

DOCTORAL THESIS

Europeanization and the Influence of the European Union's Economic and Fiscal Policy Reforms on National Budgetary Processes

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TALLINN UNIVERSITY OF TECHNOLOGY
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Declaration:

Hereby I declare that this doctoral thesis, my original investigation and achievement, submitted for the doctoral degree at Tallinn University of Technology has not been submitted for doctoral or equivalent academic degree.

Kati Keel

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**Euroopastumine ning Euroopa Liidu
majandus- ja fiskaalpoliitika reformide mõju
riikide eelarveprotsessidele**

KATI KEEL



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List of Publications

The list of author's publications, on the basis of which the thesis has been prepared:

- I **Keel, K.** (2021). The impact of EU's macroeconomic and fiscal surveillance measures on the budgeting process of Estonia. *Halduskultuur: The Estonian Journal of Administrative Culture and Digital Governance* 21(2), 22-42 (**ETIS 1.1**)
- II Raudla, R.; **Keel, K.**; Pajussaar, M. (2018). The Creation of the Fiscal Council in Estonia: Exploring the Explanations for Its Institutional Design. *Public Budgeting & Finance*, 38 (2), 61–80 (**ETIS 1.1**)
- III Raudla, R.; Bur, S.; **Keel, K.** (2019). The Effects of Crises and European-Level Fiscal Governance Reforms on the Budgetary Processes of Member States. *JCMS Journal of Common Market Studies*, 58 (3), 740–756 (**ETIS 1.1**)

Author's Contribution to the Publications

Contribution to the papers in this thesis are:

- I The author of this dissertation is the sole author of the article.
- II The author was involved in conducting the empirical research.
- III Author contributed to the development of the framework regarding the EU level reforms and Europeanization literature.

Abbreviations

EU	European Union
SGP	Stability and Growth Pact
CSR	Country-specific recommendation
ECOFIN	Economic and Financial Affairs Council
EFB	European Fiscal Board
EMU	Economic and Monetary Union
MIP	Macroeconomic imbalance procedure
MoF	Ministry of Finance
MTBF	Medium-term budgetary framework
MTEF	Medium-term expenditure framework
OECD	Organisation of Economic Co-operation and Development
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability, Coordination and Governance

Introduction

Fiscal discipline in the European Monetary Union (EMU) has been in the heart of the European Union's (EU) economic and fiscal policies and has historically been seen as a core ability of the member states to maintain sustainable public finances and address macroeconomic imbalances (Barbier-Gauchard et al, 2021). Likewise, over time there has been a growing belief in the idea that strict fiscal rules limiting the discretion of political actors can ensure fiscal discipline (Doray-Demers and Foucault, 2017). This line of thinking was incorporated into the Maastricht Treaty already in 1992 and has gradually been enforced through the Stability and Growth Pact (SGP) and its successive reforms. The SGP is the EU's main tool for safeguarding low budgetary deficits as well as sustainable sovereign debts in the member states and has evolved considerably over time. Yet, similarly with various policy fields that enjoy shared competences between the EU and national levels, its application is far more complex. On one hand, reforms of the SGP have tried to push for better enforcement and, on the other hand, sought to make the framework more sensitive to diverse economic contexts (Van der Veer, 2021). Moreover, the credibility of the EU's framework has been questioned on numerous occasions and the subsequent reforms of the SGP have created diverse views. For example, it has been argued that the reforms in 2005 initially weakened the EU's enforcement powers, whilst subsequent changes starting from 2011 have been seen as significantly strengthening the centralized control of the European Commission (Ibid). Whilst the intention of the EU's fiscal rules is to discipline national governments and policy actors, they should not be seen in isolation, as national governments have gradually also adopted their own fiscal rules (Barbier-Gauchard et al, 2021).

After the global financial crisis in 2008-2010, the European Union stepped up its efforts to cope with the aftermath of the crisis by addressing the sovereign debt problems and by enhancing the promotion of fiscal discipline in the member states. As a direct consequence, starting from 2011 the governance framework of the European Union's economic and fiscal policy went through several changes. The Stability and Growth Pact – the core of the EU's fiscal governance framework – was reinforced by the Six-Pack¹, the Two-Pack², the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, and the rules were firmly grounded into the European Semester process. The core policy elements of the reforms undertaken at time included: more emphasis on medium-term budgetary planning and more transparent budgetary processes, reinforcing budgetary and fiscal surveillance and coordination for the Eurozone countries, broadened scope of economic surveillance to include macroeconomic imbalances, strengthening the corrective arm of the SGP, creating independent monitoring of compliance with fiscal rules at the national level, multilateral assessment of the member states' budgetary plans that follows a common timeline (European Commission, 2020) and, for those member states who are contracting parties of the

¹ Six-pack stands for the package of five regulations and one directive aiming at strengthening the economic and fiscal governance in the EU and the euro area: Regulation 1175/2011 amending Regulation 1466/97; Regulation 1177/2011 amending Regulation 1467/97; Regulation 1173/2011; Directive 2011/85/EU; Regulation 1176/2011 and Regulation 1174/2011.

² Two-pack stands for two regulations: Regulation 473/2013 and Regulation 472/2013.

Fiscal Compact³, a requirement to lay down balanced budget rules in their domestic legislation.

Although it has been more than 10 years since the latest major changes were made to the EU's legislative framework, research into the institutional consequences of these reforms is still emerging (e.g. see Catania, 2011; Quaglia, 2013; Popescu, 2015; Ioannou et al, 2015; Calmfors, 2015; Barnes et al, 2016; Claeys et al, 2016; Eyraud et al, 2017; Raudla et al, 2018; Raudla and Douglas, 2020; Haas et al, 2020; Verdun and Zeitlin, 2018; Karremans, 2021; Horvath, 2018; Crespy, 2020; Van der Veer, 2021). On one hand, there are studies that criticise the enforcement of the SGP (e.g. Schmidt, 2020) or the lack of democratic legitimacy of the framework (Bremer and Bürgisser, 2022; Csehi and Schulz, 2021), whilst other studies (e.g. Genschel and Jachtenfuchs, 2018 in Van der Veer, 2021) argue that it interferes and centralises control over the "core state powers". In terms of budgetary processes, the existing literature rather focuses on the role of national parliaments (Steinbach, 2019; Majone, 2014; Jancic, 2016; Verdun and Zeitlin, 2018; Hallerberg et al, 2018; Csehi and Schulz, 2021) or on the specific core elements of the SGP reforms (Eyraud and Wu, 2015; Raudla et al, 2018; Raudla and Douglas, 2021; Raudla and Douglas, 2022). The European Semester and its ability to trigger policy change in the member states has also received considerable attention in the academic literature (e.g. Darvas and Leandro, 2015; Mariotto and Franchino, 2020; Efstathiou and Wolff, 2019; Mariotto, 2022; Bokhorst, 2021; Verdun and Zeitlin, 2018). However, there is a lack of qualitative studies in the Europeanization literature about the effects of the latest EU's economic and fiscal governance reforms on the budgetary processes of the member states. Europeanization literature has mostly focussed on other policy fields – e.g. monetary, cohesion, environmental, social, and transport policy. Regarding fiscal policy, the Europeanization literature has looked at fiscal governance and the development of fiscal institutions in East Central Europe before and after EU accession (Halleberg and Yläoutinen, 2010) or focused more specifically on the Eurozone (e.g. LeMay-Boucher and Rommerskirchen, 2015) or fiscal consolidation (Kickert and Randma-Liiv, 2015).

Given the current times of fiscal uncertainty as well as ongoing discussions and negotiations on revising and improving the Stability and Growth Pact rules once again, it is of utmost importance to understand the impacts these past reforms have had on the member states in the first place. The purpose of this thesis is to build on the existing knowledge on Europeanization in order to explain and better understand the empirical implications different fiscal and economic policy measures of the EU have had on the member state's budgetary processes. Since several studies (e.g. Combes et al, 2017; Barbier-Gauchard et al, 2021) have indicated that the impact of fiscal rules may vary in different environments, the thesis aims to attain the set objectives through in-depth case studies, focusing on a limited number of member states. As the EU level reforms, together with the financial crisis, have been seen as influential phenomena in shaping national fiscal policies, understanding their effects is vital to draw conclusions for future actions (Pataccini et al, 2019).

