Constitutional judgment 3-4-1-8-09

JUDGMENT
OF THE SUPREME COURT EN BANC

No. of the case	3-4-1-8-09
Date of judgment	16 March 2010
Composition of court	Chairman Märt Rask, members Tõnu Anton, Jüri Ilvest, Peeter Jerofejev, Henn Jõks, Ott Järvesaar, Eerik Kergandberg, Hannes Kiris, Lea Kivi, Indrek Koolmeister, Ants Kull, Villu Kõve, Lea Laarmaa, Jaak Luik, Priit Pikamäe, Jüri Põld and Harri Salmann

Court Case	Request of the Tallinn City Council to declare the following unconstitutional and invalid: 1) § 16 of the 2009 Supplementary Budget Act and Related Acts Amendment Act and subsection 16 (3) of the Roads Act amended by it; 2) subsection 17 (1) of the Supplementary Budget Act and clause 5 (1) 1) of the Income Tax Act amended by it; 3) subsections 19 (2) and (3) of the Supplementary Budget Act and §§ 12^2 and 31^3 of the Occupational Health and Safety Act established by them; 4) subsections 20 (3) and (4) of the Supplementary Budget Act and §§ 8^1 and 28^1 of the Rural Municipality and City Budgets Act established by them; 5) subsection 16 (4) of Regulation No. 49 of the Government of the Republic of 5 March 2009 "Division and Scope, Conditions and Procedure of Division of Budget Equalisation Fund Allocations of Local Authorities in the 2009 State Budget Act"; 6) Regulation No. 50 of the Government of the Republic of 5 March 2009 "Detailed List of Obligations Assumed by Local Authority and Entities Dependent on Local Authority, Conditions and Procedure for Submission of Requests for Approval of Assumption of Obligations and Evaluation of Request and Procedure for Refunding Suspended Funds".
Basis of proceeding in the Supreme Court	Petition of the Tallinn City Council of 2 April 2009
Date of hearing	22 September 2009
Persons participating in the hearing	Väino Linde (Chairman of the Constitutional Committee of the Riigikogu), Janek Laidvee (Adviser/Head of Secretariat of the Constitutional Committee), Ulrika Eesmaa (representative of the Minister of Justice), Indrek Teder (Chancellor of Justice), Ave Henberg (Adviser to the Chancellor of Justice), Tiit Rebane and Sulev Liivik (representatives of the Minister of Finance), and representatives of the Tallinn City Council in the person of Aivar Pilv (sworn advocate), Merit Helm (sworn advocate) and Priit Lello (Legal Director of the City of Tallinn).

DECISION

1. To declare unconstitutional the failure to adopt such legislation of general application, which:
1) would stipulate what obligations imposed on local authorities by law are of a local character and what are of a national character;
2) would distinguish between the funds allocated to local authorities for deciding on and organising local issues from the funds allocated for performance of national obligations and provide for funding of the national obligations imposed on local authorities by law out of the state budget.

2. To reject the petition of the Tallinn City Council to declare the following invalid:
1) § 16 of the 2009 Supplementary Budget Act and Related Acts Amendment Act and subsection 16 (3) of the Roads Act amended by it;
2) subsection 17 (1) of the Supplementary Budget Act and clause 5 (1) 1) of the Income Tax Act amended by it;
3) subsections 19 (2) and (3) of the Supplementary Budget Act and §§ 12^2 and 31^3 Occupational Health and Safety Act established by them;
4) subsections 20 (3) and (4) of the Supplementary Budget Act and §§ 8^1 and 28^1 of the Rural Municipality and City Budgets Act established by them;
5) subsection 16 (4) of Regulation No. 49 of the Government of the Republic of 5 March 2009 “Division and Scope, Conditions and Procedure of Division of Budget Equalisation Fund Allocations of Local Authorities in the 2009 State Budget Act”;
6) Regulation No. 50 of the Government of the Republic of 5 March 2009 “Detailed List of Obligations Assumed by Local Authority and Entities Dependent on Local Authority, Conditions and Procedure for Submission of Requests for Approval of Assumption of Obligations and Evaluation of Request and Procedure for Refunding Suspended Funds”.

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(A) Sections 8^1 and 28^1 and the right to assume debt obligations
(B) Subsections 8^1 and 28^1 of the RMCBA and the right to the stability of the system of funding local government functions
(C) Constitutionality of assumption of obligations
(VIII) Constitutionality of subsection 16 (4) of the BEF Regulation

FACTS AND COURSE OF PROCEEDING

1. On 20 February 2009 the Riigikogu passed the 2009 Supplementary Budget Act and Related Acts Amendment Act (RT I 2009, 15, 93) that entered into force on 1 March 2009.

2. On 5 March 2009 the Government of the Republic adopted Regulation No. 49 "Division and Scope, Conditions and Procedure of Division of Budget Equalisation Fund Allocations of Local Authorities in the 2009 State Budget Act" and Regulation No. 50 "Detailed List of Obligations Assumed by Local Authority and Entities Dependent on Local Authority, Conditions and Procedure for Submission of Requests for Approval of Assumption of Obligations and Evaluation of Request and Procedure for Refunding Suspended Funds".

3. By Decision No. 61 of 2 April 2009 the Tallinn City Council decided to file with the Supreme Court the petition to declare:
a) § 16 of the 2009 Supplementary Budget Act and Related Acts Amendment Act (the Supplementary Budget Act) and subsection 16 (3) of the Roads Act (entered into force on 1 March 2009; provision amending subsection 16 (3) of the RA) amended by it invalid;
b) subsection 17 (1) of the Supplementary Budget Act and clause 5 (1) 1) of the Income Tax Act (entered into force on 1 April 2009; provision amending clause 5 (1) 1) of the ITA) amended by it unconstitutional;
c) subsections 19 (2) and (3) of the Supplementary Budget Act and §§ 12^2 and 31^3 of the Occupational Health and Safety Act (entered into force 1 July 2009; §§ 12^2 and 31^3 of the OHSA) established by them unconstitutional;
d) subsections 20 (3) and (4) of the Supplementary Budget Act and §§ 8^1 and 28^1 of the Rural Municipality and City Budgets Act (entered into force on 1 March 2009; §§ 8^1 and 28^1 of the RMCBA) established by them invalid;
e) subsection 16 (4) of Regulation No. 49 of the Government of the Republic of 5 March 2009 "Division and Scope, Conditions and Procedure of Division of Budget Equalisation Fund Allocations of Local Authorities in the 2009 State Budget Act" (entered into force on 13 March 2009; the BEF Regulation) invalid;
f) Regulation No. 50 of the Government of the Republic of 5 March 2009 "Detailed List of Obligations Assumed by Local Authority and Entities Dependent on Local Authority, Conditions and Procedure for Submission of Requests for Approval of Assumption of Obligations and Evaluation of Request and Procedure for Refunding Suspended Funds" (entered into force on 13 March 2009; the AO Regulation) invalid.
The petition reached the Supreme Court on 7 April 2009.

4. The Constitutional Review Chamber of the Supreme Court discussed the petition of the Tallinn City Council in its session on 26 May 2009. By a ruling of 26 June 2009 the Constitutional Review Chamber referred the matter to the Supreme Court *en banc*. The Supreme Court*en banc* discussed the petition of the Tallinn City Council on 22 September 2009.

OPINIONS OF THE PARTICIPANTS IN THE PROCEEDING

5. The Tallinn City Council finds that the petition is admissible, because it has been submitted for the purpose of protecting the constitutional guarantees of local authorities and prejudice of these guarantees is possible in the case of the challenged provisions.

Amendments of the Income Tax Act, Roads Act and Occupational Health and Safety Act prejudice the petitioner's financial guarantee, above all, because the state does not allocate enough money to the local authority for performance of its functions and has not reduced the scope of obligations in proportion to the expenditure cut. The amendments to the Rural Municipality and City Budgets Act and the AO Regulation

that transfer the authorisation to decide over the expedience of using funds to the central power and the BEF Regulation that limits the petitioner's rights secured by the Social Welfare Act (SWA) prejudice the petitioner's financial autonomy.

Thus, prejudice of the guarantees of local authorities arising from §§ 154, 157 and 160 of the Constitution is possible.
In the court session the Tallinn City Council noted regarding the admissibility of the petition with regard to the Occupational Health and Safety Act that although the challenged provisions of the act are equally aimed at all people, they exert additional pressure on the budgets of local authorities and therefore local authorities have the right to challenge the provision.

6. According to the Tallinn City Council, the entire Supplementary Budget Act is in conflict with subsection 3 (1), § 10, subsection 115 (1), subsection 116 (2) and § 154 of the Constitution.

The Supplementary Budget Act is in conflict with subsections 115 (1) and 116 (2) of the Constitution. According to subsection 115 (1) of the Constitution, a state budget act can only contain all the expenditure and revenue accounts of the state, not regulate generation of income or incurring of expenses. Nevertheless, the Riigikogu passed the Supplementary Budget Act along with "the Related Acts Amendment Act", amending 20 acts in total. The petitioner admits that it is possible to amend other legislation in connection with the supplementary budget, but these amendments must be made to acts before passing the supplementary budget and only thereafter can the forecast revenue and expenditure be entered into the state budget on the basis of the amended acts. It has been provided for in subsection 116 (2) of the Constitution that the Riigikogu shall not eliminate or reduce expenditure in the state budget or in its draft which is prescribed by other acts. With the State Budget Act revenue and expenditure can be set only within the limits set by the acts in force at the time of passing the State Budget Act. Based on the aforementioned the said act is also in conflict with subsection 3 (1) of the Constitution, according to which the powers of state shall be exercised solely pursuant to the Constitution and acts that are in conformity therewith.

The Tallinn City Council finds that the period of one month that was left between passing the supplementary budget and the entry into force of the acts related to it is not reasonable for the petitioner to be able to make the required rearrangements. According to § 154 of the Constitution, the rules of funding local authorities have to be so stable as to comply with the principle of legal certainty. A disproportionately short period of time for adaptation to the new regulation violates the principle of legal certainty.

7. The provision amending clause 5 (1) 1) of the ITA is, according to the Tallinn City Council, in conflict with subsection 3 (1), §§ 10, 12 and 14, subsection 116 (2) and §§ 154 and 157 of the Constitution.
The amendments to the Income Tax Act that entered into force on 1 April 2009 the portion of personal income tax allocated to local authorities was reduced from 11.93% to 11.4%. Thus, in the middle of the budgetary year of 2009 the most important and largest source of income of local authorities was reduced by 53 percentage points, i.e. by 300,000,000 kroons, according to the explanatory memorandum of the draft act.

The petitioner finds that reduction of the income tax portion allocated to local authorities is in conflict with the principles of legal certainty, financial system stability and sufficient funding stipulated in §§ 10, 154 and 157 of the Constitution in their combined effect.

The state has treacherously increased its revenue at the expense of local authorities, violating the agreement made between local authorities and the state at the end of 2008 regarding the increase of the income tax portion accruing to local authorities. According to the agreement, the income tax portion was increased in order to compensate for the transfer of default interest on overdue income tax and land tax to the state budget as of 1 January 2009.

In order to compensate for the decrease of the revenue of local authorities the obligations imposed on local authorities under the Preschool Child Care Institutions Act (PCCIA), Youth Work Act (YWA) and Sports Act (SA) were cut (see §§ 8, 9 and 15 of the Supplementary Budget Act). The Tallinn City Council finds

that these amendments are in conflict with the constitutional obligations of preserving the Estonian nationality and culture and safeguarding persons' fundamental and social rights. These amendments are also in conflict with § 154, the first sentence of subsection 3 (1) and subsection 116 (2) of the Constitution. Furthermore, these amendments are in conflict with § 7 of the RMCBA, because they do not strike a balance between the funds allocated to local authorities and the obligations imposed on them. There is a principle that if after passing the state budget any legislation reducing the budget revenue is adopted, the obligations imposed upon the local authority will be reduced or, if the obligations are not reduced, full funding of the obligations must be ensured, but this principle has not been followed.

Due to the amendment of the Preschool Child Care Institutions Act local authorities are as of 1 April 2009 obligated to admit to nursery schools all children aged 18 months to seven years instead of the former 12 months to seven years. According to the petitioner, the amendment may have an impact only on the length of nursery school waiting lists, but it does not serve to reduce the administrative expenses of nursery schools. Also, it is not possible to stop providing preschool education to children who are receiving it at the time the amendment enters into force, but remain below the new age limit.

By amendment of the Youth Work Act and Sports Act local authorities are given the right to support these areas based on what they can afford with their budget. These areas were supported based on what local authorities could afford with their budget also before, because former legislation did not set any maximum or minimum levels for these areas. Thus, the amendment of the Sports Act and the Youth Work Act do not bring about any consequences that would change the current situation.

In addition, the petitioner finds that in reducing the revenue base of local authorities the state is not solidary with local authorities. First, it must be taken into account that the combined impact of economic recession and legislative amendments will double the negative pressure on the revenue base of local authorities. Also, it must be taken into account that against the background of the overall decline of revenue the increase of the state's revenue at the expense of local authorities directly harms the interests of the inhabitants of the local authorities, because the availability of the public services provided via the tax revenue and their quality will fall. Therefore, reducing the portion of personal income tax in combination with §§ 12 and 154 of the Constitution is in conflict with the welfare state principle contained in the Preamble and § 10 of the Constitution.

8. In the opinion of the Tallinn City Council the provision amending subsection 16 (3) of the Roads Act is in conflict with § 154 of the Constitution, articles 9 (1) and (2) of the European Charter of Local Self-Government (RT II 1994, 26, 95; the Charter) and § 7 of the RMCBA.

According to the provision amending subsection 16 (3) of the RA, the division of funds for management of national roads and local roads for each budgetary year is specified in the state budget. The second sentence of subsection 16 (3) in force until 1 March 2009 stated that the total amount of expenditure prescribed by the state budget for financing of road management shall be equal to no less than 10 percent of the proceeds planned from fuel excise duty at the rate specified in subsection 16 (2) of the RA.

According to subsection 25 (3) of the RA, rural municipality and city governments shall organise the management of local roads and are required to create the conditions for safe traffic on such roads. By the supplementary budget the total amount of funds allocated for management of local roads was reduced below the level of 10% of the road management funds based on the justification that the state budget revenue is insufficient for payment of support to local roads in the said amount. However, the amount of the obligations of local authorities was not changed, as required by the combination of § 7 of the RMCBA, articles 9 (1) and (2) of the Charter and subsection 154 (2) of the Constitution.

9. According to the Tallinn City Council, §§ 12^2 and 31^3 of the OHSA are in conflict with § 10, subsection 116 (2) and § 154 of the Constitution.

According to § 12^2 of the OHSA, the employer must pay the employee compensation from the fourth to the

eight day of an illness or injury at the rate of 80% of the average wage of the employee. According to § 31^3 of the OHSA, the obligation is applicable to certificates for sick leave where the release from employment or service duties starts on 1 July 2009 or later. The amendment results in considerable expenses for the petitioner as well as employers.

The Occupational Health and Safety Act was amended after approval of the budgets of local authorities and therefore the liabilities of the City of Tallinn will increase in 2009 by the amount of sickness benefits payable to employees. However, by the legislative amendments the state has failed to provide local authorities with funds for covering the related expenses, thus breaching § 154 of the Constitution, article 9 (1) and (2) of the Charter and subsection 7 (1) of the RMCBA.

Since the obligation to pay sickness benefits is a new expense arising from an act, which the employer, i.e. the City of Tallinn, has to cover, the state is in breach of subsection 116 (2) of the Constitution. The state budget is not accompanied by sources of revenue covering the expenditure or calculations of revenue, thus also violating subsection 116 (1) of the Constitution.

10. The Tallinn City Council argues that §§ 8^1 and 28^1 of the RMCBA are in conflict with §§ 10, 11, 13, 154 and 160 of the Constitution.

Section 8^1 of the RMCBA that entered into force on March 1 imposed credit restrictions on local authorities in a situation where the Gross Domestic Product (GDP) has fallen for two consecutive quarters. Furthermore, local authorities were ordered to seek the approval of the Ministry of Finance with regard to assumption of their debt obligations. According to § 28^1 of the RMCBA, the restrictions remain in force until the end of 2011.

The petitioner argues that binding local authorities' right of assuming obligations to the GDP is not sufficiently clear in legal terms to ensure that local authorities understand unambiguously whether they have the right to use other sources of financing for performance of the functions imposed on them by the state and organisation of local affairs. Since the GDP is related to the state's overall economic development, it could change each quarter.

The restrictions are not suitable, necessary or proportional for ensuring macroeconomic stability and controlling the budgetary position of general government. Establishment of a single restriction on all local authorities is also disproportionate due to the fact that it does not take into account the local authorities' actual financial status, revenue base size, existing obligations and the ability to perform them. Contrary to what has been stated in the explanatory memorandum of the Supplementary Budget Act, the restrictions will not prevent local authorities' financial difficulties, but may cause them instead. Due to these restrictions local authorities cannot take cash loans for compensating any imbalances between revenue and expenditure.

The explanatory memorandum of the State Budget Act mentions fulfilment of the European Union's so-called Maastricht criteria as one of the aims of the restrictions established for the purpose of introducing the euro as soon as possible. The petitioner finds that the state's interest in introducing the euro is not a constitutional value and as such it cannot outweigh the principle of autonomy of local authorities provided by the Constitution or the fundamental breach of the institutional guarantee.

The petitioner finds that based on the decentralisation principles arising from subsection 154 (1) of the Constitution and from the Charter the legislature cannot ignore the local democracy and subject the activities of local authorities to the central power of the state in matters falling within the competence of local authorities. The obligation to seek the approval of the Ministry of Finance regarding debt obligations thus prejudices the right of autonomous decision-making regarding local issues and such prejudice is also disproportionate.

11. According to the Tallinn City Council, the AO Regulation issued on the basis of subsections 8^1 (2) and (7) of the RMCBA is also in conflict with §§ 10 and 154 of the Constitution.

The AO Regulation is in conflict with the Constitution first of all because it has been issued on the basis of a provision delegating authority, which is unconstitutional for the reasons described in the previous point.

However, this regulation is in conflict with the constitutional guarantees of local authorities regardless of the constitutionality of § 8^1 of the RMCBA. Section 2 of the regulation which details the substance of the obligations specified in subsection 8^1 (1) of the RMCBA stipulates that a local authority must seek the approval of the Ministry of Finance with regard to virtually each and every long-term borrowing, which requires making monetary payments for performance of the obligation in the future. According to the Tallinn City Council, such restriction of the decision-making right of local authorities is more extensive compared to § 81 of the RMCBA and as such it is also disproportionate and in breach of the principle of the autonomy of local self-government arising from § 154 of the Constitution.

12. The Tallinn City Council argues that subsection 16 (4) of the BEF Regulation is in part in conflict with subsections 3 (1), 87 (6) and 154 (2) of the Constitution.

The petitioner has contested subsection 16 (4) of the BEF Regulation to the extent that it establishes the prerequisite that the unused subsistence benefits of previous years be exhausted in order to be eligible for allocation of additional funds for subsistence benefits. At the same time subsection 42 (4) of the SWA allows a local authority to use unused subsistence benefits on the conditions and pursuant to the procedure determined by the local authority. Establishment of an additional condition for payment of subsistence benefits in the BEF Regulation regarding allocation of additional funds is in conflict with subsections 87 (6) and 3 (1) of the Constitution due to the absence of a provision delegating authority.

Since the BEF Regulation must be implemented *ex tunc* as of 1 January 2009 (§ 21 of the regulation), subsection 16 (4) of the regulation violates the city's budget stability requirement. The petitioner has expected that it can use the unused subsistence benefits of previous years for payment of other social benefits. The new regulation has substantively imposed on it the obligation to pay the state's social benefits out of its own funds, which is in conflict with subsection 154 (2) of the Constitution.

13. The Constitutional Committee of the Riigikogu argues that the petition of the Tallinn City Council is inadmissible with regard to declaring the provision amending subsection 16 (3) of the RA and §§ 12^2 and 31^3 of the OHSA invalid, because the given provisions do not prejudice the constitutional guarantees of local authorities.

The provision amending subsection 16 (3) of the RA is neutral and does not result in an automatic decrease of the budgetary allocations of local authorities. Furthermore, no subjective right to a fixed share of the accrual of the state tax arises from the constitutional guarantees of local authorities. Sections 12^2 and 31^3 of the OHSA also concern other employers besides local authorities. The Constitutional Committee argues that it is important whether the financing system as a whole provides local authorities with sufficient funds.

