provision was declared unconstitutional by the Constitutional Review Chamber in its Judgement No. 3-4-1-12-07 (of 29 September 2007). The ruling stated that laws should treat equally all persons who are in a similar situation but that unequal treatment of equals can be justified when there is a reasonable and appropriate ground for it. The CRC argued that although the *Riigikogu* had pursued a reasonable aim – promoting high culture – when enacting this norm, the norm was not appropriate because it failed to

²⁶ As the Court argued, this was in contradiction with Article 3 Section 1 of the Constitution, which establishes that state power shall be exercised solely on the basis of the Constitution and such laws that are in conformity with the Constitution and with Article 94 Section 2 of the Constitution, which states that the ministers shall, on the basis of the law, issue decrees.

²⁷ Similar provision also existed in the 2002 VAT Act.

achieve the desired aim. The Chamber noted that this provision in the VAT Act enables the performing arts institutions that meet the requirement of having at least 10 per cent of their financing coming from public law funds to apply the 5 per cent value added tax rate to *all* their performances and concerts, irrespective of whether these are high-culture performances and concerts or not. The Chamber was not convinced that the circle of private performing-arts institutions offering high-culture events was confined to those institutions in whose annual budgets the public funds make up at least 10 per cent. Therefore, the Chamber noted that the provision of the VAT Act provided for arbitrary discrimination and was not in conformity with the principle of equal treatment, arising from Article 12 Section 2 of the Constitution.

As a result of the Court's judgement, those organisers of performances who had paid a higher VAT rate in the time period 2005-2007 could demand back the 13 percentage points they had paid extra. The estimations of these costs for the budget reached 10 million kroons (about 640,000 euro) (Linnamäe 2007). Also, as a result of the Court's judgement, the 5 per cent rate applied to *all* performances or concerts organised by a state, municipal or private performing-arts institution – leading to a wider circle of beneficiaries from the lower VAT rate, which also implied lower revenues for the state budget.

After the Court's judgement, there were discussions in the *Riigikogu* pertaining to the application of VAT to culture. The leading party in the coalition government (the Reform Party) suggested increasing the VAT rate for all concerts and performances to 18 per cent; such an amendment to the Value Added Tax Act was adopted in December 2008 and enacted on 1 January 2009.

3.6. The Timber Case

The Judgement No. 3-4-1-5-98 of the Constitutional Review Chamber (of 17 June 1998), which became known as the “timber case”, had important implications for the interpretation of the Taxation Act and for the Estonian tax system as a whole. The case concerned a regulation of the Government of the Republic entitled “Instructions for Transactions Carried out with Timber” (adopted by the Government on 18 December 1992), and it came to the Constitutional Review Chamber through concrete review. The court case was initiated by a firm that had been required by the Tax Board to pay unpaid income tax and interests, because in deducting expenditure from income, the firm had failed to meet some of the requirements of the “Instructions for Transactions Carried out with Timber” (the “Instructions”). The Constitutional Review Chamber found that the “Instructions” were unconstitutional, since they had not been issued on the basis of a delegation norm previously provided for by the legislature; thus, it violated Article 87 sub-point 6 of the Constitution (stipulating that the Government shall issue regulations on the basis of and for the implementation of law); the Forest Act, containing the delegation norm, had only been adopted in May 1995 – that is, later in time than the pertinent regulation itself. The CRC stated that a delegation norm has to be *directed to the future*; otherwise, the principle of legal certainty would be violated. As an important corollary, the CRC noted that the Taxation Act establishes that taxpayers are required to pay *only* such state taxes as are prescribed by *law*, at the rates and pursuant to the procedure pro-

vided for in tax acts. The CRC underlined that this provision gives taxpayers the grounds to expect that their liability to pay state taxes proceeds from a tax act, and this liability may be specified on the basis of regulations issued pursuant to a tax act. As the CRC remarked, the Forest Act is not a tax act; therefore, a regulation of the Government issued pursuant to the Forest Act can not affect the tax liability of taxpayers. The Court emphasised that the system of legal acts has to be comprehensible to the addressees of the law, and it should be taken into account that the taxpayer may not be able to find a single norm affecting his or her tax liability outside the limits prescribed by a tax act.