To guide the discussions of this thesis, Europeanization is used as an underpinning theoretical concept. Since the mid-1990s, a growing number of studies have analysed whether, how and under what conditions the EU influences its member states – starting

³ Out of the 27 Contracting Parties to the Treaty on Stability, Coordination and Governance, 22 are formally bound by the Fiscal Compact. 19 Euro area Member States plus Bulgaria, Denmark and Romania, who chose to opt in; Communication from the European Commission COM(2017) 1200 – The Fiscal Compact: Taking Stock.

from affecting domestic policies and institutions to reshaping beliefs, identities, norms and collective understandings (Börzel and Risse, 2007; Pollac, 2010) (for an overview see I). In light of these questions, Europeanization has quickly become one of the central concepts in the EU studies (Börzel and Panke, 2013). The EU's influence on various national policies is probably one of the most studied fields in the Europeanization literature (Featherstone, 2003; Graziano and Vink, 2013). On the one hand, there are signs that domestic institutions have managed to stay resistant to the pressures of Europeanization (Anderson, 2002; Schmidt, 2006). On the other hand, it has been argued that, in one way or another, member states still react to the demands of the EU (Kassim, 2003) but the institutional adjustment can differ considerably from one country to another (Featherstone and Radaelli, 2003; Graziano and Vink, 2007). Moreover, interactions between the EU and the domestic institutions vary (Wallace, 2010), depending on the policy field and policy instrument used (Bache, George and Bulmer, 2011). Due to the increasing role played by the EU in economic and fiscal policy-making, understanding and explaining the developments in fiscal governance, whether in a single country or the EU as a whole, has become increasingly important both in empirical as well as in theoretical terms. As budgeting is one of the fundamental processes in the public sector and widely considered a core state competence, this could also bring in an interesting and more nuanced view for the Europeanization literature. Hence, the thesis looks specifically at the interactions between existing institutional arrangements in budgetary decision-making and external pressures coming from the EU. For this purpose, the thesis takes a top-down approach in its understanding of Europeanization (Börzel and Panke, 2013; Sanders and Bellucci, 2012).

The main research question addressed in the thesis is: **How have the EU level reforms in economic and fiscal governance from 2011-2013 influenced budgetary processes⁴ in the member states and how to explain the outcomes.** More specifically, the following research questions are addressed:

- How has the creation of national fiscal councils, the introduction of the structural budget deficit rule, the requirement to adopt medium term expenditure frameworks and the revamped European Semester shaped budgetary processes in the member states?
- Which institutionalist traditions highlighted in the Europeanization literature have, based on conducted case studies, an explanatory power to unveil the impact of the EU's economic and fiscal policy on the member states' budgetary processes?

The main body of argument is developed in three original articles that focus on selected measures of the EU's economic and fiscal governance framework, namely the structural budget deficit rule, creation of national Fiscal Councils, requirement to adopt medium term expenditure frameworks and the European Semester (including peer evaluation, annual evaluation of the draft national state budgets and multilateral surveillance).

The first article (I) addresses Estonia as an in-depth single case study and brings all the different EU fiscal policy framework elements together under one umbrella. The goal

⁴ The thesis identifies budgetary process as the rules that govern the preparation, adoption and implementation of the budget (Hallerberg et al., 2009)

is to identify possible interactions and mutual influences between various EU level measures. In terms of Europeanization, the article develops a general theoretical framework to analyse these various measures and their possible domestic impacts on the budgetary process of Estonia. Similar theoretical assumptions are also present in the following papers. **The second article (II)** continues the approach of a single in-depth case study by examining more closely the creation of the Fiscal Council in Estonia. The paper focuses on the creation and institutional design of the Fiscal Council and offers a more nuanced view on the actors' motives in creating an institution due to pressures from the EU level. **The third article (III)** presents a comparative case study focusing on Finland, Austria and Portugal in order to explore how the experience of the crisis and the fiscal governance reforms at the EU level have influenced budgetary processes in those member states. The paper ties together Europeanization, fiscal governance and public crisis management literature. As the experiences of the crises provided the general setting into which the EU level reforms were inserted, the three approaches and their potential effects were examined together.

The introduction of the thesis is structured as follows. After the introduction and the methodology, chapter 2 provides an overview of the history and policy context of the EU's economic and fiscal governance framework. Drawing on different streams of institutionalist research, it discusses how and through which mechanisms Europeanization can trigger domestic change in the national budgetary processes. Chapter 3 addresses additional context specific factors that influenced the budgetary processes but were not sufficiently covered by previous discussion. Chapter 4 gives conclusive remarks and avenues for further research.

1 Methodology

To answer the research questions, the thesis is built up as a comparative synthesis of empirical findings from the articles and the case studies. The articles were based on in-depth empirical case studies, all touching upon various elements of the EU's fiscal governance framework. Qualitative research design was chosen since case studies allow us to investigate research questions more in-depth, hence allowing to understand the impacts on a national level together with context dependent knowledge (Yin, 2009; Yin, 2012). Moreover, as establishing causality in Europeanization research – e.g. to what extent different changes at a national level are genuinely triggered by EU-level policies – remains a challenge (Radaelli and Exadaktylos, 2009), adopting a case study approach can help to overcome this bias. However, the shortcoming of case studies is that they do not allow statistical generalization, as there is a risk of not having a representative amount of cases included (Gerring, 2004). Even though wider theoretical generalizations from case studies are possible (Yin, 2012), they need to take into account different situational circumstances and have to be approached with caution.

The selection of cases was based on the following reasoning. The selected countries cover different administrative traditions. Furthermore, all selected countries are rather similar in their size and can be considered to be small EU member states (Lehtonen, 2009). The size of a state is a relevant factor since it has been argued that small states can be more dependent on European integration than the large ones (Wivel, 2010). Hence, choosing small countries allows us to assume that the EU influence on these member states could be more extensive than in the large ones.

The sources of data for all the case studies in the thesis were document analysis (draft laws and explanatory memorandums, country specific policy documents, staff working documents, reports and analysis published by the European Commission during the European Semester process) and semi-structured interviews conducted with public officials. For the three articles, altogether 50 interviews were conducted in 2014–2018. These consist of 18 interviews with public officials from Estonia (from the MoF, the Bank of Estonia, and the Parliament); 8 interviews with Finnish officials (from the Finance Ministry, Parliament and the Prime Minister's Office); 10 interviews conducted with officials, former officials and country experts from Portugal (from the Finance Ministry, Parliament, Fiscal Council); and 14 interviews done in Austria (former or current officials from the Finance Ministry, line ministry, Fiscal Council, Parliament, Prime Minister's Office, country expert).

Estonia serves as a central case study in the thesis, being in focus in two different papers. For the first paper (I) that develops the general framework on Europeanization, Estonia can be seen as having favourable conditions for Europeanization to occur. Estonia provides an interesting case in terms of budgetary processes and fiscal policies since Estonia has long been praised as the role model for fiscal conservatism (Raudla and Kattel, 2011). This has been driven by the fundamental belief among Estonian policy-makers that balanced budgets (and low debt) help to ensure macroeconomic stability (Ibid). Yet, until 2014 and before the implementation of the Fiscal Compact, Estonia did not have a fiscal rule stipulating budget balance or a deficit target in their domestic legislation (Raudla et al, 2018). Moreover, the budgetary process in Estonia has been characterized as containing a very small number of veto points and being highly centralized, with the minister of finance having historically extensive agenda-setting and negotiating powers (Raudla, 2010). Hence, we could assume these three aspects would

interplay and trigger additional reforms in budgetary processes. Furthermore, research on the implementation of the European Semester suggests that Estonia might have a better implementation record of country-specific recommendations than other member states (Haas et al, 2020). Therefore, in light of the research questions, the Estonian case can help to understand what could be the overall potential impacts of the EU's fiscal governance measures on budgetary processes and what the drivers behind these impacts are. For the second paper (II), Estonia also provides an interesting case study as the paper looks at the creation of the national Fiscal Council in a situation where policy actors did not see a need for an institution, did not want it, but still had to create it.

The final paper (III) brings all the aforementioned aspects together into a comparative study of Austria, Portugal and Finland. The selection of cases for the comparative case study was based on the following considerations. All three countries are small eurozone countries, which enhances comparability. At the same time, they all experienced different degrees of crisis, therefore offering views on different economic contexts: Portugal went through a deep fiscal crisis, which necessitated the involvement of the Troika, while Austria experienced a moderate fiscal squeeze and Finland an even milder one (III).