The petition is admissible with regard to declaring invalid the provision amending clause 5 (1) 1) of the ITA and §§ 8^1 and 28^1 of the RMCBA as well as the AO Regulation and subsection 16 (4) of the BEF Regulation.

14. According to the Constitutional Committee, the reduction of income tax allocations is not in conflict with the principles of legal certainty or stability of the system of financing local authorities, because they do not give local authorities any constitutional immunity against reduction of their revenue base in any situation whatsoever. The financial crisis and the resulting decrease in budgetary funds is a sufficiently good reason for prejudicing the stability of the financing system. The residents of the state and of a local authority cannot be put on the opposite sides by arguing that the state performs "its" functions at the expense of local authorities. Furthermore, the Constitution does not establish any specific proportion for division of revenue between the state and local authorities, the legislature being competent to amend these proportions where necessary.

Upon reviewing the constitutionality of the RMCBA, the Constitutional Committee refers to its opinion submitted in constitutional review Case No. 3-4-1-7-09 discussed in the Supreme Court (petition of the Narva City Council to declare § 81 of the RMCBA invalid). According to the opinion, the restrictions to assumption of obligations are intense, but they are justified by a weighty economic policy goal of fulfilling the criteria required for joining the euro area. The verification of expediency provided for in subsections 81 (2) to (5) of the RMCBA may be in conflict with the requirements of the Charter and the supervision provisions of the Constitution, but upon evaluating it account must be taken of the fact that the autonomy of local authorities is not absolute.

Upon adopting the BEF Regulation the Government of the Republic has not exceeded the provision delegating authority arising from subsection 42 (6) of the SWA, because the regulation regulates a situation where a local authorities applies for additional funds for payment of subsistence benefits. Subsection 42 (4) of the SWA does not give local authorities the subjective right to prescribe the benefits specified in the provision in any event, but only when there are budgetary funds for that purpose.

The Supplementary Budget Act is not unconstitutional as a whole. The Constitution does recognise the Supplementary Budget Act as a separate act, but subsection 115 (1) of the Constitution does not in principle preclude amended of other legislation of general application by the same act. The purpose of 116 (2) of the Constitution is not to preclude switching effective act amendment acts to the draft State Budget Act where they are necessary for implementation of the State Budget Act. It contains the principle that a budget act or a draft thereof must not ignore the expenses that have been prescribed under other acts.

15. In a letter appended to the opinion of the Constitutional Committee of the Riigikogu the Finance Committee of the Riigikogu finds that the petition of the Tallinn City Council must be rejected.

The specific characteristics of the proceedings and the time of entry into force of the supplementary budget arose from considerable deterioration of the state’s economic situation sparked by the global financial crisis. In previous years the state has balanced the budget deficit of local authorities. During the economic recession the accrual of state revenue has decreased rapidly and more than the revenue of local authorities. Upon making the legislative amendments relating to the supplementary budget, the state has proceeded from the need of performance of the duties of the state as a whole. Although the stability of financing local authorities is an important value, it cannot be an end in itself. The need to prevent a situation where the state cannot perform its financial obligations weighs more than the need for ensuring the budgetary regulation stability of local authorities.

The amendments of the RA and the OHSA violate the autonomy of local authorities. Upon reduction of the income tax portion accruing to local authorities, it must be taken into account that the functions of the local authorities have been reduced as well, whereby in previous periods the state has increased the income tax portion accruing to local authorities without adding any new obligations. The restriction set out in the RMCBA to the debt obligations of local authorities is proportionate, because it arises from unfavourable economic conjuncture and the state does not have any alternatives of limiting an increase of the general government debt through the consolidated deficit of local authorities.

16. The Minister of Justice finds that the petition of the Tallinn City Council regarding the provision amending subsection 16 (3) of the RA is not admissible. The provision did not change the scope of the functions of local authorities. Furthermore, the guarantees of local authorities do not stipulate any subjective right to a specific portion of accrual of a state tax, which could be used for management of local roads. Thus, the provision does not prejudice subsection 154 (1) of the Constitution. Since management of local roads is, in essence, a local function, the financing thereof must not be ensured pursuant to the procedure provided by subsection 154 (2) of the Constitution and therefore the provision amending subsection 16 (3) of the RA does not prejudice the guarantee arising from subsection 154 (2) of the Constitution.

17. The Minister of Justice argues that the provision amending clause 5 (1) 1) of the ITA prejudices the local

financial autonomy, but does not violate the constitutional guarantees of local authorities and is constitutional.

The entire Supplementary Budget Act and thus the provision amending clause 5 (1) 1) are not in conflict with subsection 116 (2) of the Constitution whose idea is to preclude conflicts between the budget and the acts in force. When in general there is the principle that a later provision replaces an earlier one, subsection 116 (2) means that the annual State Budget Act does not have such impact. When a conflict emerges between the State Budget Act and acts in force, amendment of the budget must be initiated. If the revenue and expenditure part of the state budget submitted by the government entails amendment of other acts, these are unconstitutional insofar as the budget and the acts in force are in conflict. The situation is the opposite if the Government of the Republic submits a draft State Budget Act that calls for amendment of other acts, but which is submitted jointly with all the required amendment acts and respective explanations in the explanatory memorandum of the state budget. If the Riigikogu passes the State Budget Act as well as amendments to the acts in force at the same time, the conditions of subsection 116 (2) of the Constitution are fulfilled. Thereby it is not important whether other acts are read by the Riigikogu as separate acts or the Government of the Republic submits them and one consolidated draft whose implementing provisions make the required amendments to the acts in force.

The provision amending clause 5 (1) 1) of the ITA was not adopted in violation of the legitimate expectation principle. The Constitution does not stipulate any specific financing system model and the legislature may change the financing system. The financial autonomy cannot be absolute. The need to ensure the stability of the local self-government budget regulation is not weightier than the state's interest in preventing a situation where there is the risk that the state cannot independently perform its financial obligations. If changes in accrual of income become evident relatively unexpectedly, it is inevitable that amendments must be adopted and enforced quickly in order to ensure the budget balance. In a situation of economic recession it is not unforeseeable that budgetary funds aimed at local authorities can be restructured in order to ensure the basic functions of the state. Local authorities were informed of redistribution of the state budget funds via the Cooperation Council of Local Authorities before the act was passed.
The provision amending clause 5 (1) 1) of the ITA is also substantively constitutional. The purpose of the provision is to stabilise state reserves based on budgetary funds, prevent a situation where the state cannot independently fulfil its financial obligations in an unstable economic situation, and control the budgetary position of the entire general government. The Minister of Justice finds that for the purpose of the budget local authorities are considered a solidary part of the public sector. In order to stabilise the state budget operating expenses need to be divided between parts of the public sector. The Cooperation Council of Local Authorities noted that if the total amount of the income tax portion and the Budget Equalisation Fund is reduced, the functions placed on local authorities must be reduced as well. The legislature did so. Reduction of the income tax portion of local authorities is necessary for reducing the public sector's operating expenses. This follows the solidarity principle and equal treatment of all persons operating in the public sector in the interests of stabilising the economy of the state. Leaving the income tax deficit depending on economic difficulties solely to the central power to deal with would be disproportionately burdensome. The provision amending clause 5 (1) 1) of the ITA is also proportional. The legislature reduced the functions of local authorities respectively. Besides, the decrease of the income tax portion only accounts for a small portion of the budget of the City of Tallinn and does not threaten the economic capacity of local authorities on the whole. In a parliamentary state the government and the legislative assembly are responsible for using the limited resources of society and therefore they must be able to shape the fiscal policy. Local authorities can obtain the missing funds through local taxes. In addition, on the basis of subsection 36 (3) of the Local Government Organisation Act (LGOA) a local authority can impose duties on individuals and entities for the purpose of ensuring provision of the registered immovable or territory belonging to them or in their possession and the adjacent public territory with public services and amenities.

18. The Minister of Justice argues that sections 12^2 and 31^3 of the OHSA regulate persons' subjective rights in the defence of which the council of a local authority cannot file a constitutional review petition. If this provision were to be declared invalid, no employer would have to perform this obligation. The petition is

inadmissible with regard to these provisions.

19. When analysing the constitutionality of §§ 8^1 and 28^1 of the RMCBA the Minister of Justice refers to its opinion given in constitutional review Case No. 3-4-1-7-09 discussed in the Supreme Court. According to the minister, these provisions influence the financial condition of local authorities and thus prejudice the guarantee of local self-government. The legitimate goal of establishment of a restriction is to prevent a threat in the public interest, whereby the state cannot independently perform its financial obligations in an unstable economic situation as well as to control the budgetary position of general government and to ensure the availability of public services. According to the RMCBA, local authorities are treated as part of the public sector. Before adoption of the contested provision there was no regulation according to which the loan burden of a local authority could have been regulated based on public interests or the consolidated budget deficit of the local authority be limited. With the regulation specified in § 8^1 of the RMCBA the insolvency of local authorities is prevented at the time of nationwide economic recession. For local authorities it is important to perform the obligations that have imposed on them by the legislature by law or which are the functions of the local government by nature. To that end they get money from the state and other sources provided by law. In order to enable the state to operate in such an economic situation that influences all entities and individuals, restrictions ensuring the functioning of the sate are justified. One such tool may be limiting borrowing in the public sector. The measure is necessary, because it follows the solidarity principle, equal treatment of all persons operating in the public sector and the interests of stabilising the economy of the state. Imposing the obligation to restrict debt obligations only to the central power would be disproportionately burdensome. A local authority's right to use funds required for performance of its functions would be prejudiced if acquisition of any additional funds was precluded by law. In the present case local authorities still have the right to impose local taxes and the duty specified in subsection 36 (3) of the LGOA. Local authorities do not have to take a loan or assume any other long-term obligations and it is not the only way of increasing their budget revenue or reducing their budget expenditure. Section 81 of the RMCBA is not a measure that disproportionately limits the autonomy of the local self-government and the act does not result in an unconstitutional situation.
The AO Regulation is also constitutional for the same reasons that § 81 of the RMCBA is.

20. The Minister of Justice finds that subsection 16 (4) of the BEF Regulation prejudices the right of decision-making of local authorities and that the petition is admissible with regard to the provision. However, there is no ground for declaring the provision unconstitutional. The provision of the regulation is not in conflict with 42 (4) of the SWA. The BEF Regulation provides that if a local authority has received money from the state budget for payment of subsistence benefits pursuant to previous forecasts, the funds must be used according to their purpose for subsistence benefits. If it is not enough, additional benefits can be applied for. A local authority cannot ask the state for funds in order to pay the social benefits that the local authority itself has prescribed. This would mean performance of essentially local functions with state funds.

21. The Minister of Finance argues that the petition of the Tallinn City Council is inadmissible with regard to declaring subsection 16 (3) of the RA invalid, because the said provisions cannot prejudice the constitutional guarantees of local authorities.

Management of local roads is a function of local authorities. Receiving targeted allocations from the state for performance of essentially local functions of local authorities is not covered by the guarantee of the subjective legal status of local authorities. The state's duty is to ensure a sufficient revenue base does not include financing any possible essentially local duties even if in previous years the state has found a way of supporting the performance of such duties.

22. The petition is not admissible with regard to sections 12^2 and 31^3 of the OHSA either. Establishment of the regulation set out in them is not essentially part of the functions of local authorities. The right to a revenue base that is part of the right to municipal self-administration is not related to any amendments to be implemented in the legal order. Furthermore, based on the petition it would be unfounded to presume that upon implementation of the contested provision the local authorities' right to a sufficient revenue base is not

ensured.

23. As regards the provision amending clause 5 (1) 1) of the ITA, the Minister of Finance argues that reduction of the portion of income tax revenue allocated to local authorities may prejudice the right to municipal self-administration of the local self-government, but in the framework of abstract review of provisions it is not possible to evaluate objectively, whether the contested provision prejudices the requirement of sufficient funding or not. The Minister of Finance argues that clause 5 (1) 1) of the ITA, jointly with other allocations, provides local authorities with a sufficient revenue base for performance of municipal and national functions. In the given case budgetary amendments were made due to changes in the overall economic environment in order to ensure a stable budgetary position of the general government.

24. The Minister of Finance argues that the petition is also inadmissible with regard to subsection 16 (4) of the BER Regulation, because it cannot prejudice the right to municipal self-administration of local authorities. Subsection 42 (2) of the SWA regulates a situation where a local authority has a surplus of funds for payment of subsistence benefits in the current year and decides to pay social benefits or render social services to those in need out of the surplus for the purpose of fostering their subsistence. Subsection 42 (4) does not consider the balances of subsistence benefit funds of previous years, but the balances specified in the given budgetary year in the budget drawn up by a local authority.
According to subsection 4 (6) of the 2008 State Budget Act, local authorities were to transfer the balance of subsistence benefits unused by the end of the budgetary year to the next budgetary year for the same purpose. The transferred funds become a part of the next year's budget and in order to evaluate whether there is the surplus specified in subsection 42 (4) of the SWA the year's total subsistence funds must be taken into account. Thus, if the amount allocated from the funds transferred to the current budgetary year and from the subsistence funds allocated to a local authority for the current budgetary year exceeds the actual need in the year, the local authority may use the opportunity specified in subsection 42 (4) of the SWA. If the local authority does not plan any surplus of the subsistence funds, there is no ground for application of subsection 42 (4) of the SWA. Owing to the combined effect of subsections 42 (3) and (4) of the SWA, a surplus of the funds allocated for subsistence benefits from the state budget can only occur in one budgetary year. Upon realisation of the right granted in subsection 42 (4) of the SWA, the local authority must constantly monitor that there is no situation where the funds have been spent for other social benefits and services and there is a deficit of the funds required for payment of subsistence benefits.

Thus, subsection 16 (4) of the BER Regulation is not related to the regulation of subsection 42 (4) of the SWA, does not specify it or establish other independent terms and conditions for restriction of local authorities' right to municipal self-administration. Prejudice of the right to municipal self-administration is not possible in the case of this provision.

25. According to the Minister of Finance, subsection 8^1 (1) of the RMCBA prejudices local authorities' right to municipal self-administration and subsections (2) to (7) allow for adversely affecting the right specified in subsection 154 (1) of the Constitution to independently organise any and all local matters. However, § 8^1 of the RMCBA does not prejudice local authorities' right to a sufficient revenue base. In the abstract provision review procedure it is not possible to evaluate whether the obligation to provide local authorities with a sufficient revenue base has been performed. Arising from § 160 of the Constitution, the requirement to ensure organisational independence of local authorities with regard to the state may also have been prejudiced. The arguments made regarding § 154 of the Constitution also apply to prejudice of this right.

The purpose of the restriction is to improve the budgetary position of the general government, without which there would be a risk that the state lacks liquid assets for financing its planned expenditure and it is not able to fulfil the so-called Maastricht criteria that need to be fulfilled in order to introduce the euro. There is a dominant public interest in introduction of the euro in the current economic crisis and therefore the state has made achievement of this goal a priority.

Limitation of assumption of obligations is suitable for ensuring the budgetary balance of the general government, because it contributes to the creation of a stable economic environment. The measure is

necessary, because there are no alternatively efficient measures for reduction of the general government expenditure or increasing revenue in such a manner that the general government debt does not increase as a result of the consolidated deficit of local authorities. Also, it has a positive impact on prevention of local authorities' financial difficulties. The chosen measure is proportional, because the regulation does not establish any absolute prohibition on assumption of obligations and for the purpose of reducing the intensity of the regulation the restriction has been established for a fixed term.

The restriction provided for in § 8^1 of the RMCBA does not give the Government of the Republic the right to interfere with the decision-making competence of local authorities, because the Minister of Finance does not have the right to limit expenses or investments. The Government of the Republic can only limit the assumption of obligations for these investments.

Limitation of the expenditure of the state and local authorities is based on the principle of solidarity. While the revenue of local authorities decreases by 1.5% due to cutting the income tax portion, the state budget expenditure was cut by 6.7% with the supplementary budget for 2009. A comparison of the budgetary possibilities of local authorities and the state shows that the situation of local authority budgets in comparison with previous years is better than that of the state. The petition of the Tallinn City Council does not mention any function whose performance has become impossible due to a lack of funds arising from the contestant provisions.

The *vacatio legis* principle has not been violated upon implementation of section 8^1 of the RMCBA. The Cooperation Council of Local Authorities was informed of the intended restrictions. The term between publication and entry into force of the act was short for a reason so that the state could operatively start controlling the budgetary position of the general government regarding the year 2009 and minimise the possibility of assumption of loan obligations by local authorities in the period between publication of the act and the entry into force of the act.

26. As regards the AO Regulation, the Minister of Finance argues that since it does not impose any duties on local authorities not specified in § 81 of the RMCBA, but merely details the provisions of the section, the Government of the Republic has not exceeded its discretion arising from provisions delegating authority.

27. First, the Chancellor of Justice explains that the financial autonomy of local authorities arises from the combined effect of subsections 157 (1) and 154 (1) of the Constitution. This means that the budget of local authorities is not a part of the state budget. The financial autonomy's scope of protection includes, first of all, the right to decide, regardless of the state budget, how to use funds for performance of municipal functions, i.e. to determined the respective expenditure side of the budget. At the same time the right does not extend to those funds that have been allocated for performance of national functions pursuant to subsection 154 (2) of the Constitution. The financial autonomy also includes the freedom of activity in the matter of how to finance the performance of local functions. The state cannot fully determine the size of local authorities' revenue, but the legislature must provide them with the opportunity of creating their own revenue base, considering subsection 157 (2) of the Constitution. Local authorities must have the opportunity to enter into financing transactions whose objective is to finance expenditure out of the revenue of future budgetary periods (see paragraph 8 of article 9 of the Charter).

28. The combined effect of subsections 154 (1) and (2) of the Constitution results in the financial guarantee of local authorities, which is an inevitable prerequisite of the main guarantee of local self-government. The financial autonomy concerns first of all the question of how can funds be used, but the financial guarantee protects the availability of adequate funds of a local authority for performance of its functions. Establishment of a system for financing local authorities, which provides local authorities with funds for performance of local and national functions is a function arising from § 154 of the Constitution. The local authority is entitled to go to court in order to protect the financial guarantee.

29. At the same time it must be taken into account that local authorities participate in civil relationships as legal persons in public law and their operating expenses are influenced by all the measures that are taken

against all persons (e.g. amendments in private law). Since the purpose of the constitutional guarantees of local authorities is to ensure local authorities' position in the administrative organisation of the state and their essential competence, the financial guarantee can be prejudiced only if the legislative measure specifically prejudices local authorities and not all parties of civil relationships in the same way. Otherwise the right of appeal of local authorities provided for in § 7 of the Constitutional Review Procedure Act (CRPA) would become virtually unlimited. Therefore a local authority cannot apply for protection against any measure that somehow influences its revenue and expenditure ratio unfavourably.

Thus, one of the prerequisites of the admissibility of the petition filed for protection of the financial guarantee of local authorities under § 7 of the CRPA is that the contested legislation regulates specific relationships between a local authority and the state. However, situations where by a few measures concerning all persons the state increases the operating expenses of local authorities to such an extent that performance of functions becomes more difficult cannot be precluded. In such an event a local authority can contest only the legislation that regulates the funding system, which causes the insufficiency of funding, not measures aimed at all persons. Secondly, the contested legislation must directly reduce the local authority's revenue base or impose on it additional duties that increase expenditure, whereby the revenue base remains unchanged. Thirdly, the decrease of the revenue base or the additional obligation must have an impact that exerts actual pressure on performance of the functions of local authorities. Thus, a local authority must indicate in the petition, among other things, the performance of which local or regional functions is impeded by the legislation contested by the local authority.

30. The Chancellor of Justice finds that the petition is inadmissible regarding §§ 12^2 and 31^3 of the OHSA, because these provisions do not regulate specific relations between local authorities and the state. Sections 12^2 and 31^3 of the OHSA concern the duties of all Estonian employers, not simply those of local authorities. If §§ 12^2 and 31^3 of the OHSA were declared invalid, the staff costs of all employers would fall, i.e. the staff costs of both private and public sectors would decrease. Thus, the provisions of the OHSA contested by the Tallinn City Council are not specifically aimed at local authorities, but at employers operating in Estonia in general.