This decision of the Constitutional Review Chamber can certainly be considered to have important implications for guaranteeing the transparency of the tax system as a whole: it purports that taxpayers can rely on the regulations pointed out by the tax acts and do not have to search for all other possible acts they might have to conform with when paying taxes. Although this principle had been established by the 1994 Taxation Act itself, it had not been strictly adhered to in practice. The Court's decision turned this provision into a focal point and facilitated the emergence of this requirement as one of the underlying constitutional principles of the tax system in Estonia.

3.7. Constitutional rulings on lower-level acts concerning taxation

There have been two further constitutional review judgements by the Constitutional Review Chamber that concern regulations implementing the income and social tax acts. With the Judgement No. 3-4-1-8-98 (of 23 November 1998), a regulation issued by the Minister of Finance was declared unconstitutional because there was no delegation norm in the Social Tax Act according to which such instructions could be issued by the Minister of Finance. The Judgement No. 3-4-1-5-2000 of the Constitutional Review Chamber (of 12 May 2000) declared a regulation issued by the Government unconstitutional because it had been based on an invalid delegation norm and the Government had exceeded the delegation norm and imposed restrictions that the delegation norm in the law had not foreseen.

4. Discussion

The development of tax laws in Estonia has, in important aspects, been influenced by the constitutional review by the Legal Chancellor, the President and the Constitutional Review Chamber of the Supreme Court. On the whole, the institutions of constitutional review have repeatedly sought to affirm and extend the rights of taxpayers.

In all ten tax cases concerning the Taxation Act or acts pertaining to income tax, social tax or value added tax, the Constitutional Review Chamber found that the tax norms (which were unfavourable to taxpayers) violated the Constitution. The constitutional review decisions of the Supreme Court have consistently steered the development of the system of tax laws towards greater clarity and transparency. In seven cases, the norms concerning taxation were declared unconstitutional because of

delegation norms: they either lacked a valid delegation norm in the law, exceeded the authority provided for in the existing delegation norm, or the authority to issue a regulation should have not been delegated to the Minister of Finance.

As a result of the decisions of the CRC, the system of rules pertaining to taxation has become more comprehensible, accessible and transparent for taxpayers. Taxpayers have the right to rely *only* on existing tax laws and regulations based on the delegation norms stipulated by these laws (with the delegation norms directed to the future and not retroactively), which follow exactly the delegation norms and do not exceed them. The Court has sought to protect taxpayers from excessive interference from the executive by declaring regulations that exceeded the delegation norms stipulated in legislative acts to be unconstitutional. In fact, for the general development of the legal system in Estonia, the CRC's judgements on taxation have been paradigmatic, since they have clarified the implications of the principle of legal certainty for a system of laws and regulations. Also, as a result of the Court's decisions, an important fiscal constitutional principle has emerged, stating that all financial obligations in public law – irrespective of what exactly they are called – have to be established by laws (that is, by the legislature and not by the executive). Thus, the institutions of constitutional review in Estonia have repeatedly sought to curtail the powers and discretion of the executive branch in taxation, and emphasised the need to establish important aspects of taxation by law (i.e., by the legislature) and not have them delegated to the executive.²⁸

In sum, the judgements of the constitutional court in Estonia corroborate Conjecture 1, outlined in section 2, postulating that constitutional courts in transition countries will favour taxpayers in their decisions.²⁹ Furthermore, most of the CRC's decisions pertaining to taxation have imposed budgetary costs on the state. Budgetary implications were especially clear for the interest-rates case of 2002 and the value added-tax case of 2007. The willingness of the Constitutional Review Chamber to adopt decisions that impose budgetary costs corroborates Conjecture 2 suggesting that constitutional courts in transition countries are willing to adopt decisions that bring about high budgetary costs. Conversely, the readiness of the CRC to impose significant budgetary costs appears to go against Conjectures 3 and 4, and also the hypotheses proposed by Vanberg (2005), Epstein, Knight and Shvetsova (2001) and Hansford and Damore (2000), which stated that a constitutional court would be unwilling to go against the preferences of the other branches and pass judgements with significant budgetary costs. In other words, the constitutional court in Estonia has not been as "constrained" by other political branches as one would expect on the basis of strategic interaction models. Also, the judgements of the Estonian CRC offer contrary evidence to the proposition of Epstein, Knight and Shvetsova (2001), according to which constitutional courts in CEE countries would be deferential to the parliamentary preferences in judgements that concern institutional prerogatives of

²⁸ For an analysis of how constitutional review and constitutional debates have shaped the organic budget law in Estonia, see Raudla (2011). The evolution of the roles of the executive and the legislature in the budget process in general has been discussed in Raudla (2010c).