2 Europeanization and budgetary decision-making

“For a quarter of a century, the Stability and Growth Pact has provided a shared basis for EU fiscal policies and an essential underpinning for the Economic and Monetary Union. Yet the Pact’s shortcomings have also been all too evident, whether one looks at the development of public debt in the EU, at investment levels or our economic growth performance over the past two decades. Moreover, the challenges we face today are a world away from those of the 1990s. Public debt has surged and so have our investment needs, be it for the green and digital transitions, security and defence or the resilience of our industrial supply chains.”

Paolo Gentiloni, Commissioner for Economy, April 2023

This quote comes from Paolo Gentiloni, the Commissioner responsible for economic affairs. One of his distinct responsibilities as the Commissioner is to apply the Stability and Growth Pact by using the flexibility allowed by the rules to support investment while also safeguarding fiscal responsibility. The European Commission initially launched a review of the EU’s economic and fiscal governance framework in February 2020. However, the review was put on hold due to the COVID-19 pandemic and relaunched again in 2021. New legislative proposal by were published in April 2023. As during the past three years Europe has faced multiple crises that have also strained public finances, the context of how the EU fiscal rules operate has changed significantly. The quote by Commissioner Gentiloni certainly sets the tone for the assessment of the EU’s economic and fiscal policy rules in the future, which are currently being negotiated and at one point will be agreed upon by the member states. Both the EU and the member states are still facing times of great fiscal and economic uncertainty while trying to develop new paths to reform the EU’s economic, fiscal and budgetary rules. In order to better understand the institutional as well as policy impacts the current EU’s economic and fiscal policy reforms have had on member states and their budgetary processes, it is important to map out how the EU’s economic and fiscal rulebook has been developed over time through several successive reforms.

2.1 Policy context of the EU’s economic and fiscal governance reforms – past and present

Already in 1992, the Maastricht Treaty laid the grounds of the single currency area by fostering fiscal discipline⁵. The developed framework for economic governance at that time involved a single monetary policy and decentralized fiscal policies – the result of the only political compromise possible at that time, as member states were reluctant to give up their fiscal sovereignty (European Fiscal Board, 2020). The fiscal rules were first introduced into the Maastricht Treaty mainly under the pressure from Germany and the Netherlands, mostly for domestic reasons (Heipertz and Verdun, 2004). That is not surprising, as it has been argued that countries occupying a higher rank in the European financial hierarchy have more capacity to influence the development of regulatory frameworks (Pataccini et al, 2019). Ever since, the EU has gradually developed a broader and increasingly complex framework of economic and fiscal policy coordination with the

⁵ The Maastricht Treaty set a limit of 3% of GDP for nominal deficits and 60% of GDP for debt, or at least the debt had to approach that level at a satisfactory pace.

emphasis on ensuring better enforcement and compliance with the rules (Larch et al, 2020). Over time the framework has advanced in waves and changes have been introduced for example in response to new economic challenges or different crises, together with the experience of past implementation (European Commission, 2020).

Ideally, fiscal rules should combine necessary flexibility to allow for proper policy choices together with much needed simplicity and enforceability to discipline government behaviour (Morris et al, 2006). Hence, the Stability and Growth Pact⁶ (SGP) was put in place in 1997 for the practical implementation of the Maastricht Treaty and to strengthen the coordination, monitoring and surveillance of national fiscal policies. Moreover, sanctions were foreseen for breaches of the 3% deficit limit, unless they were the result of exceptional circumstances (Ibid). The SGP also required the member states to adopt a medium-term orientation for fiscal policies and to prepare stability and convergence programmes to reflect this (European Fiscal Board, 2019). The budgetary rules were seen as rather simple and easy to understand, but their shortcomings quickly became apparent when they were put into practice. The 3% that was supposed to act as a ceiling became more of a target for many member states. Moreover, the nominal deficit targets of the SGP proved difficult for some member states in a recessionary environment and even caused pro-cyclical tightening (European Fiscal Board, 2020). At the same time, the task of sanctioning was left collectively to the countries themselves, i.e. it was up to the Council to decide on the pace of progress back to below 3% (Ibid; Morris et al 2006.). The most prominent failure of this system emerged in 2003 when the Council failed to give Germany and France instructions on how to exit excessive deficits.

Therefore, the SGP went through a major reform in 2005 with the overall aim to take the economic conditions of every member state more into account. By framing the deficit rule in nominal terms, the EU's rules had not been able to take into account the fact that during economic decline government budget balances would worsen even without discretionary interventions on the part of governments (Larch and Santacroce, 2020). Shifting the focus to the cyclically-adjusted budget balance was intended to fix that problem (Ibid). Accordingly, since the reform in 2005, a stronger emphasis was put on the structural fiscal effort, along with other changes introduced to the framework. Notably, the member states were required to set a medium-term objective (in the form of a structural balance) at the centre of their fiscal policy, towards which each country must move at a sufficient pace (improving the fiscal position by 0.5% of GDP per year under normal circumstances). In addition, the excessive deficit procedure was clarified and a possibility was created for the Commission to take into account different circumstances, i.e. to take a more analytical approach when assessing compliance with the rules. (Explanatory memorandum of Estonian Ministry of Finance, 2022)

However, the financial and economic crisis that hit the EU in 2008 exposed additional vulnerabilities of the rules. For example, not all member states were implementing counter-cyclical fiscal policies by building up fiscal buffers during the good times in pre-crises years (Eyraud and Wu, 2015). On the other hand, Estonia stood out by implementing tough austerity measures during the crises period in 2008-2009 and thereby aggravating the economic recession (Raudla and Douglas, 2020). Moreover, the European Fiscal Board concluded in 2019 that towards the end of 2009, the sovereign debt crisis in Greece also highlighted the overall weaknesses in national governance,

⁶ EU Council Regulations 1466/97 and 1467/97

which were not addressed by the original Maastricht architecture (European Fiscal Board, 2019). Accordingly, the immediate response to the fiscal crisis was framed by the need to design even more stringent rules (Doray-Demers and Foucault, 2017).

Consequently, the crises triggered a series of additional measures to strengthen the EU's economic and fiscal governance framework even further. What is important to bear in mind is that those reforms were prepared and agreed upon in the context of a crisis. Therefore, they also aimed to considerably strengthen the existing rules in order to restore market confidence (Ibid; European Fiscal Board, 2020). Fundamental to the efforts were the successive legislative packages known as the 6-pack and 2-pack back in 2011 and 2013. The 6-pack added elements that were intended to strengthen the rules (e.g. expenditure benchmark, macroeconomic imbalance procedure, debt reduction benchmark, significant deviation procedure, financial sanctions, common principles for national budgetary frameworks, introduction of European Semester), as well as some elements that added flexibility and brought in more discretion (e.g. structural reform and investment clauses) (for an overview see European Fiscal Board, 2019). The latter were inserted to foster growth-friendly policies by relaxing fiscal requirements for those member states that were implementing structural reforms or wanted to enhance government investments (Ibid). The 6-pack was soon after followed by the intergovernmental Fiscal Compact (as a part of the Treaty on Stability, Coordination and Governance) that was signed in 2012 and entered into force on the 1st of January 2013. It followed the same logic as the previous reforms, namely strengthening compliance with the EU's fiscal rules (Larch et al, 2021). The Fiscal Compact required from the contracting parties (19 euro area member states, as well as Bulgaria, Denmark and Romania) to lay down a structural budget balance rule in their domestic legislation. It has been argued the negotiations leading to the Fiscal Compact involved significant power asymmetry, as for example Portugal, Ireland, Italy, Greece and Spain were facing bankruptcy and were therefore more vulnerable to the EU level authorities (Doray-Demers and Foucault, 2017).

In 2013, the EU's fiscal governance framework was strengthened even further. The adoption of the 2-pack reinforced budgetary surveillance and coordination for Eurozone countries. The main elements that were introduced with the 2-pack included additional measures to strengthen the budgetary surveillance in the Eurozone – e.g. giving the European Commission monitoring and assessing powers of the euro area members' draft budgetary plans, introducing a common budgetary timeline, additional rules on structural deficit, and finally, strengthening of the national fiscal councils (European Commission, 2020). As mentioned above, with the aftermath of the recent reforms, new layers of flexibility were introduced to the framework to soften what was felt like an unbalance between debt sustainability and economic stabilization. This however led to increasing the complexity of the rules. Therefore, unsurprisingly, the past developments have increasingly led to appeals to simplify the EU's fiscal and economic policy framework and to ensure more transparency in the implementation of the rules (see e.g. European Fiscal Board, 2019; European Commission, 2020; Eyraud and Wu, 2015; Kamps and Leiner-Killinger, 2019).