31. The Chancellor of Justice argues that the petition of the Tallinn City Council is also inadmissible with regard to the provision amending subsection 16 (3) of the RA. Because this provision gives no guarantees as to what extent the Riigikogu allocates funds for management of local roads in the state budget, the provision amending subsection 16 (3) of the RA does not directly affect the revenue base of local authorities. Therefore the provision amending subsection 16 (3) of the RA does not prejudice the financial guarantee. The amount of money required for management of roads is reduced by the State Budget Act and the order of the Government of the Republic that establishes the division of funds allocated for road management to each specific local authority. This order can only be contested in an administrative court. Thus, the provision amending subsection 16 (3) of the RA does not have any direct adverse impact on the right to municipal self-administration.

32. With regard to the provision amending clause 5 (1) 1) of the ITA the Chancellor of Justice finds the petition of the Tallinn City Council admissible. The financial guarantee arising from § 154 of the Constitution in combined effect with the principle of legal certainty is prejudiced if after adoption of the annual budget a regulation that increases the expenditure of local authorities without increasing the revenue base or reduces the revenue base of local authorities without reducing or compensating their duties is established and its affects the local authorities' capacity of performing their functions. Given that the Tallinn City Council has not submitted accurate information or evidence as to what functions remain unperformed and to what extent due to the provision amending clause 5 (1) 1) of the ITA, it is impossible to evaluate whether the Constitutional Guarantees of the City of Tallinn are prejudiced or not. The prerequisite for such evaluation is identification of circumstances based on evidence.

If the Supreme Court identifies that the City of Tallinn has, as a result of the contested provision, come to a situation where it does not have enough money for covering the expenditure planned in the budget for 2009 and the expenditure must be incurred, the following must be noted. Generally, upon changing the system of

financing local authorities, the changes should take effect as of the start of the budgetary year. Thereby it is wise to specify a reasonable period of time allowing local authorities to take into account the changes in preparing their budgets.

Changes reducing the revenue base may be made and urgently enforced in the middle of the budgetary year if there is good reason for it. There was a good reason for adoption of the provision amending clause 5 (1) 1) of the ITA: the need to react to sudden worsening of the economic environment. At the same time § 7 of the RMCBA stipulates the possibility of remedying prejudice by compensating for the decreased revenue or reducing duties. Weighing the prejudice and the objective of the amendments and taking into account the possibility of remedying the prejudice, the Chancellor of Justice finds that the legislature's objective of reducing the amount of public functions and related expenditure due to strong economic recession carries more weight than the prejudice of the constitutional guarantees of local authorities.

33. As for §§ 8^1 and 28^1 of the RMCBA the Chancellor of Justice argues that the petition is admissible with regard to subsection 8^1 (1), the first sentence of subsection 8^1 (2) and subsection 8^1 (3) of the RMCBA. Only these provisions cover the matters contested in the petition of the Tallinn City Council, i.e. restrictions on debt obligations, the obligation to seek approval and the grounds of approval. However, the Tallinn City Council has failed to explain for what reason and on the basis of which provisions or principles of the Constitution the sanctions specified in subsections 8^1 (4) to (7) of the RMCBA imposed on local authorities for disregarding subsections 8^1 (1) and (2) of the RMCBA or the procedure for imposing them or the authorisation granted to the Government of the Republic are unconstitutional. Also, the petition does not contain any explanations as to why the time limit of § 8^1 of the RMCBA specified in § 28^1 of the RMCBA VLES is unconstitutional. Therefore the Tallinn City Council has failed to show how these provisions separately prejudice the guarantees of local authorities. Due to the lack of reasoning the petition of the Tallinn City Council is inadmissible with regard to the second sentence of subsection 8^1 (2) and subsections 8^1 (4) to (7) and § 28^1 of the RMCBA.

Subsection 8^1 (1), the first sentence of subsection (2) and subsection (3) of the RMCBA are not in conflict with the principle of legal clarity and are formally unconstitutional in other respects as well.

The goals of the restrictions contained in these provisions as expressed in subsection 8^1 (1) of the RMCBA and in the explanatory memorandum of the Supplementary Budget Act (fulfilment of the Maastricht criteria of the European Union regarding the general government deficit and prevention of a strong increase of local authorities' debt in the environment of the economic recession) have not been precluded under the Constitution and are suitable for justifying the given restrictions. The restrictions concerning the general government deficit are also suitable and necessary.

Furthermore, the goal of the restrictions has more weight than the prejudice of the financial autonomy caused by them, which makes subsection 8^1 (1), the first sentence of subsection (2) and subsection (3) of the RMCBA constitutional.

The AO Regulation is in accordance with the relevant provision delegating authority and does not impose any additional restrictions on the financial autonomy in comparison with the act.

34. According to the Chancellor of Justice, with regard to subsection 16 (4) of the BEF Regulation the petition is admissible. This provision is in conflict with subsections 154 (2), 3 (1) and 87 (6) of the Constitution. Upon interpretation of the provision delegating authority that serves as the basis for the BEF Regulation in the combined effect with subsection 42 (4) of the SWA it can be concluded that there was no ground for establishment of the regulation specified in subsection 16 (4) of the BEF Regulation. If the law states that a local authority may use the outstanding balance of subsistence benefits for payment of social benefits and provision of social services on the terms and conditions determined by the local authority without losing the right to receive additional subsistence benefit funds from the state budget in the next budgetary year, the Government of the Republic cannot impose such a condition in the regulation as a prerequisite for obtaining additional subsistence benefit funds.

35. The Minister for Regional Affairs argues that the petition of the Tallinn City Council is inadmissible insofar as it requests that the provision amending subsection 16 (3) of the RA be declared invalid. The petition is also inadmissible to the extent that it requests that the provision amending clause 5 (1) 1) of the ITA be declared unconstitutional, because the Tallinn City Office forwarded the petition to the Supreme Court after the entry into force of the amendment and could no longer request that the provision be declared unconstitutional, but had to request that it be declared invalid. The petition is inadmissible insofar as it requests declaring §§ 12^2 and 31^3 of the OHSA unconstitutional, because the expenditure of local authorities does not increase as a result of performance of state functions and thus there is no prejudice of the autonomy of local authorities. In other respects in which the petition is admissible, the Tallinn City Council's petition is unfounded and must thus be rejected.

36. The Estonian Association of Cities supports the petition of the Tallinn City Council and considers it to be justified.

37. The Association of Municipalities of Estonia supports the petition of the Tallinn City Council and argues that the contested provisions are in conflict with the constitutional guarantees of local authorities and the principles of legal certainty and proportionality.

THE CONTESTED PROVISIONS

38. Section 16 of the Supplementary Budget Act, according to which as of 1 March 2009 subsection 16 (3) of the Roads Act is effective worded as follows:

"§ 16. Financing of road management
(3) The division of funds for the management of national roads and local roads shall be specified in the state budget for each budgetary year."

39. Subsection 17 (1) of the Supplementary Budget Act, according to which as of 1 April 2009 clause 5 (1) 1) of the Income Tax Act is effective worded as follows:

"§ 5. Receipt of tax
(1) Income tax paid by resident natural persons is received as follows:
1) without taking into account the deduction provided for in Chapter 4, 11.4 percent of the taxable income of a resident natural person is received by the local authority of the taxpayer's residence;"

40. Clauses 19 2) and 3) of the Supplementary Budget Act, according to which as of 1 July 2009 §§ 12^2 and 31^3 of the Occupational Health and Safety Act are effective worded as follows:

"§ 12^2. Sickness benefit payable by employer
(1) An employer shall pay an employee compensation from the fourth to the eight day of an illness or injury at the rate of 80% of the average wage of the employee (sickness benefit).
(2) In the case of an illness or injury of an employee for which the Health Insurance Fund pays sickness benefit to the insured person on the basis of clauses 54 (1) 6) and 7) and subsection 56 (1^2) of the Health Insurance Act an employer shall pay no sickness benefit.
(3) An employer pays sickness benefit as of the fourth day of the release from the performance of their duties specified in a certificate for sick leave.
(4) An employer shall pay sickness benefit if an employee has submitted to the employer a certificate for sick leave not later than on the 90th calendar days as of the day of commencement of duties specified in the certificate of incapacity for work.
(5) An employer shall pay sickness benefit on the pay day, but not later than within 30 calendar days as of the submission of the duly formalised certificate for sick leave to the employer."

"§ 31^3. Payment of sickness benefits
An employer shall pay the sickness benefit specified in § 12^2 of this Act on the basis of certificates for sick

leave that specify release from duties as of 1 July 2009 or later."

41. Clauses 20 3) and 4) of the Supplementary Budget Act, according to which as of 1 March 2009 §§ 8^1 and 28^1 of the Rural Municipality and City Budgets Act are effective worded as follows:

"§ 8^1. Restrictions on assumption of obligations in connection with budget deficit
(1) If the Gross Domestic Product has decreased for two consecutive quarters, rural municipalities and cities and, for the purposes of the Accounting Act, entities under the direct dominant influence of a rural municipality or city (hereinafter rural municipalities and cities and entities dependent on them) over a half of whose revenue comes from the rural municipality or city, the state or other legal persons in public law or from foundations under the dominant influence of the said persons may, for up to three budgetary years and in the interest of ensuring macroeconomic stability and controlling the budgetary position of the general government, issue bonds, take loans, assume financial lease and factoring obligations, obligations arising from a service concession agreement, long-term obligations before suppliers and other long-term obligations that require payment of money in the future, solely for bridge financing of assistance to be received on the basis of the 2004-2006 Structural Assistance Act and the 2007-2013 Structural Assistance Act (hereinafter structural assistance) and assistance allocated to the Republic of Estonia under international agreements (hereinafter other foreign assistance), for ensuring the self-financing required for obtaining structural assistance or other foreign assistance or for refinancing of the aforementioned existing obligations assumed before the entry into force of the Act.
(2) Rural municipalities and cities shall seek the approval of the Ministry of Finance with regard to the obligations specified in subsection (1) of this section to be assumed by the rural municipalities and cities and entities dependent on them. A more detailed list of the obligations specified in subsection (1) of this section and the conditions of and procedure for approval of assumption of obligations and evaluation of requests shall be established by the Government of the Republic in a regulation.
(3) The Ministry of Finance shall evaluate the financial capacity of rural municipalities and cities and entities dependent on them on the basis of the information given in the budget. If the Ministry of Finance finds that a rural municipality or city or the entity dependent on it is able to ensure the self-financing required for obtaining structural assistance or other foreign assistance without assuming obligations, the Ministry of Finance may dismiss the request for assumption of the obligation or make a proposal for reduction of the amount of the obligation to be assumed.
(4) If a rural municipality or city or the entity dependent on it has assumed obligations for purposes other than those specified in subsection (1) of this section or assumed the obligations specified in subsection (1) of this section without seeking the approval of the Ministry of Finance, the Minister of Finance shall issue a directive suspending the following:
1) transfer of the allocations of the local authorities' budgets' equalisation fund of the state budget established on the basis of subsection 9 (2) of the State Budget Act;
2) transfer of amounts from income tax that are subject to transfer pursuant to the procedure for transfer of income tax to rural municipalities and cities established on the basis of subsection 5 (2) of the Income Tax Act.
(5) The Ministry of Finances informs rural municipalities and cities of suspension of the budget equalisation fund and income tax amounts without delay.
(6) The amount to the extent of which obligations not permitted under this Act were assumed shall be withheld from the amounts to be transferred from the budget equalisation fund and income tax, but no more than 20% of the funds of the budget equalisation fund to be allocated to the rural municipality or the city on the basis of the annual State Budget Act and the amount of income tax calculated for the rural municipality or the city pursuant to the procedure for transfer of income tax to rural municipalities and cities established on the basis of subsection 5 (2) of the Income Tax Act.
(7) Transfer of amounts to be transferred from the budget equalisation fund and income tax may be suspended until the lapse of the circumstance that caused the suspension. Termination of withholding amounts shall be approved by a directive of the Minister of Finance within five working days after identifying the lapse of the circumstance. The Ministry of Finance shall inform the rural municipality or the city of termination of suspension of transfer of amounts immediately after making the respective decision.

The Government of the Republic shall establish the procedure for refunding the suspended funds in a regulation."

"§ 28[1]. Implementation of Act
Section 81 of this Act shall remain in force until the end of 2011."

42. subsection 16 (4) of Regulation No. 49 of the Government of the Republic of 5 March 2009 "Division and Scope, Conditions and Procedure of Division of Budget Equalisation Fund Allocations of Local Authorities in the 2009 State Budget Act":

"§ 16. Distribution of funds earmarked as subsistence benefits
(4) A local authority is entitled to additional funds of subsistence benefits distributed on the basis of subsection (3) if the funds allocated from the budget equalisation fund for payment of subsistence benefits on the basis of this Regulation and the outstanding balance of subsistence benefits in previous years are insufficient for payment of subsistence benefits, provided that upon incurring the expenses earmarked for subsistence benefits are in accordance with the terms and conditions of the Social Welfare Act."

43. Regulation No. 50 of the Government of the Republic of 5 March 2009 "Detailed List of Obligations Assumed by Local Authority and Entities Dependent on Local Authority, Conditions and Procedure for Submission of Requests for Approval of Assumption of Obligations and Evaluation of Request and Procedure for Refunding Suspended Funds":

"§ 1. Scope of Regulation
The Regulation establishes a more detailed list of the obligations to be assumed with the approval of the Ministry of Finance by local authorities and entities dependent on local authorities, the conditions of and procedure for submission and evaluation of approval requests and the procedure for refunding such funds whose transfer from the local authorities' budgets' equalisation fund of the state budget and income tax was suspended.
§ 2. More detailed list of obligations to be approved
Assumption of such obligations that are recognised in the following account groups and classes on the basis of Annex 1 to the General Rules for State Accounting established on the basis of subsection 35 (2) of the Accounting Act shall be coordinated with the Ministry of Finance beforehand:
1) bonds issued – account groups 2080 and 2580;
2) loans – account groups 2081 and 2581;
3) financial lease and factoring obligations – account groups 2082, 2083, 2582 and 2583;
4) obligations arising from a service concession agreement – account groups 2086 and 2586;
5) long-term obligations before suppliers – account class 250;
6) other long-term obligations that require payment of money in the future – account groups 2530, 2535 and 2536, and account class 256.
§ 3. Submission of requests for approval of assumption of obligations
(1) A local authority shall submit to the Ministry of Finance a request for approval of an obligation to be assumed by the local authority and an entity dependent on the local authority for the purpose specified in subsection 81 (1) of the Rural Municipalities and City Budgets Act before entry into a contract related to the assumption of the relevant obligation, conclusion of a transaction or otherwise assuming the obligation.
(2) A local authority submits a request in the format set out in Annex 1 to this Regulation. The application of an entity dependent on the local authority shall be submitted in the former set out in Annex 2 to this Regulation. The application is submitted on paper or electronically.
(3) If by the moment of submission of a request an entity of a local authority has not approved its budget for the year in which the obligation is to be assumed, the draft budget shall be enclosed with the request.
§ 4. Processing requests
(1) The ministry of Finance shall review a request within 20 working days as of receiving it. In the course of processing the request the Ministry of Finance has the right to ask the submitter for additional information and documents for carrying out the evaluation specified in § 5 of this Regulation. The Ministry of Finance sets the term for elimination of the defects of the request or for submission of additional information and

documents.
(2) The Ministry of Finance shall inform the submitter of the request in writing of approval, partial approval or disapproval of the assumption of the obligation. In the event of partial approval of the assumption of the obligation the Ministry of Finance shall submit a reasoned proposal for reducing the obligation to be assumed.
(3) The Ministry of Finance shall not review a request if the submitter fails to eliminate the defects of the request within the prescribed term or unfoundedly fails to submit the required information or documents.
(4) The Ministry of Finance shall not approve an obligation to be assumed if:
1) the obligation is not assumed for a purpose specified in subsection 81 (1) of the Rural Municipality and City Budgets Act;
2) by assuming the obligation the local authority is not adhering to the terms and conditions specified in clause 8 (1) 1) of the Rural Municipality and City Budgets Act.
§ 5. Evaluation of requests
(1) The Ministry of Finance shall evaluate the financial capacity of a local authority on the basis of the details of an approved budget contained in a monthly report drawn up based on § 26^1 of the Rural Municipality and City Budgets Act or on the basis of the draft budget specified in subsection 3 (3) of this Regulation and that of an entity dependent on a local authority on the basis of the data submitted in the format set out in Annex 2 to this Regulation. Upon evaluation of financial capacity, the information given in reports drawn up in accordance with subsection 35 (2) of the Accounting Act shall be taken into account as well.
(2) Upon evaluation of financial capacity, it shall be analysed whether the structural assistance or other foreign assistance for the purpose of subsection 8^1 (1) of the Rural Municipality and City Budgets Act can be secured without assuming additional obligations, including by reducing the total investment, except for investments from the state budget or for covering the self-financing of assistance to be received for investment purposes from legal persons in public law, or at the expense of operating income exceeding operating expenses, reserves planned in the budget or available funds kept in deposit.
(3) If as a result of the analysis specified in subsection (2) of this section a local authority or an entity dependent on it is able to provide the self-financing required for obtaining the structural assistance or other foreign assistance without assuming the obligations specified in § 2 of the Regulation to the extent specified in the request, the Ministry of Finance shall approve the request in part.
§ 6. Refund of suspended funds
(1) Upon the lapse of the circumstances that caused the suspension, the funds suspended on the basis of subsection 81 (4) of the Rural Municipality and City Budgets Act shall be transferred as follows:
1) income tax amounts to be transferred to a local authority shall be transferred by the next due date of transfer of income tax specified in a regulation of the Minister of Finance based on subsection 5 (2) of the Income Tax Act;
2) budget equalisation fund amounts to be transferred to a local authority shall be transferred by the next due date of application for transfer of budget equalisation fund allocations specified in the conditions of and procedure for distribution of budget equalisation fund allocations to local authorities established on the basis of the annual State Budget Act.
(2) If the circumstance that caused the suspension of transfer of the funds from the budget equalisation fund lapses in the year following the year of suspension of the transfer of funds, the amounts to be refunded to the relevant local authority shall be included in the funds of the budget equalisation fund of the budgetary year following the year of the lapse of the circumstance that caused the suspension.”

OPINION OF THE SUPREME COURT EN BANC
(I) Admissibility of the petition of the Tallinn City Council

44. According to § 7 of the Constitutional Review Procedure Act (CRPA), a local authority’s council may submit a petition to the Supreme Court to declare an Act which has been proclaimed but has not yet entered into force or a regulation of the Government of the Republic or a minister which has not yet entered into force to be in conflict with the Constitution or to repeal an Act which has entered into force, a regulation of the Government of the Republic or a minister or a provision thereof if it is in conflict with constitutional

guarantees of the local self-government.

According to the Court *en banc*, on the basis of the given provision the Supreme Court is competent to substantively review petitions whereby two conditions have been fulfilled: first of all, the petition must have been submitted by the council of a local authority and second, the petition must have indicated that there is a conflict between the legislation specified in § 7 of the CRPA or one of its provisions and the constitutional guarantees of the local self-government.

45. According to § 7 of the CRPA, the possibilities of initiating constitutional review proceedings by councils of local authorities are limited. The council of a local authority cannot apply for declaring legislation or a provision thereof to be in conflict with any provision of the Constitution, but only with some of such provisions of the Constitution, which are part of the constitutional guarantees of the local self-government.

The admissibility of a petition submitted by the council of a local authority thus depends on whether the provision of the Constitution whose prejudice is argued in the petition or suspicion of whose prejudice arises due to the circumstances specified in the petition can be treated as a constitutional guarantee of the local self-government or not. If the provision of the Constitution that the petition relies on is not a constitutional guarantee of the local self-government, the petition is inadmissible pursuant to § 7 of the CRPA and must be returned without review based on subsection 11 (2) of the CRPA. This means that the Supreme Court cannot evaluate whether the contested legislation or provision may be in conflict with the provision of the Constitution specified in the petition. If the provision of the Constitution whose prejudice the council of the local authority argues is part of the constitutional guarantees of the local self-government, the petition is admissible and must be reviewed substantively. This means assessment of whether the contested legislation or a provision thereof prejudices the constitutional guarantees of the local self-government indicated in the petition and, in the case of identification of prejudice, verification of its constitutionality.