²⁹ As pointed out by one of the reviewers, it can also be argued that at least in some of the tax cases, it would have been impossible for the court to decide otherwise, since it would have not been able to legally motivate such decisions.

the other branches. In the interest-rates case, for example, the CRC decided that the legislature cannot delegate its institutional prerogative to establish financial obligations in public law to the executive, even if the legislature itself wanted that. Indeed, in the Estonian case, the Court's need to build up public support (by favouring taxpayers) and the aspiration to appear as a neutral arbiter dominated over the considerations of fiscal constraints and over the goal to secure the support of other branches of government.

Maveety and Grosskopf (2004) demonstrated in their case study on the development of minority linguistic rights in Estonia that the Constitutional Court has acted as a "conduit" in translating international norms to domestic legislation, despite the initial reluctance of the national legislature. They also consider it counter-evidence to the "constrained court" conception of constitutional review, dominant in the comparative-courts literature. The judgements of the CRC on tax cases point to the same direction and demonstrate that the Estonian constitutional court has not been significantly "constrained" in its decisions. Furthermore, the constitutional tax judgements, outlined in the previous section, even show that the CRC has been able to exert its will even in the absence of explicit external constraints like international agreements or supranational pressures on domestic actors, thus providing even stronger counter-evidence to the conception of constitutional courts as "constrained" actors.

In light of the repeatedly demonstrated readiness to issue rulings with impacts on the budget, it is interesting that the CRC itself has voiced reservations about the Court's role in budgetary policies and did, in Judgement No. 3-4-1-7-03 (of 21 January 2004), call for self-restraint in that regard. The case concerned social assistance, and the CRC had to decide whether the legislature had unconstitutionally constrained the circle of persons who qualify for social assistance (by linking the grant of subsistence benefits to cover living costs to particular kinds of dwellings, excluding, for example, student hostels). Although the Court declared such constraints unconstitutional, it noted in its decision that "A court of constitutional review must avoid a situation where the development of budgetary policies goes, to a large extent, into the hands of court. That is why in implementing social policies the court cannot replace the legislative or executive powers."

With regard to the reactions of the legislature to the constitutional judgements, in nine decisions out of ten, there was no attempt by the legislature to override the Court's decisions or to contest the decisions in public discussion, offering corroboration for Conjecture 6, suggesting that in the context of transition, the legislatures would be deferential to the court's decisions in cases that favour taxpayers' rights. For example in the case of the first constitutional dispute on the organic tax law between the parliament and the Constitutional Court in 1993, the parliament was pragmatic: despite possible financial implications of the CRC's judgement, the legislators were willing to go ahead with the changes considered necessary by the CRC without longer discussions, because of the need to have the amended Taxation Act passed as fast as possible. The debates in the *Riigikogu* hinted at a kind of a "cost-benefit" analysis of following the ruling of the court, which indicated that the benefits of parliamentary override (more gambling tax revenues) would not be outweighed by the costs of another court dispute. In the value added-tax case of cul-

tural events, the parliament did not attempt to override the Court's decision; in principle, it could have done so by re-introducing the provision that had been struck down by the court.³⁰

Only on one occasion – after the interest-rates decision – did the *Riigikogu* choose to go against the decisions of the Constitutional Court. In the “interest rates” case, the costs of the Court's judgement became the main focus of the parliamentary reaction, and the potential budgetary implications emerged as the main argument to justify the override of the Court's ruling. This provides corroboration for Conjecture 5 – at first sight – but taking into account the fact that the *Riigikogu* itself annulled the override, offers contrary evidence to that. Taking this risk was especially noteworthy given that the judgement was passed just some months before general elections. On the other hand, one should take into account that this decision was made on the very day the parliament adopted the state budget for the year 2003, and this was the first budget of the independent period with a planned (prospective) deficit. This indicates that in some cases, the possible public backlash for ignoring the court's decision can be outweighed by budgetary considerations, and these considerations can be especially weighty when the legislature is faced with a budget deficit.