Table 1: History of the EU's economic and fiscal governance framework (Source: author; based on European Fiscal Board, 2019)

Year	Reform	Aim of the reform	Main elements
1992	Maastricht Treaty	Laying the grounds of the single currency area by fostering fiscal discipline.	<ul style="list-style-type: none"> • Setting a limit of 3% of GDP for nominal deficits and 60% of GDP for debt, or at least the debt had to approach that level at a satisfactory pace
1997	Stability and Growth Pact	Practical implementation of the Treaty. Toughen the coordination, monitoring and surveillance of national fiscal policies.	<ul style="list-style-type: none"> • Corrective arm, centred on the excessive deficit procedure • Preventive arm, centred on the annual submission of stability programs
2005	Amending the Stability and Growth Pact	Take the economic conditions of every member state more into account. Create more flexibility.	<ul style="list-style-type: none"> • Focus to cyclically-adjusted budget balance • Country-specific medium-term budgetary objectives • Clarified excessive deficit procedure + a possibility for the Commission to take into account different circumstances when assessing compliance with the rules
2011	6-pack enters into force	Strengthen the rules, the enforcement of the rules and the EU level governance of the rules + add more flexibility to foster growth-enhancing policies.	<ul style="list-style-type: none"> • European Semester • National fiscal frameworks • Expenditure and debt reduction benchmarks • New Macroeconomic Imbalance Procedure (MIP) • Financial sanctions • Structural reform and investment clauses • General escape clause + unusual event clause
2013	The Treaty on Stability, Coordination and Governance	Foster fiscal responsibility.	<ul style="list-style-type: none"> • The signatories are required to lay down a structural budget balance rule in their domestic legislation
2013	2-pack enters into force	Enhanced policy coordination within the euro area.	<ul style="list-style-type: none"> • National independent fiscal institutions • Draft budgetary plans • A common budgetary timeline • Enhanced surveillance

The European Commission initially launched its latest review of the EU's economic governance framework in February 2020, focusing in particular on the 6-pack and 2-pack legislation. However, due to the COVID-19 pandemic, the review process was temporarily put on hold and was restarted again only in October 2021. While the pandemic and following policy responses at member state levels certainly had and will continue to have consequences for the subsequent discussions and decisions, the Commission itself already identified a number of strengths and shortcomings in the current EU's fiscal and economic governance framework. For example, in February 2020 the European Commission published a Communication assessing the effectiveness of the economic governance framework (European Commission, 2020). According to the Commission's own assessment, the framework has been effective in decreasing public debt levels, adjusting macroeconomic imbalances and supporting coordination of economic policies (Ibid). Nevertheless, continuous high public debt levels in certain member states are still eminent (European Commission, 2020). Moreover, at that time, the fiscal surveillance framework was considered to be rather effective in inspiring member states to return to sound budgetary positions, since the collective debt-to-GDP ratio began to decline in 2015 (Ibid). Also, the Commission highlighted that the member states' fiscal policies at large remained pro-cyclical (Ibid), despite all the previous reforms and policy lessons. Additionally, the framework has not been overly successful in protecting the level of public investment during times of fiscal consolidation (Ibid). The complexity of the EU's fiscal rules and their lack of transparency were also considered problematic.

Compliance with the EU's fiscal rules is also monitored by the European Fiscal Board (EFB), which has assessed the member states' practices in its annual reports. Along the same lines, the EFB went even further in 2020 by highlighting that in 2019 the number of member states considerably deviating from the rules was the highest since the reforms of 2011-2013 were introduced (European Fiscal Board, 2020). They agreed with the Commission's assessment that many governments did not build fiscal buffers when the economic conditions were favorable (Ibid). Hence, much of the policy criticism of the EU's economic and fiscal framework actually remained the same as it had been prior to the latest reforms.

The COVID-19 pandemic in spring 2020 turned the tables upside down and brought a radical change to the overall policy context. The crisis was met with enormous fiscal expansions in all member states (European Fiscal Board, 2020). Moreover, as the general escape clause of the SGP was triggered and activated⁷, the governments acquired significant leeway to react to the crisis as they saw fit, since they were not bound by strict EU level fiscal rules. However, as mentioned above, even before the pandemic and the Russian war of aggression caused significant disorder in public finances, the effectiveness of the EU's economic and fiscal rules had been questioned. Therefore, it remains highly valuable to understand how the reforms introduced between 2011 and 2013 have impacted budgetary processes at the national level.

Thus, as the intention is to take a step towards understanding the EU's influence on national budgetary processes by looking specifically at the interactions between existing institutional arrangements in budgetary decision-making and external pressures coming from the EU, the Europeanization literature is an appropriate starting point for the analysis. Since the mid-1990s, a growing number of studies have analysed whether, how

⁷ The general escape clause of the SGP is in place since spring 2020 and is currently intended to be maintained until the end of 2023.

and under what conditions the EU influences its member states – starting from affecting domestic policies and institutions to reshaping beliefs, identities, norms and collective understandings (Börzel and Risse, 2007; Pollac, 2010) (for an overview see I). In light of these questions, Europeanization has quickly become one of the central concepts in the EU studies (Börzel and Panke, 2013). Europeanization therefore provides a solid framework for analysing how EU level fiscal governance reforms from 2011-2013 have come into effect and influenced national budgetary processes. Europeanization literature also helps to understand which various domestic factors could influence the EU's economic and fiscal policy impact at the member state level.

2.2 Europeanization and domestic change in the budgetary processes

All the conducted case studies indicate that the EU's fiscal and economic governance framework has led to changes and shifts in the domestic budgetary processes (I; II; III). At the same time, the influences have varied. Therefore, the immediate follow-up question is how and through which mechanisms those changes happened and what triggered the domestic change.

Considerable amount of literature on Europeanization shares a common suggestion that Europeanization must be inconvenient, meaning that the level of domestic change depends on the "misfit" between EU and domestic institutions, policies or processes (Börzel and Risse, 2000; Radaelli, 2003; Risse et al, 2001). Cowles, Caporaso, Risse (2001), Heritier et al (2001) and also Börzel and Risse (2003, 2007) argue that the "fit" between EU and the domestic level explains why the impact of Europeanization differs from one state to another and why some states experience stronger adaptational pressure. Hence, the lower the compatibility between the European and domestic processes, policies, and institutions, the larger the potential changes (Börzel ja Risse 2003, 2007). At the same time, if the misfit between the EU requirement and existing policies is too large, the policy actors are likely to resist actual changes or changes may be difficult to materialize into actual practices (Börzel and Risse 2003, 2007). Therefore, transformation most probably takes place when the misfit between domestic arrangements and EU requirements is moderate (Börzel and Risse 2003, 2007). However, adaptational pressures do not trigger domestic change automatically (Graziano and Vink, 2013). As budgeting is one of the core processes in the public sector and widely considered a core state competence, then even with strict and coercive measures prescribed by the EU rules, they may not always lead to fundamental changes in the budgetary processes (III). Therefore, it is no surprise that across different EU level measures, the impact of Europeanization and the degree of domestic change varies (I; III) and misfit alone is not a sufficient factor to induce and explain domestic change (Börzel and Risse 2003, 2007; Knill and Lehmkuhl, 2002).

The adaptational pressures and the degree of influence coming from external rules or commitments strongly depends on domestic institutional factors (Börzel and Risse, 2003; Bache, George and Bulmer, 2011; Graziano and Vink, 2013; Schmidt, 2002). Thus, even if EU rules prescribe specific instruments and institutions, they may not necessarily lead to considerable changes in policies. Europeanization literature draws upon various new institutionalist approaches and theoretical concepts in order to explain countries' responses to the pressures from the EU level. The following sections examine which institutionalist traditions highlighted in the Europeanization literature have, based on conducted case studies, an explanatory power to unveil the EU's economic and fiscal policy impact on the member states' budgetary processes.