46. If the council of the local authority contests the legislation or provision based on several provisions of the Constitution of which some can be treated as constitutional guarantees of the local authority and some not, the petition is admissible. In such an event the Supreme Court can substantively evaluate whether the contested legislation or provision is in accordance with provisions of the Constitution specified in the application or arising from the circumstances indicated in the petition, which provisions contain the constitutional guarantees of the local self-government. However, the Supreme Court is not competent to evaluate whether the contested legislation or provision prejudices these provisions of the Constitution specified in the petition, which are not part of the constitutional guarantees of the local self-government. As an exception it must nevertheless be reminded that if the contested legislation or provision prejudices some constitutional guarantee of the local self-government, it is necessary, upon evaluation of the formal constitutionality of the prejudice, to check the compliance of the legislation or provision with such provisions of the Constitution, which are not part of the constitutional guarantees of the local self-government, but on the basis of which a decision on the formal lawfulness of the identified breach must be made. For instance, if it becomes evident that a regulation of the Government of the Republic prejudices some constitutional guarantee of the local self-government, upon evaluation of the constitutionality of the prejudice it must be identified, among other things, whether the regulation of the Government of the Republic has been given in accordance with the provision delegating authority and is thus in accordance with subsections 87 (6) and 3 (1) of the Constitution.

47. The Constitutional Review Chamber of the Supreme Court has found in previous case law that in order to evaluate the admissibility of a petition of the council of a local authority it must be verified, in addition to point 1, whether prejudice of the constitutional guarantees of the local self-government is possible in the case of the contested legislation or provision is possible (see, for example, point 16 of the judgment of the Constitutional Review Chamber of the Supreme Court of 16 January 2007 in Case No. 3-4-1-9-06 and point 17 of the judgment of 19 January 2010 in Case No. 3-4-1-13-09).

48. The Court *en banc* finds that according to § 7 of the CRPA, the possibility of prejudice of the

constitutional guarantees of the local self-government is not a prerequisite for the admissibility of the petition. The conclusion that in the case of some legislation or provision it is not possible to prejudice the constitutional guarantees of the local self-government means that the absence of prejudice is obvious. Identification of the impossibility of prejudice or its obvious absence requires specification of the scope of protection of the relevant constitutional guarantee and explanation of whether the contested legislation or provision can negatively impact the scope of protection. However, this is a substantive evaluation of the constitutionality of the contested legislation or provision. The absence of an (obvious) prejudice of the constitutional guarantee of the local self-government means that the legislation or its provision and the constitutional guarantee of the local self-government are not in conflict. Thus, denying the possibility of prejudice of the constitutional guarantees of the local self-government in the case of the contested legislation or provision the Supreme Court does not refuse assuming a position regarding the unconstitutionality argued in the petition, but deems the petition unfounded. Neither § 7 of the CRPA or any other provision gives reason to conclude that such petitions from local authorities that argue the conflict between contested legislation or provision and the constitutional guarantees of the local self-government, but are obviously unfounded, should be returned without review. Therefore the Court *en banc* finds that if a petition of the council of a local authority argues that contested legislation or provision prejudices some constitutional guarantee of the local self-government, but in the case of the legislation or provision the prejudice of the given guarantee is not possible, the petition must be dismissed, not returned without review based on subsection 11 (2) of the CRPA.

49. The Court *en banc* finds that out of the provisions whose prejudice is argued by the Tallinn City Council in its petition for declaring the contested legislation unconstitutional the constitutional guarantees of the local self-government for the purposes of § 7 of the CRPA have been set out solely in §§ 154, 157 and 160 of the Constitution. Therefore, in this matter, the Court *en banc* is, based on § 7 of the CRPA, competent to verify only whether the legislation contested in the petition prejudices – and, if there is prejudice, whether it violates – the requirements provided for in §§ 154, 157 and 160 of the Constitution.

The remaining provisions of the Constitution and other legislation that is prejudiced by the contested legislation according to the petition of the Tallinn City Council, cannot be treated as the constitutional guarantees of the local self-government for the purposes of § 7 of the CRPA. Therefore, the Court en banc cannot evaluate in this procedure whether the contested legislation is in conflict with these provisions or not. The only exception is provisions that determine the formal constitutionality of the prejudices of the constitutional guarantees of local authorities (see point 46 above).

(II) Financial guarantees of local authorities

50. Before evaluating the foundedness of the petition of the Tallinn City Council the Court *en banc* explains what the financial guarantees of local authorities mean, i.e. what are the rights of local authorities arising from the Constitution which are associated with their economic ability to perform public functions and what are the state's obligations corresponding to these rights. The Court en banc also explains how these rights are related to local authorities' right to municipal self-administration.

Upon opening the essence and scope of the financial guarantees arising from the Constitution, it is important to take into account the European Charter of Local Self-Government ratified by the Riigikogu, especially article 9 "Financial resources of local authorities." The Charter expresses the general principles of organisation of local self-government adopted in the member states of the Council of Europe that have ratified the Charter. According to § 2 of the European Charter of Local Self-Government Ratification Act, the Republic of Estonia undertakes to follow any and all articles of the Charter in the territory subjected to its jurisdiction. The Charter sets out the minimum requirements that the state must keep in mind upon organisation of local self-government, incl. upon funding local authorities. Therefore the Court *en banc* finds that the Charter plays an important role in interpreting the provisions of the Constitution concerning the organisation of local self-government.

51. Chapter XIV of the Constitution sets forth a legal basis for local self-government. This chapter establishes the principles of the representative democracy of local authorities (§ 156 of the Constitution), the

basis for relationships between the state and local authorities (§§ 154, 157, 158 and 160 of the Constitution) and the bases of relationships between local authorities (§ 159 of the Constitution). Sections 154 and 157 to 160 of the Constitution along with the Charter grant various rights to local authorities (i.e. constitutional guarantees). The obligated subject of these rights is the state and in this context it means first of all the legislature and the executive. Considering article 11 of the Charter, these are rights that are protected by courts and in order to enforce these rights a local authority can, depending on the nature of the dispute, bring a case against the state to an administrative court or directly to the Supreme Court on the basis of § 7 of the CRPA.

52. Public functions which local authorities have been created to perform in the interests of their residents are, according to § 154 of the Constitution, divided into local self-government functions (“local issues” specified in subsection 154 (1) of the Constitution) and national functions specified in the second sentence of subsection 154 (2) of the Constitution.

53. The most important constitutional guarantee of local authorities is the right provided for in subsection 154 (1) of the Constitution to independently decide and organise all local issue (local authorities' right to municipal self-administration).

Based on the substantive criterion, local issues are issues that arise from and are concerned with the local community and that are according to the formal criterion not covered by or, under the Constitution, placed within the competence of a state body. The legislature has the right to make the performance of some local function compulsory for a local authority (a local self-government function arising from law), provided that in the light of the right to municipal self-administration it is a proportional measure for attainment of a goal permitted under the Constitution. Local government functions are thus divided into local government functions arising from law (including “compulsory local government functions”) and other functions (including “voluntary local government functions”) whose performance is not prescribed by law.

54. The right and obligation to independently decide and organise all local issues based on law arising from subsection 154 (1) of the Constitution also includes making decisions regarding how to use the funds allocated for resolution of local issues. Subsection 157 (1) of the Constitution specifies the right to municipal self-administration and stipulates that a local authority has its own budget whose drafting bases and procedures are provided by law. The budget of a local authority is part of the public sector budget, but not part of the state budget. The right to municipal self-administration extends to budgeting and adoption of a budget insofar as it concerns incurring expenses required for performance of local government functions. The right to municipal self-administration does not extend to decision-making on the use of these funds that have been allocated to local authorities pursuant to the second sentence of subsection 154 (2) of the Constitution for performance of national functions.

55. The right and duty to independently decide and organise local issues based on law, including to decide how to spend the money allocated for resolution of local issues, can be exercised by a local authority only if it has enough money. Therefore the right to municipal self-administration specified in clause 154 (1) of the Constitution essentially presupposes that local authorities be granted the right to sufficient funds for performance of local government functions. Thereby, in accordance with the said right, sufficient funding of the local government functions arising from law as well as of other local government functions not provided by law must be ensured in accordance with the said right.

Such interpretation of subsection 154 (1) of the Constitution is supported by article 9 of the Charter which states that local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers (par. 1) and that local authorities’ financial resources shall be commensurate with the responsibilities provided for by the constitution and the law (par. 2). The Constitutional Review Chamber of the Supreme Court has assumed the same position earlier when explaining the meaning of subsection 154 (1) of the Constitution (see Judgment of the Constitutional Review Chamber of the Supreme Court of 9 June 2009 in Case No. 3-4-1-2-09, point 42).

56. The state's obligation to establish such a funding system that provides local authorities with sufficient funds for performance of local government functions corresponds to local authorities' right to sufficient funding for performance of local government functions. It is up to the legislature to decide what sources (e.g. accrual of state taxes directly to the local budget, allocations from the state budget, local taxes, etc.) the sufficient funds must come from.

Upon shaping the system of funding local government functions, the legislature must also make certain that the money allocated for performance of local government functions be distinct from the funds allocated for performance of national duties. This allows a local authority to understand what funds are meant for deciding and organising local issues. This, in turn, allows for deciding how to use the money allocated for resolving local issues. In addition, the distinction between funds allocated for local government functions and national functions allows for evaluating the sufficiency of the funds allocated for local government functions.

Also, the system of funding local government functions must be diverse and flexible enough to take into account actual changes that need to be made for performance of these functions. Financial equalisation mechanisms or analogous measures must be applied in the defence of local authorities whose funds are smaller so as to balance the uneven division of the potential sources of revenue and expenditure between local authorities. Local authorities must be involved in making decisions regarding the funding system. Where possible, the funds allocated to local authorities should not be bound to funding specific projects in order to preserve as high independence in the performance of the functions as possible. The receipt of assistance should not deprive a local authority of the freedom to act within the limits of its competence at its own discretion.

57. The right to municipal self-administration also includes the right to decide the funding of the expenditure of the budgetary year at the expense of the revenue of future periods (the right to assume debt obligations). The existence of such right is supported by paragraph 8 of article 9 of the Charter, according to which, for the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

58. According to subsection 157 (2) of the Constitution, a local authority has the right, on the basis of law, to levy and collect taxes and impose duties. The right of local authorities to levy their own taxes is recognised by paragraph 3 of article 9 stating that at least part of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.

59. According to the Court *en banc*, a financial guarantee allowing for the exercise of the right to municipal self-administration is also the right to the stability of the system of funding local government functions (see judgment of the Supreme Court *en banc* of 19 April 2004 in Case No. 3-3-1-46-03, point 25). The right arising from, on the one hand, the principle of the rule of law and, on the other hand, subsection 154 (1) of the Constitution, specifies the principle of legitimate expectation in financial relationships between local authorities and the state.

60. However, in addition to local government functions, local authorities also perform national duties (see point 52 above). According to the second sentence of subsection 154 (2) of the Constitution, duties may be imposed on local authorities either pursuant to law or by agreement with the local authority.

According to the second sentence of subsection 154 (2) of the Constitution, expenditure related to the duties of the state imposed on local authorities by law shall be funded from the state budget. The second sentence of subsection 154 (2) of the Constitution grants local authorities the right to funding of state-imposed duties of the state from the state budget. The state is obligated to finance national duties imposed on local authorities.

61. Thus, financial guarantees serve as the basis for arrangement of financing of local authorities, which

arrangement, on the one hand, consists of the system of funding local government functions and, on the other hand, of provisions regulating the funding of national duties imposed on local authorities by law. The financial guarantees of local authorities include the right to assume debt obligations, the right to levy taxes and impose duties, the right to sufficient funds for performance of local government functions, the right to the stability of the system of funding local government functions, and the right to full and complete funding from the state budget of national duties imposed by law.

(III) Scope of protection of financial guarantees

62. Next, the scope of protection of the financial guarantees applied in resolving this case must be specified.

(A) Right of assume debt obligations

63. The right to municipal self-administration, as mentioned above, entails the right to independently decide on assumption of debt obligations. Assumption of debt obligations (e.g. loan, financial lease, issue of bonds, other long-term obligations that require payment of money in the future) allows local authorities to make investments necessary for performance of their functions at the expense of future revenue. Without assumption of debt obligations the performance of some local government function (e.g. construction of infrastructural civil engineering works) may be much harder.

The right to assume such obligations protects local authorities against the state’s interference in making these decisions. The state is obligated to refrain from establishment of such legislation that prevents local authorities from obtaining funds from the capital market. This means that the state does not have to act as local authorities' creditor or guarantee their obligations.

64. The right to assume debt obligations is not an unlimited right. The right may be limited on the same conditions as the right to municipal self-administration arising from subsection 154 (1) of the Constitution.

Upon prejudice of the right to assume debt obligations, the competence, procedural and formal requirements arising from the Constitution, the principle of legal clarity and the first sentence of subsection 3 (1) of the Constitution, i.e. the prerequisites for formal constitutionality of the prejudice, need to be observed.

The prejudice must have a goal permitted under the Constitution. Subsection 154 (1) of the Constitution states that “all local issues shall be resolved and managed by local authorities, which shall operate independently pursuant to law.” The Court en banc finds that “independently pursuant to law” must be understood as the legislature's authorisation to limit the independence of local authorities for achievement of any freely established goal that is not in conflict with the Constitution.

Prejudice of the right to assume debt obligations must be suitable, necessary and proportional. The prejudice may not distort the essence of the right.

(B) Right to sufficient funds for performance of local government functions

65. The right to sufficient funds for performance of local government functions arising from subsection 154 (1) of the Constitution means that the state is required to adopt legislation that ensures at least the minimum amount of funds for local authorities for performance of local functions, i.e. allows for performing at least the minimum local functions to the minimum extent required. Thus, the level of funding local government functions must be in accordance with the scope of the functions imposed on a local authority (see also paragraph 2 of article 9 of the Charter). In addition to performance of the local functions provided by law, a local authority must have money for exercising the right to municipal self-administration in order to decide on and arrange important local issues not regulated by law. It is important, as the Chancellor of Justice justly notes, that local authorities be granted not only the legal, but also the actual opportunity to decide whether and how to resolve local issues.

66. Upon establishing the regulation referred to in the previous point the legislature has extensive discretion as the maker of the state’s economic and tax policies. However, this does not mean that the legislature would be completely free to decide, by referring to some economic or tax policy arguments, to what extent to allow

for funding local functions. Otherwise the legislature could deprive the local self-government as a constitutional institution of substance. As noted, local authorities must be provided with at least the minimum level of funds required for performance of local functions. Otherwise subsection 154 (1) of the Constitution has been violated.

Also, subsection 154 (1) of the Constitution sets out the principles that the system of funding local government functions must comply with. The independence of a local authority in deciding and organising local issues requires that the funding of local government functions as a whole is not disproportionately dependent on one-off allocations by the state, but adequately mirror the overall economic situation. Also, the system of funding local government functions must take into account differences in the social, demographic, geographic and economic situation of local authorities.

67. The minimum level of local functions that need to be performed whose funding must be ensured and that thus determine the sufficient level of funding of the local authority arises, above all, from subsection 154 (1) of the Constitution and, secondly, from the local functions imposed on the local authority by the Constitution and law.

Subsection 154 (1) of the Constitution requires that a local authority perform at least all the essential local functions. Thus, the money required for performance of these functions must be granted to the local authority. Essential local functions, i.e. local functions that need to be performed pursuant to subsection 154 (1) cannot be listed exhaustively. Also, in the case of different local authorities these may differ, depending on the specific needs of the local authority as well as on the preferences of the local community. These are such local functions whose performance can reasonably expected from the local authority at the given time and in the given space. Important local functions such as the required extent of their performance change over time. These largely depend on the overall socio-economic situation and the level of welfare of society. Changes in the socio-economic environment may change both the local functions that need to be performed as well as the presumable extent and quality of performance of these functions.
Besides subsection 154 (1) of the Constitution these local functions whose performance has been prescribed by the Constitution (e.g. subsections 28 (4) and 37 (2) of the Constitution) or acts must be separately kept in mind when determining the minimum level of local functions. The need for financing local functions arising from law is directly affected by requirements established to the performance of these functions in acts and in lower-ranking legislation.

An important criterion for determined the minimum funding needs of local functions in the case of a specific local authority is that the level of the local public services of the local authority does not fall substantially below the general level of similar services in other local authorities in Estonia due to the lack of funds. For instance, according to the purpose of § 28 of the Constitution, a situation where the secured main social fundamental rights, to the extent for which the local self-government is responsible, vary substantially in different regions of the state due to differences in the economic capacity of local authorities, is unacceptable. According to § 14 of the Constitution, the guaranteeing of rights and freedoms is the duty of the legislature, the executive, the judiciary and the local self-government. According to the said provision, the state cannot allow a situation where the availability of primary public services depends largely on what the economic capacity of the local authority of a person’s residence or registered office is.

68. As mentioned, the right to sufficient funds for performance of local functions requires that the system of funding local government functions provide local authorities with sufficient revenue for performance of local functions at least to the minimum extent required. At the same time the said right does not protect a local authority against the existing funding system becoming less favourable, if as a result thereof the funding of the local authority's own functions does not become insufficient. The right to sufficient funds for performance of local government functions does not include the right according to which the level of funding of local functions once achieved can never be reduced. It is possible that in some period the local government functions are funded to an extent exceeding the minimum required for ensuring sufficient funding. It is a decision whose existence without time limits is not guaranteed under the Constitution. The state must retain the possibility to make the system of funding local government functions correspond to the

overall economic situation and the economic and monetary policy goals of the state. Paragraph 1 of article 9 of the Charter also places local authorities' right to sufficient funds in the framework of the state's economic policy.

Thus, the right to sufficient funds does not prohibit the state to reduce the funding of local government functions. The prerequisite is that after reduction of funding the local authority preserves the ability to perform local functions to the minimum extent necessary.

69. The right to sufficient funds for performance of local government functions requires that the state establish a system for funding local government functions that is appropriate and ensures sufficient funding of local functions. Thus, violation of the said right can arise only from such provisions (or failure to adopt them) that regulate (or that, due to the failure to adopt, do not sufficiently regulate) the system of funding local government functions. These include provisions or their absence as a result of which the funding of local functions proves insufficient in the specific local authority.

At the same time a provision cannot violate the right to sufficient funds for performance of local government functions for the reason that it makes performance of some local function compulsory for the local authority or otherwise increases the costs of performance of local government functions. It does not matter whether the obligation of additional cost specifically influences local authorities or a broader circle of addressees (e.g. an increase of the tax burden as a result of which the local authorities' costs of hiring workforce or purchasing goods and services required for performance of local functions increase). There is no reason to claim that the insufficient of funding local functions in the case of a specific local authority is caused by the costs of performance of a specific local authority function (e.g. the one that has been established the most recently).

If the performance of a local function is made compulsory or the costs of performance of the existing duties are increased by law and as a result of which the funding of a local authority's own functions becomes insufficient, the right to sufficient funding has been violated. However, in such an event the right is not violated by the legislation that obligates local authorities to perform a specific local function or increases the costs of performance of local functions, but the legislation regulating the funding of local functions to the extent that it does not provide the local authority with funds for performance of local functions at least to the minimum extent required. However, it cannot be precluded that the state, finding that the funding of local functions cannot be increased for the purpose of eliminating the violation, reduces the requirements arising from law regarding performance of local functions. As a result thereof the funding of local government functions may become sufficient and the violation of the right of the local authority arising from the legislation regulating funding may terminate.

The contents of this point only concern the right to sufficient funds for performance of local government functions and does not mean that the Constitution does not set any limits to the state upon making the performance of local functions compulsory. Where the state makes the performance of some local function compulsory it may disproportionately prejudice the independence of a local authority in deciding on and organising local issues (see also point 64 above).

70. The requirements imposed on the system of sufficient funding of local government functions by subsection 154 (1) of the Constitution do not concern only the level of funding local functions. To keep the right to sufficient funding from becoming a mere illusion and from devaluating the right to municipal self-administration as a whole to a mere declaration the state must, in order to comply with the requirements of subsection 154 (1) of the Constitution, establish such a system for funding local government functions that allows for evaluating the level of sufficiency of the funding of local government functions on a case-by-case basis. Otherwise it becomes impossible to identify whether the local authority's right to sufficient funding has been violated or not. However, a right has actual substance only if violation of the right can be identified.