The interest-rates case and the legislative reaction to it provides a very clear illustration of the competing pressures that a legislature is subject to when deciding how to react to a court's decision that has high budgetary costs. On the one hand, saving budgetary costs make an override more attractive; at the same time, the expected negative public backlash following an override makes it a less attractive choice for the legislature. As the interest-rates case shows, the legislature can be so split between these two forces that it can choose to override first and then annul the override. Further, the interest-rates case illuminates the importance of intermediary institutions of constitutional review – like that of the Legal Chancellor – in facilitating the “cooling down” of the legislative bravado and offering a window of opportunity for reconsideration. As the Estonian case exemplifies, whether the legislature chooses to override the Constitutional Court's decision and stick to that override, clearly depends on the symbolic role attached to the override. The Legal Chancellor and the involved interest groups viewed the override as a paradigmatic case, violating the rule of law and the balance of powers, and they managed to make these arguments dominant in the constitutional discourse that followed the override. In other words, the parliamentary override was clearly dramatised in the public discourse: it was viewed as undermining the constitutional order and sending abroad a negative signal about Estonia; this, in turn, led to the annulment of the override. In further models concerning the parliament's reaction, the interactions between the considerations of the budgetary costs and negative public backlash following an override should be spelled out more clearly, with the understanding that idiosyncratic features of a country can play an important role.³¹

³⁰ Still, one has to note that the costs of this judgement were mitigated by an amendment made to the VAT Act that abolished the preferential value added tax rate for cultural events, enacted in January 2009.

³¹ In Hungary, for example, the legislature deferred to the constitutional court in the “Bokros package” case, where the decision of the court imposed substantial costs to the budget (Boulanger 2006).

5. Final remarks

In sum, the Estonian case demonstrates that a constitutional court in a transition country has been willing to go ahead with “costly” constitutional judgements when protecting the rights of taxpayers, which provides counterevidence to the models developed in the literature concerning the interactive and strategic relations between constitutional courts and legislators. Based on the existing models brought out in the literature on constitutional politics, one would have expected the constitutional court to be more deferential to other branches of government in cases that imply extensive costs to the public budget.

When comparing the Estonian constitutional court with other transition countries, it appears that the willingness of the CRC to impose budgetary costs is by no means unique. As Sadurski (2002, 4) has noted, some of the decisions of the constitutional courts in CEE countries “have had enormous budgetary implications.” This is indeed noteworthy, given that one would expect more self-restraint by constitutional courts, with regard to the “costliness” of its decisions, in countries that face rather stringent budgetary constraints, as has been the case in most CEE countries during transition. The readiness of the constitutional courts in CEE to go repeatedly against the prevailing majority preferences in the legislatures by adopting “costly” decisions hence appears to go against a hypothesis put forth by Vanberg (2005). Indeed, in the transitional context, where young constitutional courts have to build up their reputation and garner political capital in the form of public support, the strategy of visible deference to other government branches may backfire. As Bond (2006) has demonstrated with the case studies of Hungarian and Polish constitutional courts, it was *not* through the decisions where these courts deferred to other branches (or refrained from adjudicating controversial cases) that they built up the diffuse support. Rather, as Bond (2006, 18) notes, it was “precisely in their moments of well-calculated boldness that they achieved the most.” Indeed, when the courts were too deferential, they were seen as “bow[ing] to political expedience at the expense of constitutional coherence” (Brzezinski 2000, 175). It also seems that those CEE constitutional courts that have been willing to adopt “costly decisions” (e.g. in Hungary, Poland, Slovenia and Estonia) are also the ones that have garnered “deep legitimacy among the public” and have become “permanent features of the new political landscape” (Scheppelle 2003, 221, drawing on Schwartz 2000).³²

The Estonian case study also indicates that a constitutional court’s readiness to issue rulings that impose budgetary costs should be viewed in a dynamic perspective: if the legislature continuously defers to the constitutional court’s costly decisions

³² There is little evidence that the CRC in Estonia and constitutional courts in CEE would attempt to systematically estimate the financial implications of their decisions. This stands in stark contrast to the practice of constitutional courts in some Western European countries. Rolla and Groppi (2002, 157), for example, have referred to the practice of the Italian Constitutional Court to issue evidence-gathering orders about the costs of possible judgements that strike down laws; it has even created a specific office with the purpose to quantify the financial burdens of the constitutional review decisions before they are adopted. Further, in order to avoid the creation of budgetary burdens with its decisions, the Constitutional Court in Italy has sought to develop innovative decision techniques, which, while aiming at the recognition of rights, leave it up to the legislature to choose the means for implementing them and to decide on the necessary budgetary appropriations.