2.3 Europeanization and rational choice institutionalism

Rational choice institutionalism emphasises Europeanization as a process in which domestic actors purposefully promote their interest (Börzel and Risse, 2000). In doing so, they might face increasing political opportunities and/or constraints. Hence, a misfit or an incompatibility between the EU and domestic level could open up new opportunities for redistribution of power at the domestic level (Ibid). Whether EU pressures lead to domestic redistribution of power depends on the ability of the domestic actors to use the opportunities and avoid the constraints (Börzel and Risse 2000, 2007). Whether redistribution of power will take place and whether domestic actors are capable of using the presented opportunities is argued to depend on the number of veto points and facilitating institutional structures (Börzel and Risse, 2007). Veto points in the state's institutional structure can restrain or complicate domestic adoption (Haverland, 2000; Héritier et al, 2001): the more widely the power in the national decision-making process is distributed and the more various actors have their say in deciding the policy direction, the harder it is to find consensus to undertake changes (Börzel and Risse, 2003). This is mainly because multiple veto points in the domestic decision-making process provide actors with entry points to block any unwanted changes (Bentzen, 2009). On the other hand, the existence of certain formal institutions might offer domestic actors various recourses and also trigger domestic change (Börzel and Risse, 2000). Moreover, from the perspective of rational choice (e.g. Shepsle, 1989) the actors could also be interested in the persistence of existing routines (Knill and Lenschow, 2005) and attempt to minimize the impacts of EU rules on actual practices.

Based on these considerations, we would therefore have several expectations in the context of EU's fiscal policy reforms. First, we would expect that the actors responsible for transposing the requirements would indeed **opt for minimizing alternatives** – going for the “easiest” or “cheapest” solution available. However, based on empirical findings, we can see this has not always been the case. There are two cases in the **Estonian** context, where this did not happen (**I**; **II**) – when transposing the structural budget balance target into the national legislation as well as when designing the national Fiscal Council.

For the former, according to the Fiscal Compact, the contracting parties were required to have a legislate structural deficit rule in their domestic legislation (according to the Fiscal Compact the annual structural balance should not exceed –0.5% of GDP). The structural budget balance rule has clearly had an effect on the Estonian budgetary process, since it was introduced in the legislation only due to the Fiscal Compact. The focus had previously been on the nominal balance (**I**). Yet, Estonia established stricter rules than prescribed by the Fiscal Compact (**I**), going beyond the minimal requirements. Estonia included the structural budget balance rule in the revised State Budget Act adopted in 2014 and established a stricter rule than prescribed by the EU and required the structural budget position to be in balance or in a surplus (**I**; Explanatory memorandum of draft budget law, 2013). Based on the conducted interviews it could be argued that applying a more ambitious structural balance target could be a **strategic reaction** to the annual evaluation of the draft national state budget plans by the European Commission. Hence, it also provides a good example of how two different measures (also in terms of their coerciveness) coming from the EU's fiscal governance framework were interlinked (**I**).

Regarding the Fiscal Council, the Estonian government also decided not to adopt the “easiest” alternative when designing the national Fiscal Council nor did it create the weakest institution possible (II). The “easiest” alternative would have been to locate the Fiscal Council within the Ministry of Finance. Instead, the new State Budget Act (adopted in 2014) foresaw that the Fiscal Council would be an independent body, supported in its activities by the Bank of Estonia (II). This demonstrates the need to look deeper into the **potential motives** guiding the institutional designers when choosing between various solutions. The existing institutional setting and path dependence (II) provided much clearer explanations why the Fiscal Council was attached to the Bank of Estonia, rather than any other existing body (Ibid). The decision to attach the Fiscal Council to the Bank of Estonia was influenced by how the capacities of macroeconomic analysis had historically evolved in Estonia (II). Yet, the in-depth case analysis also showed, that the bureaucratic agents were also creating a possible new veto point into the budgetary process as an ally for themselves, as they feared that future (left-leaning) governments might be more prone to violating the structural balance rule (II). Hence, having a stronger Fiscal Council was viewed as a potential ally of the MoF or an additional safeguard in guarding fiscal discipline (Ibid). Hence, it indicates that in order to understand and explain the institutional design of the Fiscal Council in Estonia, one needs to look into the explanatory perspectives from different strands of institutionalist research simultaneously, since none of the analytical lenses alone provide a complete explanation (II).

Furthermore, the empirical findings from Portugal and Austria regarding implementing the requirement to establish credible, effective medium-term budgetary frameworks (hereinafter: MTBF) provide an interesting input to the debate. In principle, MTBF is an arrangement in the budgetary process setting requirements for the following: certain financial information to be presented at a specific time in the fiscal year; procedures for making multi-year forecasts and plans for revenue and expenditures; and obligations to set expenditure limits beyond the next annual fiscal year (Harris, Hughes, Ljungman and Sateriale, 2013). It therefore provides all the systems and rules that the government must follow in the budgetary process. While it can be assumed that the underlying intention set out in the directive on requirements for national budgetary frameworks was to push for establishing a strong MTBF framework that is strict and binding for the annual budget, it left certain manoeuvring room for the member states on how binding the framework actually should be. The empirical findings from Portugal and Austria suggest that there was a strong element of rational thinking linked with the adoption of MTBF in both countries, even though they also did not opt for minimizing alternatives (III). For example, the Portuguese government already anticipated in advance the potential requirements that were later included in the EU-wide directives and adopted the legal provisions pertaining to the MTBF beforehand. Yet, the combination of the crisis experience and the Troika’s demands facilitated the process (Ibid). Austria on the other hand was building on reforms that were already planned several years before and the EU level requirement on MTBF-s did not change their course (III).

Secondly, as discussed above, EU fiscal policy measures can also potentially influence national budgetary processes by **shifting the distribution of power and resources between domestic actors** (Börzel and Risse 2000, 2003). Hence, based on existing literature we would also expect EU fiscal policy measures to influence national budgetary processes less directly, by altering the “rules of the game”. In this regard and based on existing Europeanization literature we would assume that the changes introduced by the

EU's fiscal governance framework might **benefit executive powers** instead of parliamentary powers (Kassim et al, 2000; Börzel and Risse, 2007). The strategic impact of the EU's fiscal policy framework on the budgeting processes was observed in Estonia (I), Portugal (III), Austria (III) and Finland (III), especially due to the requirement to introduce structural deficit targets (I; III), the need to create national Fiscal Councils (I) and as a result of the European Semester (I).

To begin with, the introduction of the structural budget balance rule has increased the authority and influence of the Ministry of Finance in all of these countries (I; III). In Estonia, it happened mainly due to the complexities in calculating, explaining and evaluating the structural budget position (I). On the other hand, the focus on structural budget balance has also brought in additional actors to the domestic budgetary process, namely the Fiscal Council and the European Commission. This is also mainly triggered by the complexity of calculating the cyclical position of the budget and by the fact that the EU annually evaluates draft state budget plans through the European Semester process (I). In many cases, the Ministry of Finance and the European Commission have evaluated the cyclical position of the Estonian annual budget somewhat differently. Consequently, it has enabled the Fiscal Council to enter and mediate the debate and gain additional visibility in the process as well as allowed the MoF officials to share the blame for any potential mistakes (I; II). In a similar vein, European-level fiscal governance reforms in Portugal caused the previously bottom-up budget process to become more top-down, as the experience of the crisis together with the EU's fiscal governance reforms strengthened the role of the Ministry of Finance (III). Moreover, the empirical analysis shows somewhat similar arguments in explaining the outcome: given that the structural deficit target is highly complex, it offered the Ministry of Finance an informational advantage in budget discussions vis-a-vis the spending ministries (III). In addition, compliance with the EU level spending rules in combination with the crisis experience brought in the need to monitor the expenditures of the line ministries more tightly, giving the Ministry of Finance additional tools to exercise that power (e.g. the need to create a single treasury account, increasing the use of frozen appropriations, III). EU's fiscal governance reforms also reinforced a top-down approach and strengthened the Ministry of Finance in Austria, where the complexity of the structural deficit target provided the Ministry of Finance with additional arguments in budgetary negotiations with line ministries (III).