71. The possibility of funding local functions is required pursuant to subsection 154 (1) of the Constitution also because local authority could seek judicial protection against the insufficiency of funding local

functions. A local authority must have the opportunity to request that a court declare legislation regulating the funding of local functions to be in conflict with subsection 154 (1) of the Constitution insofar as it does not provide the local authority with funds for performance of local functions to at least the minimum extent required. Also, a local authority whose funding system does not ensure at least the minimum level of funds required for performance of local functions has the right to demand in court on the basis of subsection 154 (1) of the Constitution that the state provide the missing funds. Without the possibility of judicial control there would be no legal consequences if the state violated local authorities' right to sufficient funding. Article 11 of the Charter stipulates that local authorities shall have the right of recourse to a judicial remedy in order to secure free exercise of their powers and respect for such principles of local self-government as are enshrined in the constitution or domestic legislation.

In order to enforce the right to sufficient funding in court a local authority must be given a reasonable opportunity to certify that the funding system does not allow for performance of local functions at least to the minimum extent required.

72. In order to evaluate in each single case whether the funding of local government functions is sufficient, it is, first of all, necessary to know how much money the local authority can get for performance of local functions. Therefore subsection 154 (1) of the Constitution requires from the system of funding local government functions that it be clearly distinguishable what funds are earmarked for performance of local government functions and what funds are meant for performance of national functions imposed on the local authority by law.

Identification of the revenue earmarked for performance of local functions using the so-called surplus method according to which the portion of the accruals of the local authority that exceeds the cost of performance of national duties is to be used for performance of local functions is not in compliance with subsection 154 (1) of the Constitution. Identification of the funds designated for performance of local functions using the so-called surplus method does not usually allow for evaluating its sufficiency before the end of the budgetary year when the actual volume of performance of national duties has become clear. This considerably harms the possibilities of the local authority to apply for judicial protection against violation of subsection 154 (1) of the Constitution.

In addition, the use of the surplus method puts the local authority in a financially uncertain situation. Since the exact volume of state duties and thus also the amount of money required for performing them becomes clear only after the end of the budgetary year, it is unclear, upon drafting rural municipality and city budgets using the surplus method, what portion of the planned revenue can actually be used for financing local government functions. Also, upon identification of the revenue designated for performance of local functions using the surplus method, the risk of an unplanned increase of some national duty remains with the local authority. If it becomes evident before the end of the budgetary year that the performance of a national duty requires more money than forecast in the budget, the local authority is likely forced to find funds lacking for performance of the national duty at the expense of the funds planned for performance of its own functions. Thus, the surplus methods does not allow for a clear distinction between the money earmarked for performance of local functions and the money earmarked for performance of national functions. However, such distinction is the prerequisite for subsection 154 (1) and the second sentence of subsection 154 (2) of the Constitution.

73. Obviously, in order to distinguish between the funds earmarked for local government and national functions as well as to evaluate how much money local authorities need for performance of local government functions at the minimum level required it is necessary to have a clear understanding of what the national duties imposed on local authorities by law and what the essentially local government functions are. Thus, subsection 154 (1) of the Constitution demands that the acts that establish some duty of the local authorities specify whether it is a local government or national function. The Court *en banc* has noted in the past that the prerequisite for adherence to § 154 of the Constitution upon funding local authorities is the clarity regarding what the national duties imposed on local authorities by law are (judgment of the Supreme Court en banc of 19 April 2004 in Case No. 3-3-1-46-03, point 22).

Upon specifying the local government and national functions, the legislature has the decision-making freedom within the limits set by the Constitution. In a situation where the legislature has not distinguished between the local government and national duties, the court resolving the dispute can do it on a case-by-case basis. Obviously, the court can verify whether the law is in conflict with the Constitution by designating some essentially local government function as a national function or by considering a national duty a local government duty. However, it is not the court's duty to identify in general what duties imposed on local authorities are national and what duties are local. However, such overall identification of the local functions is the prerequisite for adherence to subsection 154 (1) of the Constitution as well as the second sentence of the second subsection of the same section.

(C) Right to full funding of national duties imposed on local authorities from the state budget

74. Subsection 154 (2) of the Constitution states: "Duties may be imposed on a local authority only pursuant to law or by agreement with the local authority. Expenditure related to the duties of the state imposed on local authorities by law shall be funded from the state budget." The second sentence of subsection 154 (2) of the Constitution regulates the coverage of expenses related to national duties imposed on a local authority. It follows from the provision that a local authority as the right to full funding from the state budget of the national duties imposed on it by law. The said right protects the local authority against having to use funds earmarked for performance of local government duties for performance of national duties imposed on it by law. A situation where a local authority has to find money for performance of national duties at the expense of local functions or make a choice as to which of these duties to perform is in conflict with the second sentence of subsection 154 (2) of the Constitution.

Similarly to the right to sufficient funding for performance of local government functions arising from subsection 154 (1) of the Constitution, the right provided for in the second sentence of subsection 154 (2) of the Constitution demands that it be possible to verify whether the state respects the right to the full funding of national duties from the state budget. This means that, according to the second sentence of subsection 154 (2) of the Constitution, the duties imposed on a local authority by law must be funded in a manner that allows for evaluating whether the state actually covers from the state budget all the expenses of the national duties imposed on local authorities by law. Also, a local authority must have the opportunity to protect itself in court in the event of insufficient funding of national duties imposed by law. A local authority may demand that the absence of such a regulation that would ensure full funding of a national duty imposed on the local authority by law be declared to be in conflict with the second sentence of subsection 154 (2) of the Constitution. Also, a local authority whom the money required for performance of some national function has not been allocated, has the right to demand in court on the basis of the second sentence of subsection 154 (2) of the Constitution that the state provide the funds required for performance of the national function. However, the local authority cannot contest the national duty as such on the basis of the second sentence of subsection 154 (2) of the Constitution. The second sentence of subsection 154 (2) of the Constitution can be considered strictly as a financial guarantee of the local self-government whose goal does not include allowing local authorities interference with resolution of state affairs.

75. Thus, the second sentence of subsection 154 (2) of the Constitution demands that a local authority be given a reasonable opportunity to prove that the funds accruing to it for performance of national duties do not cover the expenses required for performance of national duties. To that end the acts imposing duties on local authorities must stipulate whether these duties are local or national. Also, there must be clarity as to what funds have been allocated to the local authority for deciding on and arranging local issues and that funds have been allocated for performance of national duties imposed by law.

76. The second sentence of subsection 154 (29 of the Constitution establishes specific requirements for allocating money to local authorities for performance of local government functions. According to the second sentence of subsection 154 (2) of the Constitution, expenditure related to the duties of the state imposed on local authorities by law shall be funded from the state budget. The Court en banc finds that the second sentence of subsection 154 (2) of the Constitution means the state budget within the meaning specified in subsection 115 (1) of the Constitution, i.e. an act annually adopted by the Riigikogu, which sets

forth any and all revenue and expenditure.

Among other things, the principles of universality and transparency of the state budget arise from subsection 115 (1) of the Constitution (see also judgment of the Supreme Court *en banc* of 17 March 2000 in Case No. 3-4-1-1-00, point 19). According to the principle of universality, the state budget must contain any and all revenue and expenditure of the state. Thus, the state budget must also recognise the expenses of the state that, according to the second sentence of subsection 154 (2) of the Constitution, arise upon covering the expenses related to the national duties imposed on local authorities. The principle of transparency of the state budget requires at least that the costs of performance of national duties imposed on local authorities be recognised as function-based state budget entries. This means that the state budget must clearly and transparently specify how much money is allocated for performance of one or another national duty imposed on local authorities. How the money to be allocated for performance of some national duty is divided between local authorities does not have to be indicated directly in the state budget, but may be specified in legislation adopted on the basis of the state budget.

77. The second sentence of subsection 154 (2) of the Constitution also means that without any legal basis a local authority must not use the funds allocated to it for some national function for performance of other national duties or local government functions. At the same time the Constitution does not prohibit the state from providing in law or in legislation regulating the allocation of funds to local authorities the terms and conditions in the case of which the local authority may use the funds obtained for performance of a national function for financing other national duties or local government functions.

(D) Right to stability of the system of funding local government functions

78. Upon regulating relations between local authorities and the state, the legislature must adhere to the principle of legal certainty that forms a part of the principle of the rule of law. Legal certainty demands, among other things, that the subjects of law could be certain of the persistence of the established provisions (the principle of legitimate expectation). Local authorities' right to the stability of the system of funding local government functions follows from the principle of legitimate expectation in combination with subsection 154 (1) of the Constitution. This right stipulates the principle of legitimate expectation in relationships between local authorities and the state in matters concerning funding.

79. The Supreme Court *en banc* has previously found regarding the stability of the funding system that the stability of the system of financing local authorities is an important value. A stable and foreseeable financing system allows local authorities to draft more accurate development plan and implement them more effectively (see judgment of the Supreme Court *en banc* of 19 April 2004 in Case No. 3-3-1-46-03, point 25). A stable funding system is inevitable for independent decision-making on and arrangement of any and all local issues. Unstable funding may subtly deprive local authorities of their independence. Therefore local authorities need to be able to act in reasonable expectations that the regulation established for funding their functions remains stable and it is not suddenly made less favourable to local authorities, especially in the middle of the budgetary year.

80. Thus, the right to the stability of the funding system protects local authorities against major unexpected adverse amendment of the legislation regulation the funding of local government functions to the detriment of local authorities, especially in the middle of the budgetary year.

Adverse amendment means, above all, reduction of the funding of local government functions. Any piece of legislation doing so prejudices the right to the stability of the funding system even if it does not result in the insufficiency of funding local government functions. Among other things, this means that reduction of the level of funding of local authorities once achieved prejudices the stability of the funding system. However, a situation where the revenue of local authorities decrease without any interference by the state (e.g. a decrease in tax revenue) cannot deemed such prejudice.

The right to the stability of the funding system does not cover the constitutional requirement that any time any legislation is adopted by the Riigikogu or the Government of the Republic following the adoption of the

state budget, which legislation decreases the budget revenue or increases the budget expenditure of a local authority, these amounts must be compensated for or the duties imposed on the local authority must be reduced accordingly. The aforementioned does not mean that the legislature could not establish such regulation on its own initiative in the interests of local authorities.

81. The stability of the funding system cannot be an end in itself (see judgment of the Supreme Court *en banc* of 19 April 2004 in Case No. 3-3-1-46-03, point 25). Adverse amendment of legislation regulating local government functions is not precluded. The stability of the funding system cannot mean that the regulation in force at some point is cemented forever along with the level of funding ensured at the time. Local authorities cannot expect that the legislation regulating their funding is never amended. The state has the right to amend the legislation regulating funding, where necessary. This may bring about a decrease in the funds to be allocated to local authorities or otherwise harm the regularity of funding them.

82. The right to the stability of the funding system may, similarly to other rights arising from subsection 154 (1) of the Constitution, be limited on the same terms and conditions as the right to municipal self-administration (see also point 64 above).

83. In the event of major amendment of the funding system local authorities must be granted the right to be heard. Local authorities must be involved in making decisions concerning funding them (see paragraph 6 of article 9 of the Charter).

The right to the stability of the funding system also requires that if the state does decide to make the legislation regulating funding considerably more unfavourable, the state must, based on the substance of the amendment, grant local authorities a sufficient period for adaptation to the new regulation (*vacatio legis*).

The principle of legal certainty means, among other things, that a reasonable period must be granted for enforcement of new legislation during which the addressees can access the new provisions and reorganise their activities accordingly. Legal certainty means a situation where the state does not arbitrarily and, so to say, overnight establish new legislation.

Upon creation of a new legal situation, the legislature must thus ensure that the addressee of law has a reasonable, i.e. sufficient amount of time for reorganising its activities. Sufficiency (reasonableness) can be evaluated by taking into account the nature of the legal relationship under observation, the scope of amendment of the legal relationship and the resulting need for reorganisation in the activities of the addressees of the provision as well as by evaluating whether the amendment in the legal environment was foreseeable or not.

(IV) Constitutionality of the provision amending clause 5 (1) 1) of the Income Tax Act (ITA)
(A) Constitutionality of the provision amending clause 5 (1) 1) of the ITA and organisation of funding of local authorities
84. By the provision amending clause 5 (1) 1) of the ITA the Riigikogu reduced the portion of the revenue from the taxable income of resident individuals accruing to the local authority of the taxpayer’s place of residence (the income tax portion) from 11.93% to 11.4%. The provision was adopted on 20 February 2009, published in the Riigi Teataja on 28 February 2009 and entered into force on 1 April 2009 pursuant to subsection 23 (2) of the Supplementary Budget Act.

85. The income tax portion is the main stable source of income of local authorities which is not directly bound to expenses under the legislation in force. The amount to be transferred to local authorities out of the declared gross income (i.e. income from which the deductions provided for in the Income Tax Act have not been made) forms a significant part of the revenue of local authorities. In 2008 local authorities obtained on average 51% of their budget revenue from the income tax portion (then 11.9%) received on the basis of clause 5 (1) 1) of the ITA (see A. Jõgi. Analysis of Revenue, Expenditure and Financing Transactions of Implementation of Local Authorities’ Budget 2008 (overview). Tallinn: Ministry of Finance, 2009, p. 4).

By the provision amending clause 5 (1) 1) of the ITA the accruals of one of the main sources of income of local authorities was thus decreased in comparison with the amount that would have accrued to local authorities if the former wording of clause 5 (1) 1) of the ITA was still in force. Such reduction took place in the middle of the budgetary year of local authorities (see subsection 2 (2) of the RMCBA). The time left between the publication and entry into force of clause 5 (1) 1) of the ITA was one month.

86. According to the Court *en banc*, it is possible that the provision amending clause 5 (1) 1) of the ITA may violate the right to sufficient funding for performance of local government functions. Since the provision amending clause 5 (1) 1) of the ITA reduces accruals of one of the main sources of income of local authorities, it may, among other things, result in a situation where the funds earmarked for performance of local government functions are insufficient for performance of the functions to the minimum extent required.

87. Also, it is possible that the provision amending clause 5 (1) 1) of the ITA may violate the right to full funding of national duties from the state budget, i.e. to cause a situation where the national duties imposed on a local authority are not fully financed from the state budget.

88. In the present case the Court *en banc* cannot identify whether the provision amending clause 5 (1) 1) of the ITA indeed violates the right of the City of Tallinn or another local authority to sufficient funds for performance of local government functions or the right to full funding of national duties from the state budget.

89. The right to sufficient funds for performance of local government functions has been violated if funds for performance of local functions at the minimum level required are not granted to a local authority (see point 65 above). In order to identify whether reduction of an accrual of a local authority violates the right to sufficient funds, it is necessary first to know whether the money accruing from the source has been earmarked for performance of local or national functions. The given right may be violated by reduction of the funds earmarked for performance of local functions. Neither the Income Tax Act nor any other legislation specifies what portion of the income tax accruing to a local authority is to be used for performance of local government functions and what part of the income tax portion must be used for performance of national duties. Based on the legislation in force one can but presume that local authorities have to finance the decision-making on and arrangement of local issues as well as performance of national duties from the income tax portion to an unspecified extent.

90. In addition, in order to identify a violation it must be found out whether after reduction of the funds the funding of local government functions in the specific local authority falls below the minimum level required. For the purpose of identification of the minimum level of funding there must be clarity about what the minimum level of local functions to be performed in the specific local authority is and thus also what the cost of performance of these functions is. Furthermore, it must be known how much funds the existing funding system allows local authorities to obtain for performance of local functions.

The existing system of funding local authorities does not allow for obtaining what the minimum level of local functions to be performed in a local authority is or how much money local authorities can obtain for performance of local functions. The level of local government functions cannot be identified because the limits of national and local functions are vague in the legislation in force. Also, the existing system of funding local authorities does not indicate what funds have been allocated to the local authority for deciding on and arranging local issues and what funds have been allocated for performance of national duties imposed by law.

91. The Court *en banc* has stated above that for the purpose of complying with the requirements of subsection 154 (1) of the Constitution the state must establish such a system for funding local government functions that allows for evaluating the level of sufficiency of the funding of local government functions on a case-by-case basis. According to the second sentence of subsection 154 (2) of the Constitution, the duties imposed on a local authority by law must be funded in a manner that allows for evaluating whether the state

actually covers from the state budget all the expenses of the national duties imposed on local authorities by law. Thereby subsection 154 (1) and the second sentence of subsection 154 (2) of the Constitution require from the system of funding local government functions that it be clearly distinguishable what funds are earmarked for performance of local government functions and what funds are meant for performance of national functions imposed on the local authority by law. It is also necessary that the acts that impose duties on local authorities stipulate whether a function is that of the local self-government or the state (see points 70-76 above).

92. The legislature has not established a system of funding of local authorities that complies with subsection 154 (1) and the second sentence of subsection 154 (2) of the Constitution (see points 89-90 above). Therefore the Court *en banc* cannot evaluate in the present case whether the City of Tallinn or another local authority has, following the reduction of the income tax portion accruing to local authorities, enough money for performance of the local functions at the minimum level required, i.e. whether local authorities' right to sufficient funds has been violated by reduction of the income tax portion or not. Also, the legislation in force does not allow for evaluating in the present case whether the performance of the national duties imposed on local authorities by law has been fully funded also after reduction of the income tax portion.

93. The aforementioned means that the existing system of funding local authorities must, to the extent that it does not allow for evaluating the constitutionality of the provision amending clause 5 (1) 1) of the ITA, be declared unconstitutional. More precisely, it is in conflict with subsection 154 (1) and the second sentence of subsection 154 (2) of the Constitution not to adopt such legislation of general application that distinguishes between the funds earmarked for local authorities for deciding on and arranging local issues and the funds earmarked for performance of national obligation and specifies the funding of national duties imposed on local authorities by law from the state budget.

Furthermore, it is in conflict with subsection 154 (1) and the second sentence of subsection 154 (2) of the Constitution not to adopt such legislation of general application that stipulates what duties imposed on local authorities are local and what are national.

94. Declaring the failure to adopt the legislation of general application specified in the previous point unconstitutional means that the legislature must establish such legislation of general application that allows for distinguishing between funds allocated to local authorities for deciding on and arranging local issues from the funds earmarked for performance of national duties and provides for funding of the national duties imposed on local authorities by law from the state budget. The legislature must also establish clarity in what functions imposed on local authorities are local government functions and what functions are national.

95. The Court *en banc* finds that alone the unconstitutionality established in point 93 of this judgment does not serve as the basis for declaring the provision amending clause 5 (1) 1) of the ITA unconstitutional. The fact that the compliance of legislation or a provision with the constitutional guarantees of the local authority cannot be verified due to the unconstitutionality of the standards regulating the funding of local authorities, is a separate violation that, as such, does not allow for declaring the contested legislation unconstitutional. Declaring legislation or a provision thereof unconstitutional cannot be based on assumptions.

96. The aforementioned also means that declaring merely the system of funding local authorities partially unconstitutional does not give the City of Tallinn or any other local authority the right of claim against the state for compensation of the income tax amount foregone due to the provision amending clause 5 (1) of the ITA.

97. The Tallinn City Council argues that the amendments to the Preschool Child Care Institutions Act, the Youth Work Act and the Sports Act that, according to the explanatory memorandum of the Supplementary Budget Act, were established for the purpose of reducing the obligations in proportion to the reduction of the income tax portion, do not serve their purpose. The petitioner considers this fact a violation of the financial guarantees.

The Court *en banc* finds that in a situation where it is unclear whether after reduction of the income tax portion the funding of local functions has fallen below the minimum level required and whether the performance of national duties is unfunded by the state to some extent it cannot be concluded based on the mere fact of the measures taken for compensation for the reduction of the income tax portion not covering the resulting deficit that the right to sufficient funds for performance of local government functions and the right to full funding of national duties from the state budget have been violated. A violation is a situation where the resulting deficit does not allow local authorities to performed local government functions at the minimum level required or if it is obvious that the money allocated for performance of national duties does not really cover the expenses related to them.

98. Partial unconstitutionality of the funding of local authorities identified in this judgment does not completely preclude the possibility of the local authority to prove that the existing system of funding local authorities does not provide it with sufficient funds and therefore violates its right to sufficient funds for performance of local functions and/or the right to full funding of national duties imposed on it by law from the state budget. In order to prove such a violation the local authority must demonstrate that its revenue as a whole does not allow for funding all the functions that need to be performed at least at the minimum level required (incl. by following the standards provided by law). Thereby the conflict of the system of funding local authorities with the Constitution described in previous points may ease the burden of proof of the local authority in some instances and partially or fully transfer to the state.