over time, the court also becomes more willing to adopt costly decisions. Hence, one can conjecture that the court, when deciding whether to issue a costly ruling or not, will take into account how many times the legislature has recently overridden the costly decisions of the court. The Estonian case illustrates this dynamic very well. The legislature had until 2002 always deferred to the decisions of the Constitutional Court, and the Court became continuously more inclined to adopt costly decisions. After the legislature had been forced into reversing the override, the Constitutional Review Chamber demonstrated continued (and even increased) willingness to pass costly rulings (e.g. the 2007 VAT decision), since the “finality” of the constitutional court’s decisions was even more firmly established after the retreat of the *Riigikogu* in the interest-rates case. Indeed, a major implication of the constitutional discourse that emerged after the override (in the interest-rates case) in 2002-2003 and led to the annulment of the override is that it certainly makes it more difficult for the parliament to override the Court’s ruling in the future because of the established “precedent” (by the parliament itself) that the parliament has to defer to the court if the constitutional order is to be protected, even if it brings about significant budgetary costs. This, in turn, can make the Constitutional Court more willing to impose costs on the parliament in the future. Thus, although Vanberg (2005) presents the models regarding the interaction between the court and the legislature as equilibrium, it might be more fruitful – especially in a transitional context – to take a more evolutionary viewpoint and account for possibilities of path dependencies that paradigmatic constitutional disputes (amounting to “critical junctures” on the path) can create.

With regard to the legislature’s reactions to costly constitutional rulings, the Estonian parliament has in most cases deferred to the Constitutional Review Chamber. At the same time, as the interest-rates case shows, the legislature can indeed be subject to competing pressures, especially when the constitutional ruling implies extensive costs for the budget. In addition, the interest-rates case points to the balancing role of the Legal Chancellor, who brought about an important “cooling down” effect, allowing additional consideration of whether going against the Court’s decision and possibly violating the rule of law would be worthwhile and whether this would be justified by the costs that could be saved by overriding the Court’s decision. Thus, further models of interactions between the legislature and the constitutional court should take note of such additional veto points in the constitutional system that could have dampening effects on the determination of the legislature to evade the court’s decision.

As there is still little systematic evidence on the differences between the constitutional courts in Europe with regard to their readiness to impose budgetary costs, further comparative studies on the willingness of constitutional courts in Western and Eastern Europe to pass costly judgements would certainly constitute a fruitful avenue of research for understanding better the incentives of the constitutional courts and the strategies they adopt in different contexts.³³ One aspect such a comparative analysis should look into is the question of whether the constitutional courts in CEE countries

³³ Useful insights could also be gained by comparing the constitutional courts in CEE with those in Latin America. Eslava (2006) has argued that constitutional courts in Latin-America have played an increasing role in fiscal policies.

are indeed more able and willing to pass costly constitutional judgements than their Western counterparts (as could be conjectured on the basis of anecdotal evidence). If the constitutional courts' strategies in different types of countries are indeed found to diverge, one should also inquire whether the reasons for that lie in different political norms (i.e., the unwritten rules governing the political arena). It can be conjectured that through an evolutionary process of continued interaction between the legislature and the constitutional court, an unwritten consensus may emerge, to the effect that budgetary issues do not belong to the realm of the constitutional court and it should therefore exercise self-restraint in that regard. Also, it would be interesting to investigate whether the willingness of the constitutional courts to impose budgetary costs changes over time: whether it is larger in the early phase of transition compared with the later phases, and whether the willingness has changed in response to the legislature's reactions to the previous decisions. Another element the comparative model should entail is the question of how the budgetary situation of the country (balance, surplus and deficit) influences the willingness of the constitutional court to pass rulings with costly budgetary implications.

ACKNOWLEDGMENTS

Research for this article was carried out with the financial support of the Mobilitas Grant of the European Social Fund (no. MJD43) and the Estonian target financing grant (no. SF0140094s08). The author is grateful to Jürgen Backhaus, Helge Peukert, Enrico Schöbel, Wolfgang Drechsler and the reviewers of the paper for useful comments on earlier versions of this paper. The author would also like to thank the participants of the conference on "Law & Economics Analysis in Governance", organised by the journal *Halduskultuur – Administrative Culture* and the Department of Public Administration of Tallinn University of Technology on 23-24 April 2010 in Tallinn, for a fruitful discussion on the paper. This article is also a revised version of chapter 10 of the author's doctoral dissertation, *Constitution, Public Finance, and Transition* (Frankfurt am Main: Peter Lang, 2010).

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