The introduction of national Fiscal Councils has also entailed strategic impacts in the national budgetary processes. In Austria and Portugal, the existence of Fiscal Councils helped to reinforce the positions of the Ministry of Finance in budget negotiations (III). In Estonia, the creation of the national Fiscal Council has added a new actor to the budgetary process and without the external pressure and EU level legislation, Estonia would not have created such a body (I; II). In addition, the Fiscal Council has also slightly shifted the powers and resources between the actors in the budgetary process: the Fiscal Council has increased its own authority e.g. through media and by providing the Cabinet and the Parliament with additional background materials (I). As already briefly discussed above, the motives of the Estonian policy-makers for creating a potentially strong body, attached to the Bank of Estonia, and affecting the power balance between the actors in the budgetary process, makes an interesting empirical puzzle – especially bearing in mind that the Ministry of Finance itself held strong veto-powers in designing the institution (I). The Ministry of Finance was above all motivated to create a potential ally and an “insurance mechanism” to prevent future governments and politicians from violating

fiscal rules (II), even though this meant constraining some of its own powers. This was nevertheless done under the assumption that the Fiscal Council would “lock in” their current policy preferences and was designed carefully so that the Fiscal Council would not be too closely involved in politics (II). Therefore, it can be argued that the policy-makers still pursued their own interest when designing the new body. Once it became clear that the new body needed to be established, the officials from the Ministry of Finance chose the Bank of Estonia because the officials from both organisations shared same ideological understandings of fiscal conservatism (II).

2.4 Europeanization and sociological institutionalism

The second dominant stream in the Europeanization literature follows the **constructivist perspective** and emphasizes the importance of reshaping existing domestic norms and collective understandings (Kelley, 2004; Börzel and Risse, 2007) that, although deeply rooted, are entirely not fixed (Bentzen, 2009). From this perspective, policy designers are likely to analyse similar policies in other countries, either with the goal of emulating a “normative ideal” or with the goal of (positive or negative) lesson-drawing (Offe, 1996; Rose, 1991). Hence, Europeanization can lead to domestic change also through the process of socialization and collective learning, resulting in the development of new identities and/or ideas (Börzel and Risse, 2003). Learning from other states and diffusing the ideas and norms can broaden the choice of alternatives considered by the actors in the domestic policy-making process in order to solve various policy problems (Knill, 2005). Börzel and Risse (2000) argue that the existence of “change agents” also influences the likelihood of a change in norms or beliefs.

Hence, following the constructivist perspective, we would expect that changes introduced by the EU’s fiscal governance framework have **reshaped existing domestic norms that guide the budgetary process** and changed the beliefs of national actors, which in turn have led to changes in the policies. As the groundwork for the EU level rulebook was established by the Maastricht Treaty and was at that time mainly done because of the pressures coming from Germany and the Netherlands, it would be difficult to claim that the original setting for the EU’s fiscal rules benefited from shared beliefs across the member states (Doray-Demers and Foucault, 2017). However, since then and with the successive reforms, the EU’s fiscal framework and the guiding norm of fiscal discipline established a solid place for itself in the EU’s institutional setting (Ibid).

The socialization mechanism is credible if it shows that policy actors were influenced by the EU level norms. The EU’s Fiscal Compact certainly facilitated an **ideational shift in Estonia**, as the government moved its focus from nominal deficits to structural deficits (I; Raudla et al, 2018). As the policy makers have explained themselves, this would not have happened without the EU’s policies (I). However, the question remains, why this was not the case after the 2005 SGP reforms that also intended to shift the focus to the cyclically-adjusted budget balance? One of the explanations certainly lies in the Fiscal Compact itself, as it required transposing the structural budget balance rule into the domestic legislation, therefore enforcing stronger coercion and national ownership. Yet, according to the officials in the Estonian Ministry of Finance, thorough discussions on the structural balance emerged only after the EU started to put a stronger emphasis on the surveillance of the structural positions of the member states through the obligation to present to the European Commission draft budgetary plans (I). This seems to support the arguments by Simmons and Elkins (2004) that regular intergovernmental meetings at multiple EU levels and peer pressure can incentivize national policy actors to change their

perspectives (Doray-Demers and Foucault, 2017). It also shows that the existence of “change agents” and fora for policy learning and multilateral discussion influence the likelihood of a change in norms or beliefs. Moreover, as Estonia wanted to **maintain its positive public image**, it hoped that the national structural balance (rather than deficit) rule would provide an additional safeguard, just in case the calculations by the Ministry of Finance and the European Commission differ (I). This confirms that the “logic of appropriateness” and the desire to look good in the eyes of the European Commission strongly influenced the decision to be more ambitious than needed even in the case of a strictly coercive EU rule. Interestingly, while in most countries in Europe the fiscal governance reforms brought about the tightening of fiscal policy, in Estonia in contrast it enabled some relaxation (and acceptance of nominal deficits) since the government could now point to complying with structural balance as a sign of being fiscally responsible (Raudla et al, 2018).

In Finland, the implications were somewhat different. Although the introduction of EU level rules on the structural deficit target brought in the need for more formalistic procedures and increased the need for stricter coordination of the budgetary policies by different levels of government, the approach induced by the EU requirements clashed with the more informal and consensus-based approach that was prevalent in Finland before the reforms (III). Hence, even though the EU rules were seen as inconvenient at the time, the domestic norms and collective understandings did not necessarily restrict the adoption of more formalized rules if the informal consensus and existing traditions in place already followed the logic of the new rules.

However, the design of the Fiscal Council in Estonia provides a contrasting example. The EU’s normative discourse on the role of Fiscal Councils and the experience of other countries had only very limited impact on the design of the Fiscal Council in Estonia. For example, the affiliation of the Fiscal Council with the central bank was not considered advisable in the EU level discourse (II), suggesting (and as discussed in the previous chapter) that national considerations prevailed over the “outside” reflections.

2.5 Europeanization and historical institutionalism

Historical institutionalism might at first seem like an unlikely suspect in explaining the domestic impacts of Europeanization, since the latter is understood as processes of change while the former emphasizes stability and persistence. Nevertheless, historical institutionalism has found wide reflection in the Europeanization literature, especially in its early stages (e.g. see Panke, 2007; Bulmer, 2009; Bache et al, 2011; Ertugal, 2021). Still, it has mostly been regarded as a narrow approach to Europeanization, concentrating only on formal elements (Grünhut, 2017) rather than looking at the behaviour and motives of different policy actors. Historical institutionalism stresses the importance of existing institutions and policy trajectories in the creation of policies (Hall and Taylor, 1996). However, when explaining the different national impacts certain EU measures can entail, understanding the lack of change might also become an important element to consider (Panke, 2007). Hence, looking into some reflections from historical institutionalism might be useful when explaining the varying domestic impacts the EU’s economic and fiscal policy measures have had in the context of national budgetary processes, especially in those cases where rational choice or sociological institutionalist approaches do not fully explain the outcome at the national level.

The focus of the historical institutionalist approach has been on the analysis of the sequences of domestic adaptations in connection to EU level political discourses,

strategies, institutions, and policies (Graziano and Vink, 2013). Domestic change is explained in connection to concepts such as path dependency and positive feedbacks (Ibid). When a government or an organization decides to take a certain path, there is a tendency for those initial policy choices to persist (Hall and Taylor, 1996; Pierson, 2000 in Raudla et al, 2017). Hence, the earlier policy choices and institutional settings influence successive decisions and modes of interactions between the policy actors through lock-in and feedback effects (Ibid). Budgeting is seen as one of the core processes in the public sector and is often characterized by well-established practices and deeply entrenched procedures. Thus, even though the new EU rules prescribe specific instruments and institutions they may not necessarily lead to considerable changes in the budgetary processes. Instead, the budgetary actors might prefer the persistence of existing routines and practises (III). Path dependencies can however be impaled by critical junctures, moments of political openness when the constraining effects of institutions can weaken and form new and enduring legacies (Hogan, 2019; Benz and Sonnicksen, 2017). Another important element in the discussion is the concept of layering. Layering as a concept has been widely used in research on institutional and policy change (Capano, 2018). Layering is defined as a mode of gradual change (Thelen, 2009; Mahoney and Thelen, 2010), as “crafting of new elements onto an otherwise stable institutional framework” (Thelen, 2004; Ibid). In terms of Europeanization and budgetary processes, our case studies show that layering, path-dependency, as well as critical junctures have all played a specific role in explaining the domestic influences of the EU’s fiscal and economic policy framework (I; II; III).

To begin with, it could be argued that the EU’s economic and fiscal policy framework itself is an example of gradual levels of successive reforms, each wave either fostering the enforcement of the rules or adding some new elements into the framework. Since the Maastricht Treaty, the EU has gradually developed a broader and increasingly more complex framework of economic and fiscal policy coordination with the emphasis on ensuring better enforcement and compliance with the original rules. Since the SGP was originally established, the following reforms from 2005 and afterwards seem to entail elements of layering, as the emphasis has always been on strengthening the existing rules as well as learning from past mistakes. Moreover, the new elements added to the framework (e.g. stronger emphasis on the structural fiscal effort; requirement to set medium-term objectives; additional flexibility clauses, creation of national Fiscal Councils – to name a few) have also been introduced gradually.