(B) Provision amending clause 5 (1) 1) of the ITA and the right to the stability of the system of funding local government functions

99. According to the Court *en banc*, the provision amending clause 5 (1) 1) of the ITA violates the right to the stability of the system of funding local government functions. Reduction of the income tax portion concerns the funding of local government functions because out of the money accruing from the income tax portion local authorities currently also have to perform local government functions to an unspecified extent.

100. The Court en banc explained above that the right to the stability of the funding system protects local authorities against major unexpected adverse amendment of the legislation regulation the funding of local government functions to the detriment of local authorities, especially in the middle of the budgetary year. Adverse amendment means, above all, reduction of the funding. The right to the stability of the funding system also requires that if the state does decide to make the legislation regulating funding considerably more unfavourable, the state must, based on the substance of the amendment, grant local authorities a sufficient period for adaptation to the new regulation (see point 83 above).

101. By the provision amending clause 5 (1) 1) of the ITA the accruals of one of the main sources of income of local authorities were reduced in the middle of the budgetary year. Such a reduction constitutes adverse amendment of the system of funding local government functions to the detriment of local authorities. Therefore the provision amending clause 5 (1) 1) of the ITA prejudices the right to the stability of the system of funding local government functions.

The prejudice of the stability of the funding system is also not precluded by the fact that along with the adoption of the contested provision the legislature also adopted a new wording of § 7 of the RMCBA and amended the Preschool Child Care Institutions Act (see § 8 of the Supplementary Budget Act), the Youth Work Act (see § 9 of the Supplementary Budget Act) and the Sports Act (see § 15 of the Supplementary Budget Act).

102. Although amendment of clause 5 (1) 1) of the ITA prejudices the right of local authorities to the stability of the system of funding local government functions it does not mean that the provision is unconstitutional. The right to the stability of the funding system may be prejudiced by the legislature on the terms and conditions given in point 82 above: the prejudice must be formally and substantively constitutional.

103. The Tallinn City Council argues regarding the formal constitutionality that the Supplementary Budget Act as a whole (incl. the provision amending clause 5 (1) 1) of the ITA) is in conflict with subsection 116 (2) of the Constitution, according to which the Riigikogu must not delete or reduce the expenses included in the state budget or draft state budget in accordance with other acts. According to the Tallinn City Council, subsection 116 (2) of the Constitution does not allow for adding amendments to other legislation to the State Budget Act, because the State Budget Act may, according to subsection 115 (1) of the Constitution, contain only specific revenue and expenditure. Emergence of revenue or incurrence of expenditure may not be regulated in the State Budget Act.

According to the Court *en banc*, the provisions of subsection 116 (2) of the Constitution do not mean that the Riigikogu cannot add provisions amending other acts to the State Budget Act (incl. Supplementary Budget Act), affecting the generating revenue and incurring expenses. This provision establishes the prohibition to reduce and delete expenses provided for in other acts merely by amending an entry of the state budget, thereby not amending the act giving rise to the respective expenses. The purpose of subsection 116 (2) of the Constitution is to prevent a situation where the Riigikogu has provided for some expense by an act, but does not allocate the required funds in the state budget. This provision must prevent a situation where the implementation of an act obligating to incur expenses is implicitly influenced via state budget entries. According to the Court *en banc*, there is no reasonable explanation as to why the Riigikogu should not be able to amend in the implementing provisions of the State Budget Act or Supplementary Budget Act the provisions obligating the incurrence of expenses that the Riigikogu itself has adopted. Thus, subsection 116 (2) of the Constitution does not demand that amendments of expenses provided for in other acts should be made by adoption of an act separate from the budget act, which should be adopted before adoption of the budget act.

104. The Tallinn City Council also argues that the provision amending clause 5 (1) 1) of the ITA is in conflict with the principle of legal certainty, because there was not enough time to make rearrangements caused by the adoption of the provision.

According to the Court *en banc*, the adaptation time between publication and entry into force of the contested provision was sufficient. According to the explanatory memorandum of the Supplementary Budget Act, clause 5 (1) 1) of the ITA was amended in the conditions of a sudden worsening of the economic situation for the purpose of improvement of the budgetary position of the general government, i.e. for reducing the state budget deficit. It was a measure that required urgent implementation. Upon making such amendments, the affected subjects may be granted a shorter than usual period for adaption to the changed situation. It must also be noted that the negative impact of the amendment was not fully manifested upon entry into force of the amendment. The income tax portion accrues to local authorities on a monthly basis and the impact of its reduction is thus expressed over a longer period. Thus, by the moment the amendment entered into force it was only partially necessary to adapt to the decreased revenue from the source. The Court *en banc* is of the opinion that the amendment was not so extensive that it would have had deep impact at the moment of entry into force.

105. The Court *en banc* notes that the purpose of the provision amending clause 5 (1) 1) of the ITA is to decrease the state budget deficit; more precisely, to compensate for the loss of planned revenue arising from the economic recession and to decelerate the decrease of the level of public services provided by the state.

The given provision was adopted in a situation where it was obvious that the state’s revenue planned in the state budget for 2009 would be lost due to the worsening of the overall economic situation. The state budget for 2009 was drafted on the basis of the Ministry of Finance’s economic forecast of the summer of 2008, which expected the economy to grow 2.6% in 2009. The supplementary budget for 2009 was prepared on the basis of the forecast that the Gross Domestic Product of Estonia will fall by 8% in real terms and by 6.5% in current prices in 2009. Therefore, at the time of adoption of the Supplementary Budget Act it was forecast that 66.405 billion kroons of the tax revenue of 77.117 billion kroons planned for the state budget of 2009 would accrue in reality, i.e. 10.712 billion kroons less. Also, it was considered realistic that non-tax revenue

planned in the state budget would decrease by 0.8 billion kroons. Thus, it was necessary to reduce the state budget deficit, incl. to increase the state's revenue (see the Draft 2009 State Budget Act and Related Acts Amendment Act (432 SE, Riigikogu XI) explanatory memorandum – available at: http://www.riigikogu.ee/?page=en_vaade&op=ems&eid=544784&u=20100117161528 [1]).

106. The Court *en banc* finds that the purpose specified in the previous point is constitutional and thus it may justify the limitation of the constitutional guarantees of the local self-government. The prerequisite thereby is, obviously, that the reduction of the income tax portion of local authorities is suitable, necessary and proportional (see also point 64 above) as a measure of cutting the state's expenditure.

107. The provision amending clause 5 (1) 1) of the ITA is a suitable measure for partial compensation of the decrease of the state's revenue and thus reduction of the state budget deficit. To the extent that the income tax portion accruing to local authorities decreases due to the provision (0.53% of the taxable income of resident individuals, without taking deductions into account), the state's revenue increases. This gives the state the chance to reduce performance of its own functions to a smaller extent than it could have been possible without reducing the income tax portion accruing to local authorities.

108. The Court *en banc* has no reason to doubt the necessity of the provision amending clause 5 (1) 1) of the ITA. It does not follow from the opinions of the parties to the procedure that upon adoption of the supplementary budget the state could have used some other measures instead of decreasing the income tax portion of local authorities in order to reduce the state budget deficit, which measures would not have harmed the stability of the system of funding local government functions or which would have done so to a lesser extent, but been at the same time just as efficient from the point of view of the state and which would not have prejudiced the interests of third parties (e.g. increased the tax burden).

109. The Court *en banc* finds that the proportionality of the provision amending clause 5 (1) 1) of the ITA (i.e. whether the reduction of the income tax portion undermines the stability of the system of funding local government functions excessively, i.e. more than the importance of reducing the state budget deficit would justify it) can be verified by the Supreme Court only to a limited extent. The provision amending clause 5 (1) 1) of the ITA regulates the purpose of use of the state's tax revenue – more precisely, its partial amendment. In that question the legislature has extensive decision-making freedom, because according to the underlying idea of the Constitution, the Riigikogu has bread discretion in establishing economic and budgetary policy goals and objectives and shaping the state budget (for comparison, see also judgment of the Constitutional Review Chamber of the Supreme Court of 21 January 2004 in Case No. 3-4-1-7-03, points 15-16). The constitutional review court can interfere here only in the event of an obvious violation. Therefore the Court *en banc* only evaluates whether the prejudice of the stability of the system of funding local government functions arising from the provision amending clause 5 (1) 1) of the ITA is clearly disproportionate.

110. By evaluating the proportionality of the prejudice of the financial stability arising from the provision amending clause 5 (1) 1) of the ITA it is necessary to find an answer to the question of whether the uncertainty brought to the system of funding local government functions – above all, the likely need to revise local budgets, development plans and other financial planning-related decisions and find new sources of income to cover the expenses in the middle of the budgetary year – clearly outweighs the importance of improving the state's budgetary position in this case. The Court *en banc* is of the opinion that the answer to this question is negative.

Firstly, it must be taken into account that the right to the stability of the funding system is an auxiliary, not a central financial guarantee. In point 81 of this decision the Court *en banc* noted that the stability of the system of funding local government functions cannot be an end in itself.

By the provision amending clause 5 (1) 1) of the ITA the portion of the revenue from the taxable income of resident individuals accruing to local authorities was reduced by 0.53 percentage points. It can be concluded on the basis of the data given in the consolidated table of monthly reports of implementation of the budgets of local authorities prepared in the Ministry of Finance on the year 2009 that due to the provision amending

clause 5 (1) 1) of the ITA the revenue of local authorities fell in 2009 by approx. 295,400,000 kroons (6,353,427,000 kroons : 11.4 * 11.93 – 6,353,427,000 kroons, where 6,353,427,000 kroons is the income tax amount that accrued to local authorities on the basis of the new income tax portion from May to December 2009). The said 295,400,000 kroons amounted to approx. 1.5% of the total budget revenue of local authorities in 2009 (20,204,382,981 kroons). Although the share of income tax is different in the budgets of different local authorities, it is nevertheless obvious that the reduction of the income tax portion influenced the budget revenue of local authorities only to the extent of a few percent.

For the aforementioned reasons there is no ground for arguing that the prejudice of the financial stability arising from the provision amending clause 5 (1) 1) of the ITA is clearly disproportionate.

111. Thus, the provision amending clause 5 (1) 1) of the ITA does not violate the local self-government's right to the stability of the system of funding local government functions.

(C) Amendments of the Preschool Child Care Institutions Act, Youth Work Act and Sports Act

112. The *Court en banc* took the view that due to be unconstitutionality of the organisation of funding local authorities it is impossible to identify whether the provision amending clause 5 (1) 1) of the ITA violates the right of a local authority to sufficient funds for a performance of local government functions or the right to full funding of national duties from the state budget (section IV, subsection A). The Court *en banc* are also found that the prejudice of the stability of the system of funding local government functions arising from the provision amending clause 5 (1) 1) of the ITA is proportionate (section IV, subsection B). These conclusions are not rebutted by the argument of the Tallinn City Council that the amendments to the Preschool Child Care Institutions Act, the Youth Work Act and the Sports Act, which were made for the purpose of balancing the prejudice of the financial guarantees of local authorities arising from the provision amending clause 5 (1) 1) of the ITA do not allow local authorities to achieve the level of reduction of costs specified in the explanatory memorandum of the Supplementary Budget Act. In spite thereof the Court en banc considers it necessary of purpose that developing legal practice to draw attention to the fact that the possibilities of saving by local authorities indicated in the explanatory memorandum of the Supplementary Budget Act are merely illusory. Balancing possible prejudices of the constitutional guarantees of local authorities with ostensible measures is not in accordance with the principle of the rule of law.

113. The wording of subsection 3 (2) of the Sports Act (SA) effective before the Supplementary Budget Act entered into force stated that rural municipalities and cities are obligated to support the work of sports organisations located in the administrative territory. However, the Sports Act did not specify any criteria on the basis of which the minimum required level of financial assistance to be granted to sports organisations by a local authority could be derived. It was completely dependent on the choices and financial possibilities of each local authority. Subsection 3 (2) of the SA did not preclude the possibility of mere non-financial support. At any rate it cannot be concluded on the basis of the previous wording of subsection 3 (2) of the SA that the size of any and all financial assistance granted by local authorities to sports organisations before 1 April 2009 was compulsory for the performance of subsection 3 (2) of the SA and that the previous wording of subsection 3 (2) of the SA would not have allowed local authorities to reduce the size of sports assistance.

As of 1 April 2009 a new wording of subsection 3 (2) of the SA was established by § 15 of the Supplementary Budget Act; according to the new wording rural municipalities and cities are obligated to approve the conditions of and procedure for supporting sports organisations from rural municipality or city budgets and the application forms and, where necessary, establish the terms and conditions of self-financing for the purpose of receiving assistance. Also, clause 21 was added to § 3 of the SA; according to the clause rural municipalities and cities are obligated to support the work of sports organisations located in their administrative territory in the event budget funds are available. In the explanatory memorandum of the Supplementary Budget Act it was noted that the amendment of the Sports Act allows for reducing the expenditure of local authorities by approx. 171,000,000 kroons.

According to the Court *en banc*, the amendments made to the Sports Act by the Supplementary Budget Act

do not change the size of the financial obligations of local authorities upon supporting sports organisations. According to the procedure effective both before and after 1 April 2009, the size of the said assistance depends on the budget and preferences of local authorities. Likewise, the said amendments to the Sports Act do not provide any ground for termination of contracts previously made with sports organisations. Therefore the savings specified in the explanatory memorandum of the draft Supplementary Budget Act cannot be achieved in reality.

114. For analogous reasons the Court *en banc* does not agree with the allegation made in the explanatory memorandum of the draft Supplementary Budget Act, according to which the amendment of the Youth Work Act made by § 9 of the Supplementary Budget Act allows for reducing the expenditure of local authorities by approx. 21,000,000 kroons.

The wording of clause 6 (1) 2) of the YWA that was effective before 1 April 2009 stipulated that the rural municipality or city council supports the youth programmes and projects of youth associations operating in the administrative territory of the rural municipality or the city and approves the conditions of and procedure for application of assistance to youth programmes and projects of youth associations from the rural municipality or city budget and the application forms. The act did not explicitly or implicitly determine the minimum required level of supporting youth programmes and projects from the local budget. Thus, it depended on the budget and preferences of the local authority.

According to the Youth Work Act amended by § 9 of the Supplementary Budget Act, a rural municipality or city council approves the conditions of and procedure for supporting youth programmes and projects of youth associations from the rural municipality or city budget and the application forms and, where necessary, requires self-financing conditions for the purpose of receiving assistance (clause 6 (1) 2) of the YWA) and, upon availability of budget funds, supports the youth programmes and projects of the youth associations operating in the administrative territory of the rural municipality or city (clause 6 (1) 21 of the YWA).

The Court *en banc* notes that the minimum compulsory amount of the money allocated to youth work by local authorities in line with this legislative amendment did not substantively change. Thus, § 9 of the Supplementary Budget Act did not enable local authorities to achieve the savings specified in the explanatory memorandum of the draft act.

115. By subsection 8 (1) of the Supplementary Budget Act the Preschool Child Care Institutions Act was amended in such a manner that the age as of which nursery school admission must be granted to children was raised from the age of 12 months to the age of 18 months. According to the explanatory memorandum, the amendment allows for reducing the costs of local authorities by approx. 260,000,000 kroons. The Minister of Finance is of the opinion that the said amount has been calculated by multiplying the number of children of 12 to 18 months of age who are potentially interested in using nursing services in Estonia and the average costs of the local authority upon payment for nursing one child.

According to the Court *en banc*, such methodology does not taken into account the existence of nursery school waiting lists in local authorities (which means that places remaining vacant of children aged 12 to 18 months should be filled with older children who would otherwise not be admitted to a nursery school). Furthermore, it has not been taken into account that in the case of these children aged 12 to 18 months whom nursery school services are provided at the time of entry into force of the legislative amendment it may not be legally possible to terminate the provision of the service merely due to the age of the child. In addition, it must be kept in mind that reduction of the number of children attending preschool child care institutions does not allow for cutting costs to the same extent. The reason lies in the fact that the size of the fixed costs of the institution providing child care services depends only partially on the number of children.

The Court *en banc* finds that although the amendment made to the Preschool Child Care Institutions Act may cut the costs of some local authorities it is not convincing that the total savings could be as large as argued in the explanatory memorandum of the draft Supplementary Budget Act.

116. As mentioned above, the fact that the legislative amendment made by the Supplementary Budget Act do not really cover the revenue foregone of local authorities due to the provision amending clause 5 (1) 1) of the ITA does not mean that the provision amending clause 5 (1) 1) of the ITA should be declared unconstitutional.

(V) Constitutionality of the provision amending subsection 16 (3) of the Roads Act (RA)

117. As regards the petition of the Tallinn City Council to declare invalid § 16 of the 2009 Supplementary Budget Act and Related Acts Amendment Act and the wording of subsection 16 (3) of the Roads Act effective as of 1 March 2009 amended by it (hereinafter the provision amending subsection 16 (3) of the RA) the Court *en banc* notes the following.

118. The wording of subsection 16 (3) of the RA effective from 1 January 2008 until 28 February 2009 stated the following: "The division of funds for the management of national roads and local roads shall be specified in the state budget for each budgetary year. The total amount of expenditure prescribed by the state budget for financing of road management shall be equal to no less than 10 percent of the proceeds planned from fuel excise duty at the rate specified in subsection (2) of this section." Subsection 16 (2) of the RA states that the total amount of expenditure prescribed by the state budget for the financing of road management shall be equal to not less than 75 percent of the proceeds planned from fuel excise duty, except excise duty on fuel marked with a fiscal marker and on natural gas, and 25 percent of the proceeds planned from excise duty on fuel marked with a fiscal marker. By § 16 of the Supplementary Budget Act contested in this case subsection 16 (3) was amended and worded as follows: "The division of funds for the management of national roads and local roads shall be specified in the state budget for each budgetary year."

Thus, by the provision amending subsection 16 (3) of the RA a provision that specified the minimum level of funds allocated for management of local roads under the annual state budget was repealed. The wording in force of subsection 16 (3) of the RA allows the Riigikogu to decide upon approval of the state budget over the allocations for management of local roads without thereby having to take into account the formal restrictions to the minimum level of the amount to be allocated.

119. The Tallinn City Council finds that the provision amending subsection 16 (3) of the RA is in conflict with the second sentence of subsection 154 (2) of the Constitution, according to which expenses related to national duties imposed on local authorities by law shall be covered from the state budget. Also, the petition seems to argue that the provision amending subsection 16 (3) of the RA violated the right of the City of Tallinn to sufficient funds for performance of local government functions. The petitioner argues that since the funds allocated to local authorities for management of roads were reduced in 2009 in comparison with 2008, the road condition requirements and road lighting standards established by the state should have been eased and thereby the obligations of local authorities should have been reduced. The City of Tallinn does have the obligation to organise the management of the city's roads, but the amount funds necessary for performance of this function has not been allocated to the city.

120. The Court en banc agrees with the Chancellor of Justice and the Minister of Finance that based on subsection 6 (1) of the LGOA and subsection 25 (3) of the RA the management of local roads is a local government function whose performance has been made compulsory by law. Therefore subsection 16 (3) of the RA regulating management of local roads or § 16 of the Supplementary Budget Act that amended it cannot violate the right of local authorities to the funding of national duties from the state budget, which arises from subsection 154 (2) of the Constitution.

121. Subsection 16 (3) of the RA does not, according to the Court *en banc,* violate the right of local authorities to sufficient funds for performance of local government functions (subsection 154 (1) of the Constitution).

As noted, management of local roads is a local government function. The right to sufficient funds for performance of local government functions demands that the state support the function insofar as the money

accruing to the local authority for performance of local functions does not allow for keeping roads in the required condition without impeding the performance of other government functions at the minimum level required. This also means that if a local authority has enough money for performance of all local functions at least at the minimum level required, the state does not have to separately finance management of local roads.

Whether the act binds the minimum amount of the money allocated to local authorities for maintenance of local roads to the expected accrual of some tax or not, does not determine whether the amount allocated to a local authority for road management along with other revenue of the local authority is sufficient for keeping the local roads in the required condition without impeding the performance of other local government functions at the minimum level required.