Yet, a more interesting question is, whether it has also had similar gradual impacts on the national level budgetary processes. From our case studies, the most prominent example of how historical institutionalism can play an important explanatory role is the creation of the Fiscal Council in Estonia (I, II). As already explained above, understanding the design and creation of the Fiscal Council in Estonia needs a much more nuanced approach and is not fully explained by rational choice or sociological institutionalist approaches. According to rational choice institutionalism, the Fiscal Council would have been created under the MoF, as this would have been the “easiest” alternative, also allowed by the EU legislation. Instead, Estonia chose to attach the Fiscal Council to the Bank of Estonia - an organization that is known for its competencies in macroeconomic analysis and forecasting. By doing so, the MoF added into the budgetary process a new potentially powerful actor, who also has a strong authority to call into question the macroeconomic forecasts and the chosen course of budgetary policies (I; II). That being said, there were still motives to create a so called “insurance mechanism” to prevent

future politicians from violating the fiscal rules and hence to “lock in” current policy preferences (II). Sociological institutionalism, on the other hand, would have assumed that while transposing the EU level requirement and creating a Fiscal Council, the actors would have analyzed similar organizations in other countries, either with the aim of finding a “normative ideal” or with the goal of lesson-drawing (Ibid.). However, in the existing normative discussions at that time, attaching a Fiscal Council to a central bank was not recommended, since there were fears that views of the central bank might influence the positions of the Fiscal Council (Calmfors and Wren-Lewis, 2011; Debrun et al, 2013 in II). Also, from a comparative perspective, attaching the Fiscal Council to a central bank was seen as an unfamiliar approach, though not entirely unique (II). Thus, to fill the gaps in explaining the design of the Fiscal Council in Estonia, we had to look at the previously existing configuration of political institutions and their interlinkages that played an important role in swaying the decision to attach the Fiscal Council to the Bank of Estonia (II). As argued in article II, path-dependency played an important role in the creation of the Fiscal Council in Estonia (II) next to other factors. Namely, given the institutional choices made in the early 1990s and the economic policy trajectories since then (Hope and Raudla, 2012; Raudla and Kattel, 2011 in II), the Bank of Estonia has become an organization with the strongest capacities for macro-economic analysis (II). Although there were different alternatives on the table (e.g. to attach the Fiscal Council to the Parliament or to a university or a commercial bank), they were eventually abandoned as that would have meant considerable capacity building. Moreover, the MoF already had had close cooperation and deep collaboration with the Bank of Estonia for years, especially when it came to macroeconomic forecasting and economic and fiscal policy discussions. Hence, the MoF hoped that these existing relationships would extend also to the Fiscal Council. (Ibid)

3 Additional context specific factors that have influenced national budgetary processes

Overall, the discussion so far has shown that specific domestic impacts of the EU's economic and fiscal framework on the national budgetary processes cannot solely be explained by one single stream of Europeanization literature. As highlighted in the previous chapters, the arguments coming from rational choice, sociological and historical institutionalisms have all played (more or less) an important role also in terms of the EU's influence on national budgetary processes. However, the empirical findings clearly illustrate that a more nuanced and context specific approach is needed to fully explain the impacts of Europeanization in the context of budgetary processes (I; II; III), especially when looking at the multiple measures holistically.

Based on previous synthesis and case studies, the thesis points to additional context specific factors that emerge in the empirical findings and have had an impact on national budgetary processes and, hence, would deserve more attention. Namely, **the nature and complexity of the rules** that can provide actors (in our cases, MoF-s) with additional arguments in the budgetary negotiations with line ministers (I; III) and, the **crisis experience** (III). Falkner et al. (2005) and Falkner et al. (2007) have also argued that Europeanization research requires a context-sensitive approach to explain why different factors matter in different settings (Ibid).

3.1 The combination of EU level rules with the crisis experiences

An important element that should be looked at in the discussion is the general setting into which the EU-level reforms were inserted. With regard to the EU's fiscal and economic governance reforms, this was the crisis experienced during 2008–2010. The crisis experience can make the shifts in budgetary processes more likely than they would be “in times of normalcy” (III). This is well supported by the claims of historical institutionalism, which provides a convincing argument also in the context of Europeanization by stressing the importance of a crisis as a condition for change as well as other historical factors creating windows of opportunity for reforms (Bentzen, 2009). As emphasized by Schmidt (2002), the changes produced by the EU rules in the member states depend, among other things, on the countries' vulnerability to global as well as European economic forces and the existing legacies (III). Therefore, these two factors might be strongly intertwined (III, Raudla et al 2019).

The sovereign debt crisis forced some countries to demand EU financial support, creating a second form of coercion (Doray-Demers and Foucault, 2017). As the crisis forced some member states to support other member states, the crisis experience also reinforced power-asymmetry by pushing lender countries to impose stronger fiscal rules (Ibid). Moreover, in response to a crisis, it is easier for policy actors to question the status quo, argue for change, and overcome resistance (III). Likewise, the experience of a crisis can create a sense of urgency among policy-makers, motivating them to depart from the incremental reform path and push for swifter change (Ibid). It is also argued that the deeper the crisis – i.e. the more severe the fiscal pressures in a country – the bigger the “window of opportunity” for more comprehensive reforms (Raudla et al, 2015 in III). We would hence expect that the member states who were receiving EU assistance after 2010 would more easily adopt stronger fiscal governance frameworks, regardless of the policy actors' own preferences or deeply rooted norms.

Our case studies indicate that, in line with this theoretical prediction, the more severe the experience of the crisis, the greater the pressure for the government to reform its budgetary processes (III). Portugal, which had faced the most severe crisis, introduced extensive reforms of their budgetary process. On the other hand, Finland did not adopt any major reforms and in Austria, where the fiscal squeeze was moderate, the crisis did not trigger reforms as comprehensive as in Portugal, but it did influence the implementation of the reforms that had been enacted before the onset of the crisis. (III)⁸

In Portugal, the vulnerability to the crisis brought in the Troika, as Portugal was forced to ask a bailout from the EU and the IMF. This, in turn, gave the Troika strong leverage to impose changes in the budgetary process. For example, Portugal's budgetary process became more top-down (in contrast to the previously bottom-up approach), as there was no other way to impose consolidation demands by the Troika (III). Moreover, due to the Troika's intervention, there was also a need for more detailed control over the implementation of the budget, and therefore the pre-crisis ideas of giving line ministries more flexibility were abandoned (*Ibid.*). All this in turn increased the role of the MoF and the trend continued even when the adjustment programme ended in 2014 (*Ibid.*). The strengthening of the role of the MoF is, on the one hand, well in line with the Europeanization literature, which argues that the EU's influence might benefit executive powers instead of parliamentary powers (Kassim et al, 2000; Börzel and Risse, 2007). On the other hand, historical institutionalism brings in the notion of critical junctures (as the crisis experience can be) that can lead to new and permanent legacies, persisting even after the crisis has passed. The Portuguese example also illustrated that regardless of the preferences or beliefs of the policy actors, the crisis experience provided an additional impetus and/or conditionality for wider reforms that otherwise would not have been considered.

Moreover, Portugal also introduced a MTBF as a legal provision at the request of the Troika and as a direct result of the crisis already in 2011 – at a time when it had not yet even entered into force as an EU requirement (III). On the one hand, this again endorses that the experience of the crisis can push policy actors to implement accelerated reforms. However, retrospectively it has been acknowledged that the requirement remained a mere paper exercise and quickly lost credibility in later years, as the expenditure ceilings were difficult to comply with during the crisis period (*Ibid.*). Austria had a similar experience with the MTBF, as introducing the MTBF during the crisis period made it challenging to stick to the expenditure ceilings (*Ibid.*). However, in the case of Austria, the MTBF had already been part of the budget reform plans even before the crisis. Hence, it cannot be argued that the crisis or EU level rules had in any way triggered it. However, crisis experience undermined the use of that instrument in both cases, despite the fact that the EU level rules encouraged it. (*Ibid.*). More detailed discussion of the functioning of the MTBFs in these countries can be found in Raudla et al. (2022).