The wording of subsection 16 (3) of the RA that entered into force on 1 March 2009 allows the state to allocate less money to local authorities than the earlier wording of the same subsection. Reduction of the funds allocated by the state to a local authority cannot violate the local authority's right to sufficient funds for performance of local government functions, because as explained in point 68 of this judgment, the said right does not protect the local authority against the system of funding local government functions becoming less favourable if as a result thereof the funding of the internal functions of the local authority does not turn insufficient. The provision amending subsection 16 (3) of the RA does not impede providing local authorities with sufficient funds for performance of local government functions. Thus, the provision does not violate the right of local authorities to sufficient funds for performance of local government functions, which arises from subsection 154 (1) of the Constitution.

122. However, the Court *en banc* finds that the provision amending subsection 16 (3) of the RA prejudices the right of local authorities to the stability of the system of funding local government functions.

The provision amending subsection 16 (3) of the RA does not reduce the amount of money allocated to local authorities, because it is set in the state budget for each budgetary year and may also exceed the minimum level specified in the wording of subsection 16 (3) of the RA that was in force before 1 March 2009. Nevertheless, in the middle of the budgetary year the provision amending subsection 16 (3) of the RA changed the previous situation whereby local authorities had the certainty that they will receive at least the minimum amount required for road management, with the amount being largely foreseeable. The wording of subsection 16 (3) of the RA in force before 1 March 2009 gave local authorities stronger confidence in planning their activities. Repeal of the security contained in the earlier wording of subsection 16 (3) of the RA as of 1 march 2009 can be treated as an unexpected and substantial amendment of legislation regulating the funding of local government functions whereby the legislation becomes less favourable towards local authorities, because it allowed the Riigikogu to reduce the funding of local government functions in the middle of the budgetary year.

According to the Court *en banc*, the provision amending subsection 16 (3) of the RA does not prejudice the right of local authorities to the stability of the funding system simply because it allows for reducing the funding of local government functions in the middle of the budgetary year. The stability of the funding system is, to a certain extent, prejudiced by the fact that the provision amending subsection 16 (3) of the RA makes it more difficult for local authorities to forecast the amount of money accruing for performance of local government functions in the future and thus also makes drafting longer-term development plans more difficult.

123. Next, the Court *en banc* will evaluate the constitutionality of the prejudice of the stability of the funding system arising from subsection 16 (3) of the RA.

124. The contents of the petition of the Tallinn City Council do not provide any ground for concluding that the provision amending subsection 16 (3) of the RA is formally unconstitutional. In point 103 of this judgment the Court *en banc* found that the requirements of subsection 116 (2) of the Constitution were not violated. Also, there are no other reasons for declaring the provision amending subsection 16 (3) of the RA formally unconstitutional.

125. Similarly to the provision amending clause 5 (1) 1) of the ITA, the purpose of the provision amending subsection 16 (3) of the RA is to reduce the state budget deficit (see point 105 above). While the provision amending clause 5 (1) 1) of the ITA allowed for increasing the state's revenue, the provision amending subsection 16 (3) of the RA created the possibility of reducing state budget expenditure at the expense of the money allocated for management of local roads.

126. The goal of reducing the state's expenditure in the case of a decrease of the revenue planned in the state budget is in accordance with the Constitution and thus the measure justifies prejudice of the constitutional guarantees of the local self-government in the case of proportionality.

127. The provision amending subsection 16 (3) of the RA gave the state the opportunity to allocate for management of local roads less than 10% of the road management funds. Thus, the provision amending subsection 16 (3) of the RA is suitable for reducing the state's expenditure.

128. The Court *en banc* has no reason to doubt the necessity of the provision amending subsection 16 (3) of the RA. The Supreme Court has no information that would allow for concluding that upon adoption of the supplementary budget the state could have used some other measures instead of decreasing the income tax portion of local authorities in order to reduce the state budget deficit, which measures would not have harmed the stability of the system of funding local government functions or which would have done so to a lesser extent, but been at the same time just as efficient from the point of view of the state and which would not have prejudiced the interests of third parties (e.g. increased the tax burden).

129. Similarly to the provision amending clause 5 (1) 1) of the ITA, the issue regulated by the provision amending subsection 16 (3) of the RA concerns partial amendment of the purpose of use of the state revenue (to be more precise, in the case of the provision amending subsection 16 (3) of the RA it is rather the creation of a possibility). Therefore the Supreme Court verifies the proportionality of the provision amending subsection 16 (3) of the RA only to a limited extent, evaluating whether the provision is clearly disproportionate (see also point 109 above).

The Court *en banc* does not find that the uncertainty caused in the system of funding of local government functions, considering its scope, would clearly outweigh the importance of reducing the state budget deficit. Therefore it cannot be found that the said provision is clearly disproportionate as a measure for cutting the state's expenditure.

(VI) Constitutionality of §§ 12^2 and 31^3 the Occupational Health and Safety Act (OHSA)

130. The Tallinn City Council finds that §§ 12^2 and 31^3 of the OHSA established by subsections 19 (2) and (3) of the Supplementary Budget Act, which impose on all Estonian employers (including local authorities) the obligation to pay employees as of 1 July 2009 benefits from the fourth to eight day of a sickness or injury to the extent of 80% of the employee's average wages, are also in conflict with the constitutional guarantees of local self-government. According to the petition, establishment of §§ 12^2 and 31^3 of the OHSA is in conflict with § 154 of the Constitution, because due to these provisions the costs of local authorities as well as employers will increase considerably, while the state has not allocated money to local authorities for covering the additional expenditure arising from §§ 12^2 and 31^3 of the OHSA.

131. According to the Court *en banc*, the establishment of §§ 12^2 and 31^3 of the OHSA does not violate the right of local authorities to sufficient funds for performance of local functions even if as a result of the combined impact of the provisions there should be a situation where the funds of the local authority are insufficient for performance of the local functions at the minimum level required.

Sections 12^2 and 31^3 of the OHSA probably increase the costs of performance of local functions, because as a result of the provisions local authorities' costs related to employees needed for performance of local functions will increase. In point 69 of this judgment the Court *en banc*found that if the performance of a local function is made compulsory or the costs of performance of the existing duties are increased by law

and as a result of which the funding of a local authority's own functions becomes insufficient, the right to sufficient funding has been violated. However, in such an event the right is not violated by the legislation that obligates local authorities to perform a specific local function or increases the costs of performance of local functions, but the legislation regulating the funding of local functions to the extent that it does not provide the local authority with funds for performance of local functions at least to the minimum extent required. In accordance with the aforementioned the Court *en banc* is of the opinion that §§ 12^2 and 31^3 of the OHSA cannot violate the right of local self-government to sufficient funds for performance of local government functions arising from subsection 154 (1) of the Constitution, because §§ 12^2 and 31^3 of the OHSA do not regulate the funding of local functions.

132. The Court *en banc* finds that there is also no ground for declaring §§ 12^2 and 31^3 of the OHSA to be in conflict with the right of local authorities to full funding of national duties from the state budget arising from the second sentence of subsection 154 (2) of the Constitution.

If a local authority has to hire employees whose functions are solely or mainly related to performance of national duties imposed on a local authority, the employee-related liabilities of the local authority will rise. Such employee-related liabilities, incl. sickness benefits paid in the framework thereof, can be viewed as expenses of performance of national duties. Sections §§ 12^2 and 31^3 of the OHSA probably increase these expenses. According to the second sentence of subsection 154 (2) of the Constitution, a local authority is entitled to full coverage from the state budget of the expenses related to performance of national duties. Thus, if the expenses of performance of national duties rise due to, for instance, a rise in employee-related liabilities, a local authority does not have to pay for such an increase at the expense of performance of local government functions, but these must be compensated from the state budget.

The Court *en banc* took the view above that a local authority cannot contest a national duty as such on the basis of the second sentence of subsection 154 (2) of the Constitution. The second sentence of subsection 154 (2) of the Constitution can be considered strictly as a financial guarantee of the local self-government whose goal does not include allowing local authorities interference with resolution of state affairs. A local authority may demand that the absence of such a regulation that would ensure full funding of a national duty imposed on the local authority by law be declared to be in conflict with the second sentence of subsection 154 (2) of the Constitution. Also, a local authority whom the money required for performance of some national function has not been allocated has the right to demand in court on the basis of the second sentence of subsection 154 (2) of the Constitution that the state provide the funds required for performance of the national function (see point 74 above).

Thus, establishment of §§ 12^2 and 31^3 of the OHSA cannot be in conflict with the second sentence of subsection 154 (2) of the Constitution. The opposite position would result in a situation where local authorities had, besides demanding full funding of national functions by the state, extensive opportunity to substantively interfere in the resolution of some state affair merely for the reason that the resolution of the issue influences the costs of performance of national duties imposed on local authorities. This would not be in accordance with the underlying idea and purpose of the second sentence of subsection 154 (2) of the Constitution. On the basis of the second sentence of subsection 154 (2) of the Constitution a local authority can file against a state a claim for compensation of the amount by which the costs of performance of national duties imposed on the local authority by law increase due to some national measure. Thus, a local authority whose costs of performance of national duties increased due to the establishment of §§ 12^2 and 31^3 of the OHSA demand that the state compensate for the rise in the expenses. To file such a claim a local authority must indicate how high employee-related liabilities it has to bear for the purpose of performance of national duties and how much they will presumably increase due to the establishment of §§ 12^2 and 31^3 of the OHSA. In a situation where legislation does not clearly specify the national and local government duties imposed on local authorities a local authority can, relying on the overall distinction criteria (see point 53 above), apply for compensation of the employee-related liabilities associated with the performance of the functions considered national by the local authority. The court resolving the dispute can evaluate whether the distinction between the national and local functions specified in the petition of the local authority is founded (see point 73 above).

133. Sections §§ 12^2 and 31^3 of the OHSA do not prejudice local authorities' right to the stability of the funding system either. In point 80 of the judgment the Court en banc explained that the said right is prejudiced by major unexpected adverse amendment of the legislation regulating the funding of local government functions to the detriment of local authorities. However, sections 12^2 and 31^3 of the OHSA are not provisions regulating the funding of local authorities.

134. For the aforementioned reason there is no ground for declaring §§ 12^2 and 31^3 of the OHSA unconstitutional.

(VII) Constitutionality of §§ 8^1 and 28^1 of the Rural Municipality and City Budgets Act (RMCBA)
(A) Sections 8^1 and 28^1 and the right to assume debt obligations
135. The Tallinn City Council has also contested subsections 20 (3) and (4) of the Supplementary Budget Act, which added §§ 8^1 and 28^1 of the RMCBA. The petitioner argues that the prohibition to assume debt obligations and the requirement to seek the approval of the Ministry of Finance for assumption of these obligations violate the right to municipal self-administration and financial guarantees of local authorities.

136. Section 8^1 of the RMCBA, which pursuant to § 28^1 of the RMCBA remains in force until the end of 2011, is applied once the GDP has fallen for two consecutive quarters. In such a situation the limits specified in subsection (1) of this section apply to local authorities and entities dependent on them with regard to bond issues as well as assuming loan, financial lease and factoring obligations, obligations arising from service concession agreements, assumption of long-term obligations before suppliers and assumption of other long-term obligations that require payment of money in the future.

Restrictions upon assumption of the obligations specified in the previous paragraph are as follows: first, local authorities and the entities dependent on them may assume debt obligations only for the purposes listed in the provision, that is, for bridge financing of structural assistance and other foreign assistance, for ensuring the self-financing required for obtaining structural assistance or other foreign assistance or for refinancing existing obligations assumed before the entry into force of the act; second, local authorities and entities dependent on them must seek the approval of the Ministry of Finance even if the obligations are assumed for the listed purposes.

The Ministry of Finance shall evaluate the financial capacity of rural municipalities and cities and entities dependent on them on the basis of the information given in the budget. If the Ministry of Finance finds that a rural municipality or city or the entity dependent on it is able to ensure the self-financing required for obtaining structural assistance or other foreign assistance without assuming obligations, the Ministry of Finance may dismiss the request for assumption of the obligation or make a proposal for reduction of the amount of the obligation to be assumed.

Suspension of allocations of the budget equalisation fund and transfer of the income tax portion are sanctions imposed in subsections 8^1 (4) to (7) of the RMCBA for violation of the restrictions set on the assumption of debt obligations.
Subsection 8^1 (2) of the RMCBA authorises the Government of the Republic to establish a more detailed list of the obligations that constitute the object of the restrictions as well as terms and conditions of and procedure for submission of approval requests and evaluation of requests. Subsection 8^1 (7) of the RMCBA authorises the Government of the Republic to establish a procedure for refunding the funds suspended by a regulation.

These provisions were adopted on 20 February 2009 and entered into force pursuant to subsection 23 (1) of the Supplementary Budget Act on the date following publication in the Riigi Teataja, i.e. on 1 March 2009.

137. According to the Court *en banc*, §§ 8^1 and 28^1 of the RMCBA, prejudice the right of local authorities to assume debt obligations. In the framework of local issues local authorities have the right to independent decision-making, i.e. without the interference by the central power as to whether to assume debt obligations

for resolution of local issues and how much debt obligations to assume. The right to assume debt obligations protects local authorities against the state's interference in making these decisions. The contested provisions of the Rural Municipality and City Budgets Act limit the independence of local authorities in assuming debt obligations. These provisions virtually establish a prohibition on assumption of debt obligations; single clearly limited exceptions have been established on the basis as the goal of these obligations. Assumption of debt obligations in these exceptional cases is subjected to the control of the central power of the state (Ministry of Finance). The sanction for disregarding the established limits is suspension of two important sources of income (budget equalisation fund and income tax portion).

138. The fact that §§ 8^1 and § 28^1 of the RMCBA prejudice the right to assume debt obligations does not mean that these provisions are unconstitutional. They are unconstitutional if it becomes evident that the legislature established them disregarding the competence, procedural and formal requirements provided for in the Constitution or if the provisions are legally unclear or if §§ 8^1 and § 28^1 of the RMCBA were not established for attainment of a goal permitted under the Constitution or if they are not proportionate for achieving their goal (see point 64 above).

139. In the opinion of the Court *en banc* sections 8^1 and § 28^1 of the RMCBA were established in line with the competence, procedural and formal requirements. In point 103 the Court *en banc* found that the requirements of subsection 116 (2) of the Constitution were not violated upon adoption of the Supplementary Budget Act (incl. the provisions under observation in this point). According to the Court *en banc*, the provisions establishing restrictions on assumption of obligations are also formally constitutional in other respects.

140. Nevertheless, the Tallinn City Council argues that §§ 8^1 and § 28^1 of the RMCBA do not comply with the requirements of legal clarity. The Tallinn City Council refers to the fact that the GDP is a varying figure whose growth and fall cannot be influenced by local authorities. The restriction on assumption on obligations based on such a statistical indicator does not allow local authorities to unambiguously understand whether they can take a loan in the budgetary year for performance of functions and how much loan they can take.

141. Legal clarity means that legislation must be sufficiently clear and understandable so legal authorities can reasonably foresee the state's activities and adjust their activities accordingly.

In the opinion of the Court *en banc* §§ 8^1 and § 28^1 of the RMCBA are sufficiently clear and understandable. The GDP is indeed a varying figure, but its change can be determined unambiguously using standardised methodology. The periodic nature of calculation and the disclosure of the GDP are not accidental either (see subsection 3 (2) of the Official Statistics Act and the lists of annual official statistical observations established on the basis thereof as well as the disclosure calendar of the Statistical Office). Binding legal consequences to such a statistical indicator precludes arbitrary action by the state. The independence of application of the restrictions is also ensured by the fact that the development of the indicator depends on the factors that are not controlled by local authorities or the state.

142. The Tallinn City Council also argues that the time given to local authorities for adapting to the restrictions contained in §§ 8^1 and § $28^1$of the RMCBA was insufficient. As regards the length of the period between the publication and entry into force of §§ 8^1 and § 28^1 of the RMCBA the Court *en banc* notes that, considering the environment of establishment of the restrictions, it was not in conflict with the principle of legal certainty. These provisions entered into force as soon as possible, i.e. on the day following the publication of the Supplementary Budget Act. Such time of entry into force is shorter than the general ten-day term provided for in § 108 of the Constitution, but is not in conflict with the Constitution, because the same section also allows for enforcing acts before ten days have passed from publication in the Riigi Teataja. If these restrictions had been enforced after a longer period, their goal would not have been attainable. Assumption of debt obligations would have undermined the state's possibilities of ensuring macroeconomic stability and controlling the budgetary position of the general government.

143. According to § 8^1 of the RMCBA, the goal of the restrictions is to ensure macroeconomic stability and control the budgetary position (i.e. budget deficit) of the general government over up to three years after the GDP has fallen for two consecutive quarters.

The goal of the established restrictions is, according to the Court *en banc*, also to perform obligations arising from the fundamental treaties of the European Union that became binding upon Estonia as of its accession to the European Union on 1 May 2004 (see Article 2 of the Act of Accession to the Treaty of Accession to the European Union). The explanatory memorandum of the Supplementary Budget Act confirms performance of these obligations as a goal of the restrictions. According to the explanatory memorandum, by amending the Rural Municipality and City Budgets Act it was attempted to give the state better control of the general government deficit in the conditions of the economic recession in order to "ensure that the Estonian state fulfils the Maastricht criteria of the European Union regarding the general government deficit" (see the explanatory memorandum of the Supplementary Budget Act specified in point 101 above, p. 92). The obligation of a Member State to refrain from an excessive state budget deficit arose from article 104(1) of the EC Treaty at the time of adoption of the Supplementary Budget Act. According to the Lisbon Treaty that entered into force on 1 December 2009, the same obligation is included in article 126(1) of the Treaty on the Functioning of the European Union (the former EC Treaty; TFEU). Performance of this obligation is a prerequisite for fulfilment of one condition of transition to the euro (a so-called Maastricht criterion) (see TFEU article 140(1) (former EC article 121(1)) and article 2 of Protocol No. 13 (former EC Treaty Protocol No. 21)). The connection between the budget deficit and the obligations of the local authorities proceeds from Protocol No. 12 (former EC Treaty Protocol No. 20) referred to in article 126(2) of the TFEU (former EC article 104(2)); according to article 2 of Protocol No. 12, for the purposes of the protocol and article 126 of the TFEU "'government' means the general government, that is a central government, regional or local government and social security funds, to the exclusion of commercial operations, as defined in the European System of Integrated Economic Accounts." According to article 3 of the protocol, the Member States shall ensure that national procedures in the budgetary area enable them to meet their obligations in this area deriving from these Treaties.

In addition to the aforementioned the explanatory memorandum of the Supplementary Budget Act notes that the restrictions of assumption of debt obligations have been established to prevent the insolvency and excessive debt burden of local authorities. In other words, they have been established in order to prevent a situation where the costs of repayment of debt obligations account for such a portion of the revenue of local authorities, that it starts adversely impacting the performance of the functions of the local authorities, incl. the obligation arising from § 14 of the Constitution to uphold fundamental rights and freedoms.

144. According to the Court *en banc*, it is legitimate to strive for these goals. The Constitution does not preclude establishment of the restrictions established in §§ 8^1 and § 28^1 of the RMCBA for the aforementioned purposes.

145. Nevertheless, the state may limit the right to assume debt obligations only using measures that are suitable, necessary and proportional for attainment of the goal of the prejudice and do not distort the very essence of the right (see point 64 above).

146. According to the Court *en banc*, restrictions established by §§ 8^1 and § 28^1 of the RMCBA are suitable for attainment of the goals listed in point 143.

Assumption of debt obligations by local authorities influences the development of their budget deficit. According to article 2 of Protocol No. 12 of the TFEU (former Protocol No. 20 of the EC Treaty), local authorities are part of general government for the purposes of European Union law. Local authorities act factually and legally in the same space as the state. They are part of the public sector and the system of exercising public authority as well as part of the public budget system and influence the state's economic position with their activities. Debt obligations assumed by local authorities thus increase the budget deficit of the entire general government. The consolidated budget of general government that includes the budgets

of all local authorities must as a whole comply with the budget deficit criteria arising from the Treaty on the Functioning of the EU. These criteria have been set forth in article 126(2) of the TFEU (former EC article 104(2)) in combined effect with article 1 of Protocol No. 12 added to the treaty (former EC Treaty Protocol No. 20). Restriction of assumption of debt obligations by local authorities is thus suitable for limiting the budget deficit of the entire general government.

Limiting the budget deficit is, in turn, a measure for ensuring macroeconomic stability and the Court *en banc* has no reason to doubt the suitability of the measure for attainment of the goal.

Limiting assumption of debt obligations thus helps to meet the obligation arising from the membership of the European Union to refrain from excessive budget deficit. Ensuring macroeconomic stability is supported through it. Considering the aforementioned, limiting the assumption of debt obligations is suitable for protecting local authorities against insolvency and an excessive burden of obligations.

147. The Tallinn City Council finds that the restrictions on assumption of debt obligations are necessary only in the case of those local authorities that have difficulties meeting their obligations and whose share in the development of the general government deficit is large.

The Court *en banc* is of the opinion that establishment of restrictions on merely some local authorities is not as efficient a measure for controlling the general government deficit as a restriction applied without exceptions as indicated in the contested provisions. The general government deficit is influenced by the debt obligations of all local authorities. The restrictions established by § 8^1 of the RMCBA help to keep the consolidated deficit of local authorities under control throughout the state.

The borrowing restrictions specified in § 8 of the RMCBA ("Taking loans") are not sufficient for limiting the budget deficit of the general government, because they do not allow for controlling a sudden rise in the debt burden. This is especially the case in a situation where the pressure towards taking a loan increases due to a decrease in other income arising from the economic recession. Subsection 8 (1) of the RMCBA stipulates only the maximum limit of all debt obligations and does not limit how much a local authority can increase its debt obligations over one year. Thus, a local authority could assume debt obligations to the extent of the limit specified in subsection 8 (1) of the RMCBA over a year, but that does not guarantee fulfilment of the budget deficit criterion. Subsection § 8^1 of the RMCBA allows for preventing such a situation.

The restrictions arising from the contested provisions do not directly specify a limit of an increase of debt obligations per budgetary year. However, an excessive rise in debt obligations is prevented by the fact that they can be assumed solely for obtaining structural assistance or other foreign assistance. Receipt of structural assistance and other foreign assistance is not fully controlled by local authority decisions and its annual size and thus the need for self-financing is limited.

In the opinion of the Court *en banc* more lax restrictions on assumption of obligations would not be as efficient for achieving the goal. Receipt of structural assistance, other assistance of the European Union or other foreign assistance increases the revenue of local authorities. Assumption of debt obligations for the purpose of ensuring the bridge financing or self-financing required for receiving such assistance thus reduces the budget deficit of general government. Other investments do not have a similar connection with an increase of the revenue of local authorities or reduction of the budget deficit.

The obligation to seek the approval of the Ministry of Finance is also necessary. If the act stipulated merely the goals for attainment of which a loan may be taken, local authorities could take loans for such purposes in order to release funds for other functions. However, upon approval the Ministry of Finance evaluates whether the assumption of the debt obligation is necessary or the self-financing can be ensured with the help of other funds available to the local authority.

For these reasons the Court *en banc* finds that the restrictions specified in §§ 8^1 and § 28^1 of the RMCBA

comply with the necessity criterion.

148. Upon deciding on the proportionality of the prejudice, the Court *en banc* weighs, on the one hand, the extent and intensity of interfering with the scope of protection of the right to assume debt obligations and, on the other hand, the importance of the objective of the prejudice.

149. Upon evaluation of the intensity and extent of the prejudice, the Court *en banc* proceeds from the following circumstances:
The limit of assumption of debt obligations may prevent performance of such local government functions for which the assistance specified in § 8^1 of the RMCBA cannot be received or for which no assistance was granted. Assumption of debt obligation is an important measure for local authorities for performance of several local functions specified in subsections 6 (1) and (2) of the LGOA. These functions include ones that require large-scale investments in construction and renovation of civil engineering works and acquisition of equipment (e.g. organisation of public transport in a rural municipality or city, management of various public institutions such as schools and libraries). According to § $8^1$of the RMCBA, debt obligations can be assumed for investment purposes only if the investment is related to structural assistance, other European Union assistance or other foreign assistance.

Even upon assumption of permitted debt obligations, local authorities are not fully independent in their decisions based on subsections 8^1 (2) and (3) of the RMCBA. A local authority must seek the approval of the Ministry of Finance with regard to each and every debt obligation to be assumed. Pursuant to subsection 8^1 (3) of the RMCBA the Ministry of Finance verifies whether the local authority assumes the debt obligation for a purpose permitted under subsection 81 (1) of the RMCBA. The Ministry also checks whether the local authority or the entity dependent on it is able to secure the self-financing required for receiving structural assistance or other foreign assistance without assuming any debt obligations. Thereby the Ministry evaluates whether it would be possible by reducing the total amount of remaining investments or at the expense of the operating income exceeding operating expenses, the legal reserve planned in the budget or available funds kept in deposit. If it is so, the Ministry of Finance can disapprove the request for assumption of the obligation or make a proposal to reduce the amount of the obligation to be assumed.

The procedure established in subsections 8^1 (2) and (3) of the RMCBA subjects local authorities virtually to the control of the state in making a decision on the issue of assuming a debt obligation as one of the local issues falling within the scope of protection of the right of municipal self-administration. According to these provisions, the state has the right to verify how it is the most reasonable to finance the project that has been declared to be worthy of implementation by the local authority.

The Ministry of Finance cannot arbitrarily refuse from granting approval. The refusal must be reasoned and disapproval can be contested by the local authority in an administrative court.

However, it should be noted regarding application of the restriction specified in § 8^1 of the RMCBA that according to the assurance of the Minister of Finance the section is interpreted in the interests of the protection of the trust of local authorities in a manner that is less burdensome for local authorities (see the explanations of the Ministry of Finance regarding approval of obligations to be assumed by local authorities – available at: http://www.fin.ee/?id=81762 [2]). According to the interpretation, loans may be taken without limit for financing obligations assumed before 1 March 2009. Obligations assumed also mean, in addition to contracts made by the date, other binding obligations before another party or other parties, which have emerged in any manner whatsoever (e.g. by publication of a contract notice). Also, the interpretation of the Ministry of Finance allows for taking overdraft for balancing the cash flow of the budgetary year if the overdraft contract contains the obligation to repay the loan by the end of the budgetary year.

The extent and intensity of the prejudice arising from the restriction of assumption of debt obligations and the obligation to seek approval of debt obligation is substantially influenced by the fact that the validity of the disputed provision is limited in terms of time. Subsection 8^1 of the RMCBA has clearly been planned as a temporary measure that, according to § 28^1 of the RMCBA, remains in force until the end of 2011.

150. In the opinion of the Court *en banc* the restrictions specified in §§ 8^1 and 28^1 of the RMCBA have important goals that arise from the economic and monetary policy of the European Union and Estonia. Attainment of these goals determines the state's economic and monetary reliability and public sector solvency.

An excessive budget deficit caused by a possible budget deficit of local authorities increases the state's debt burden. If the economic growth does not pick up, elimination of the debt will result in pressure to raise taxes or reduce the volume of public services (incl. social guarantees). In order to prevent, among other things, an excessive rise of the public debt, the maximum annual general government budget deficit permitted in the European Union is 3% of the GDP (see article 1 of Protocol No. 12 of the TFEU referred to above). Adherence to the limit is important for ensuring macroeconomic stability regardless of whether it is compulsory or helps to achieve some other political goal (such as joining the euro zone).

Refraining from an excessive budget deficit is an obligation of the European Union membership arising from the Treaty on the Functioning of the European Union (formerly, the EC Treaty).

Upon considering reasons justifying prejudice, Estonia's economic situation must be taken into account (see point 105 above). If a local authority takes a loan in a situation where its revenues decrease substantively due to economic recession, the risk that the amount spent on servicing the new debt obligation accounts for such a portion of the expenditure of the local authority increases, jeopardising the performance of other functions. As noted above, various functions of local authorities are associated with ensuring fundamental rights and freedoms which local authorities are obligated to uphold under § 14 of the Constitution. Failure to do so may result in a violation of people's fundamental rights.

151. Considering the aforementioned, the Court *en banc* is of the opinion that the need to achieve the goals of §§ 8^1 and 28^1 of the RMCBA is currently more important than granting local authorities the right to assume debt obligations to the extent available before the provisions entered into force. Therefore these provisions do not violate the right to assume debt obligations arising from subsection 154 (1) of the Constitution.

(B) Subsections 8^1 and 28^1 of the RMCBA and the right to the stability of the system of funding local government functions

152. According to the Court en banc, §§ 8^1 and 28^1 of the RMCBA also prejudice local authorities' right to the stability of the funding system.

Establishment of the restrictions specified in §§ 8^1 and 28^1 of the RMCBA means that the funding system is made less favourable for local authorities. By the entry into force of the restriction local authorities were until the end of 2011 deprived of the opportunity to consider that within the limits of § 8 of the RMCBA they have the opportunity to freely take a loan or assume other debt obligations for the planned investment.

153. Since the Court *en banc* has already identified above that §§ 8^1 and 28^1 of the RMCBA were established in a formally constitutional manner (see points 139-141 above), the Court *en banc* will evaluate whether the prejudice arising from §§ 81 and 281 of the RMCBA to the stability of the funding system is also constitutional in terms of substance.

154. The right to the stability of the funding system is prejudiced by §§ 8^1 and 28^1 of the RMCBA for the same purposes as the right to assume debt obligations (see point 143 above). Since the right to the stability of the funding system may be violated for attainment of each constitutional objective (see points 82 and 64 above), these are legitimate objections.

155. Establishment of restrictions on assumption of debt obligations is also suitable (see point 146 above) and necessary (see point 147 above) for attainment of the objectives referred to in the previous point.
In the opinion of the Court *en banc*, establishment of restrictions on assumption of debt obligations did not cause any substantial instability in the funding system. By establishment of these restrictions making such

investments that the local authorities had taken into account earlier and for which they had taken binding steps (see point 149 above) was not made impossible. The prejudice of the stability is, however, justified by weighty goals, which the Court *en banc* has discussed in point 150 above.

156. For the said reasons the Court *en banc* finds that §§ 8^1 and 28^1 of the RMCBA are constitutional.

(C) Constitutionality of assumption of obligations

157. The Tallinn City Council has also contested the constitutionality of the AO Regulation issued on the basis of subsections 81 (2) and (7) of the RMCBA. According to the Tallinn City Council, the regulation is unconstitutional, because § 81 of the RMCBA serving as the basis thereof is unconstitutional in its entirety. However, the Court en banc has found above that § 81 of the RMCBA is constitutional. Thus, the AO Regulation cannot be unconstitutional merely because the provisions delegating authority serving as the basis for it are unconstitutional.

158. The Tallinn City Council also contests the constitutionality of the AO Regulation because the provision establishes an additional restriction in comparison with the list of duties set out in subsection 81 (1) of the RMCBA.

159. The AO Regulation regulates the conditions of and procedure for implementation of subsection 81 (1), the first sentence of subsection 8 (2) and subsections 8 (3) and (7) of the RMCBA. As mentioned above, these provisions prejudice the right of local authorities to assume debt obligations. Thus, prejudice of the right can be presumed in the case of the regulation given for implementation of these provisions. Therefore it is necessary to evaluate whether the regulation that causes the prejudice, complies with the provisions delegating authority that serve as the basis for the regulation.

160. According to the first sentence of subsection 3 (1) of the Constitution, the powers of state shall be exercised solely pursuant to the Constitution and acts that are in conformity therewith. Exercising powers of state also means limiting the constitutional rights of local authorities. Subsection 154 (1) of the Constitution authorises the legislature to limit the rights arising from this provision (incl. the right to assume debt obligations). This means that by the Constitution the legislature has been given the opportunity to establish restrictions on assumption of debt obligations. On the other hand, the provision expresses the constitutional duty to establish these restrictions by law. The legislature can delegate to the executive regulation of matters that are of minor importance from the point of view of implementation of these restrictions. No competence to establish more extensive restrictions than established by law may be given to the executive. Nevertheless, the Court *en banc* notes that less intensive restrictions may also be imposed by the executive by a regulation based on an accurate and clear provision delegating authority whose intensity is in line with the restriction. This position is in accordance with the judgment of the Supreme Court *en banc* of 3 December 2007 in Case No. 3-3-1-46-06 (point 22).

161. According to subsection 87 (6) of the Constitution, the Government of the Republic shall issue regulations on the basis of and for the implementation of law. This means that a regulation issued on the basis of authorisation by the legislature must be in line with the limits, underlying idea and purpose of the provision delegating authority as well as comply with laws and the Constitution in other respects. The Government of the Republic may not exceed the authority by its regulations or start regulating issues not covered by the authorisation. Among other things it means that in a regulation the Government of the Republic may not establish on local authorities more extensive restrictions than permitted by law. A regulation that contains more extensive restrictions in comparison with law has not been established on the basis of and for the implementation of law. Such a regulation is in conflict with subsection 87 (6) of the Constitution. A regulation that establishes more extensive restrictions than an act is also in conflict with the first sentence of subsection 3 (1) of the Constitution, because by it the Government of the Republic has started exercising the powers of the state without a legal basis.

162. Thus, it must be checked whether the AO Regulation is in line with the relevant provisions delegating authority and does not establish more extensive restrictions on assumption of debt obligations in comparison

with law.

163. The legislature has authorised the establishment of the AO Regulation in the second sentence of subsection 8^1 (2) and in the last sentence of subsection 8^1 (7) of the RMCBA. These provisions place the following within the competence of the Government of the Republic: first, a more detailed list of the obligations specified in subsection 8^1 (1) of the RMCBA; second, the conditions of and procedure for the submission of requests for assumption of obligations; third, the conditions of and procedure for evaluation of requests; and fourth, establishment of a procedure for refunding suspended funds.

164. The listed areas are regulated by § 2 (more detailed list of obligations to be approved), § 3 (submission of requests for approval of assumption of obligations), § 4 (processing requests), § 5 (evaluation of requests) and § 6 (refund of suspended funds) of the AO Regulation. In § 2 of the regulation the obligations to be approved, which have been specified in subsection 81 (1) of the RMCBA, have been described through the account groups and classes of Annex 1 to the General Rules for State Accounting established on the basis of subsection 35 (2) of the Accounting Act. The listed account groups and classes do not include obligations that could be considered the obligations specified in subsection 81 (1) of the RMCBA. The Government of the Republic has established the most extensive restrictions that it can establish within its competence, but has not exceeded the limits of the authorisation granted by law.

165. According to the Court *en banc*, the AO Regulation does not establish more extensive restrictions in comparison with law. Therefore the regulation is in accordance with subsection 87 (6) and the first sentence of subsection 3 (1) of the Constitution.

(VIII) Constitutionality of subsection 16 (4) of the BEF Regulation

166. The Tallinn City Council argues that by subsection 16 (4) of the BEF Regulation the Government of the Republic has, exceeding its competence, amended the terms of use of the funds earmarked for social benefits in the wording of subsection 42 (4) of the SWA in force before 6 July 2009 (hereinafter subsection 42 (4) of the SWA), as a result of which the BEF Regulation is in conflict with subsections 3 (1), 87 (6) and 154 (2) of the Constitution as well as the principle of stability of the budget of local authorities and is formally unconstitutional.

167. Subsection 42 (3) of the SWA stipulates that funds shall be allocated from the state budget to rural municipality and city budgets for the payment of social benefits to persons living alone and to families in the case of need on the basis of the subsistence limit established by the Riigikogu and the terms and conditions for payment established by the Social Welfare Act. Subsection 42 (4) of the SWA stipulated that in the case of a surplus in the funds specified in subsection (3) of this section, rural municipality and city governments may pay social benefits to persons in need of assistance in order to contribute towards coping or provide social services under the conditions and pursuant to the procedure established by local authorities. According to subsection 16 (4) of the BEF Regulation, a local authority is entitled to additional funds of subsistence benefits distributed on the basis of subsection (3) if the funds allocated from the budget equalisation fund for payment of subsistence benefits on the basis of the same Regulation and the outstanding balance of subsistence benefits in previous years are insufficient for payment of subsistence benefits, provided that upon incurring the expenses earmarked for subsistence benefits are in accordance with the terms and conditions of the Social Welfare Act. The latter provision regulates the allocation of subsistence benefits from the budget of 2009 and it keeps in mind the outstanding balance of subsistence benefits of previous years as of the end of 2008.

168. The petitioner understands subsection 42 (4) of the SWA in such a way that the “surplus of funds” specified therein meant the balance of unused subsistence benefits as of the end of the budgetary year, which according to subsection 42 (4) of the SWA thus automatically turned into funds that a local authority could freely use for payment of local social benefits and provision of social services in the budgetary years to come. The “surplus of funds” for the purposes of subsection 42 (4) of the SWA was in the opinion of the Tallinn City Council “the outstanding balance of subsistence benefits in previous years” for the purposes of subsection 16 (4) of the BEF Regulation. As a result thereof the petitioner sees a violation of the

constitutional guarantees of local self-government – the second sentence of subsection 154 (2) of the Constitution – in the fact that subsection 16 (4) of the BEF Regulation imposed on local authorities the obligation to pay the social benefits of the state out of the funds that, according to subsection 42 (4) of the SWA, had been earmarked for payment of local government social benefits or provision of local government social services.

169. The Court *en banc* finds that the contested part of the BEF Regulation does not prejudice the constitutional guarantees of local self-government. The petitioner's view that the BEF Regulation has, disregarding the second sentence of subsection 154 (2) of the Constitution, imposed on it the obligation to pay state social benefits out of the funds earmarked for payment of local government social benefits and provision of local government social services, is wrong, relying on the wrong interpretation of the term "surplus of funds" used in subsection 42 (4) of the SWA. Not the outstanding balance of funds of previous years' subsistence benefits unused by the end of the budgetary year – as indicated in subsection 16 (4) of the BEF Regulation – but the outstanding balance of the subsistence benefit funds planned in the budget of the current year must be treated as the "surplus of funds" for the purposes of subsection 42 (4) of the SWA.

170. The legal status of the outstanding balance of the subsistence benefit funds unused by the end of the budgetary year is regulated by the annual state budget. Subsection 4 (2) of the 2008 State Budget Act stipulated that the Government of the Republic shall establish the extent of, conditions of and procedure for distribution of the support allocated to a local authority's budget from the budget equalisation fund on the basis of subsection (1) of this section and of the funds for education costs, subsistence benefits, support for municipal preschool child care institutions, funds for provision and development of social benefits and services, expenses of school lunch, supplementary payments to rural municipalities of islands and rural municipalities which include small islands, and the distribution of funds between local authorities shall be established by the Government of the Republic. Subsection 4 (6) of the 2008 State Budget Act stipulated that the balance of the funds allocated on the basis of subsection (2) of this section (except the support specified in subsection (1)) and the funds allocated under the expenditure item 4500.01 unused by the end of a budgetary year shall be transferred to the following budgetary year for the same purpose, unless the allocator has prescribed refunding of the unused funds to the state budget on other bases.

The Court *en banc* agrees with the position expressed in the opinion of the Ministry of Finance according to which the said provisions imposed on local authorities the obligation to transfer the outstanding balance of subsistence benefits unused by the end of the budgetary year of 2008 to the next budgetary year for the same purpose, i.e. payment of subsistence benefits. Thus, the balance of subsistence benefit funds unused by the end of the budgetary year of 2008 could not be treated as a "surplus of funds" for the purposes of subsection 42 (4) of the SWA.

The surplus of funds meant in subsection 42 (4) of the SWA is a situation where the total amount of the outstanding balance of subsistence benefits unused in previous budgetary years and the funds of subsistence benefits allocated to the local authority in the budgetary year exceeded the amount that had been planned for payment of subsistence benefits under the budget in force. This means that the difference between the total subsistence benefit funds of the current budgetary year (incl. the outstanding balance of previous year's subsistence benefits) and the forecast expenditure of payment of subsistence benefits in the same year constituted the "surplus of funds" that the local authority could use for payment of local social benefits and provision of local social services pursuant to subsection 42 (4) of the SWA.

171. For the aforementioned reasons subsection 16 (4) of the BEF Regulation did not narrow the right granted to local authorities by subsection 42 (4) of the SWA. The scope of regulation of these provisions did not overlap. Therefore the unconstitutionality of subsection 16 (4) of the BEF Regulation argued by the Tallinn City Council must be denied as well.

Links

[1] http://www.riigikogu.ee/?page=en_vaade&op=ems&eid=544784&u=20100117161528
[2] http://www.fin.ee/?id=81762