In terms of Europeanization literature, this brings in several additional avenues to explore. If crisis experience can reinforce power asymmetry in the Europeanization process and bring an additional level of coercion into the picture, it can act as a strong policy specific contextual element, which needs to be considered when analysing policy actors' behaviour in response to Europeanization pressures. At least in the context of EU's economic and fiscal policies. Hence, the crisis experience can be an additional factor

⁸ Impacts in Estonia have not been discussed in this paper, as they have been thoroughly addressed in other studies (e.g. Raudla et al, 2017).

that can facilitate domestic change. There is at least one type of situation where this can occur and where policy actors can be vulnerable to this type of additional pressures – namely when a member state requests or needs additional financial support from the EU. However, as the example of Portugal illustrates, not all reforms triggered by the crisis experience are lasting or permanent. Therefore, the crisis experience should rather be viewed as an additional contextual factor to consider or to embed into the analysis of a specific case.

3.2 The nature and complexity of the rules

In terms of policy complexity, the Europeanization literature discusses different modes of EU governance and their possible domestic impacts (e.g. Knill and Lenschow, 2005; Wallace, 2010), but does not address issues that might rise from the specific policy content and its possible implications. Yet, this might serve as one of the possible explanations of certain outcomes in our case studies (I; III).

Continuous legislative changes have made the EU's fiscal governance rules increasingly complex. The Stability and Growth Pact has been reformed several times (e.g. in 2005, in 2011 and in 2013). As a result, the growing complexity of the EU's fiscal policy rules is already embedded to the history of the Stability and Growth Pact (Eyraud and Wu, 2015). It has been argued that repeated attempts to adjust the EU's fiscal framework to a multitude of situations over the past years have made it complex and incoherent (Kamps and Leiner-Killinger, 2019). The European Fiscal Board and the IMF have also identified several causes of complexity in the existing EU's framework (Ibid; European Fiscal Board, 2019). With the new set of EU level reforms created between 2011-2013, more complex fiscal rules were introduced to guarantee better enforcement in a wider range of situations – e.g. the structural balance rule and expenditure benchmark were seen as suitable and good tools to avoid careless fiscal policies in good economic times (Ibid).

However, it has become clear that increasing complexity comes with its own challenges as well as implications, also impacting national budgetary processes. For example, complex rules are more difficult to communicate to the public, can be more ambiguous and can lead to constant debates between different policy actors (I; III). Before the crisis, it was generally thought that keeping the EU's fiscal rules simple and clear would help implementation through market discipline and public oversight (Eyraud and Wu, 2015). However, the 2008-2010 crisis experience indicated that too simplistic rules lacked flexibility to adapt to large shocks and did not encourage sufficiently counter-cyclical fiscal policies (European Fiscal Board, 2019). Hence, the 6-pack and the Fiscal Compact brought in additional elements for ensuring such needed flexibility, for example adding new escape clauses in case of severe economic downturns, as well as new structural indicators (Eyraud and Wu, 2015). While at that time calls were made to have more sophisticated rules, it has been argued that they are harder to communicate and explain to the wider public and can be subject to measurement biases (I; European Fiscal Board, 2019). For example, starting from the reforms back in 2005 and up until today, the introduction of the structural balance rule has led to continuous debates on how to best measure the exact impact of the economic cycle on the budgetary position (I; Kamps and Leiner-Killinger, 2019). Hence, the nature (including the complexity) of the rules might affect the strategic influence Europeanization can have on budgetary processes (I).

For example, and as already explained in the previous chapter, according to our case studies, the introduction of the structural budget balance rule increased the authority and influence of the Ministries of Finance in the member states (at the expense of national Parliaments), hence directly facilitating to shift the power balance in the budgetary processes (I; III). This was clearly observed in Estonia, Portugal and Austria. One of the explanations brought out by the policy actors themselves in those countries was that due to the complexity of calculating, explaining and evaluating the structural budget position, MoF has an informational advantage in the budget discussions (Ibid). Therefore, in terms of Europeanization and in the context of budgetary processes, it could be argued that the complexity of the rules can serve an additional external mediating factor, inducing strategic effects on the budgetary processes and therefore also contributing to influencing the power-balance between the actors involved.

4 Conclusions

The main aims of the thesis were first, to understand how the EU level reforms in economic and fiscal governance from 2011-2013 have influenced budgetary processes in the member states and secondly, how to explain the outcomes. The research questions were addressed through in-depth case studies, focusing only on a limited number of member states. Moreover, the focus was on selected measures of the EU's economic and fiscal governance framework, namely the structural budget deficit rule, creation of national Fiscal Councils, the requirement to adopt medium term expenditure frameworks and the European Semester (annual evaluation of the draft national state budgets and multilateral surveillance). To achieve the set objectives, the thesis built on the existing knowledge of Europeanization literature as it allowed to discuss how and through which mechanisms EU policies can trigger domestic change in the national budgetary processes, drawing on different streams of institutionalist research and their ability to explain the empirical findings.

Firstly, how has the creation of national fiscal councils, the introduction of the structural budget deficit rule, the requirement to adopt medium term expenditure frameworks and the revamped European Semester shaped budgetary processes in the member states?

To begin with, the case studies demonstrate somewhat significant changes in the budgetary processes in all of the studied countries triggered by the EU level reforms. Although the concrete impacts vary and it is not clear if the EU level reforms have always led to desirable shifts in the core budgetary processes of the member states (I; III). Regarding the **budgetary process of Estonia**, the structural budget balance rule has clearly had an effect on the Estonian budgetary process, since it was introduced into the legislation only due to the Fiscal Compact. Furthermore, according to the officials of the Ministry of Finance, thorough discussions on the structural balance clearly emerged only after the EU started to observe the structural positions of the member states' budgets through the European Semester process (I). Hence, it has had both strategic and cognitive impacts on the budgetary process (I). On the one hand, after the adoption of the structural budget balance rule, the authority and influence of the officials of the Ministry of Finance has increased, directly influencing the power balance in the budgetary process, as could be expected following the Europeanization literature. On the other hand, the focus on the structural budget balance has also brought in additional actors to the domestic budgetary process – the Fiscal Council and the European Commission as different policy actors have evaluated the cyclical position of the national state budgets somewhat differently (I). Consequently, it has allowed the national Fiscal Councils to enter and mediate the debate at the national level and gain additional visibility in the national budgetary processes (I; II). Secondly, the national Fiscal Council was introduced to the Estonian budget process only due to external pressure coming from the EU level legislation (I), leading to strengthened independent monitoring of fiscal policy. The creation of the national Fiscal Council shows both the institutional and strategic impacts of Europeanization on the budgetary process (Ibid). For instance, the Fiscal Council has slightly shifted the power and resources between the actors in the budgetary process – but at the same time, the Fiscal Council has also increased its own authority in the process, e.g. through media and by providing the Cabinet and the Parliament additional background materials (Ibid).

At the same time, the comparative study of **Portugal, Austria and Finland** showed that the combination of EU level fiscal governance reforms together with the crisis experience have brought about increased centralization of budgetary processes in all three countries (III). In Austria and Portugal, the combination of the crisis experience and the EU level reforms have strengthened the role of the Ministry of Finance in the budgetary process (III) – as was the case also in Estonia. However, in these three countries, the EU level reforms have not induced major changes in the adoption phase of the budget (Ibid.). Moreover, all three cases showed that the introduction of MTBFs did not have the effects it was intended to induce. For example, in Portugal and Austria, the introduction of MTBF in the middle of the crisis meant they had to be revised and became a mere paper exercise, with an undermined credibility (III). In Finland, a system of consensus-based multi-year spending limits was already in place before the EU level reforms. Therefore, the formalized general government fiscal plan approach with structural deficit targets was rather seen as a strange institutional layer that did not fit well with the existing approach (Ibid). Regarding the introduction of independent Fiscal Councils, in Austria and Finland new monitoring tasks were assigned to existing bodies. Even though in Portugal a new Fiscal Council was established, the interviewed officials in all three countries rather agreed that the new EU level requirements did not bring about significant changes to the core budget processes (III). Nevertheless, it could be argued, that the introduction of national Fiscal Councils has entailed some strategic impacts in the national budgetary processes as in Austria and Portugal, the existence of Fiscal Councils help to reinforce the positions of the Ministry of Finance in budget negotiations (III). Finally, similarly to the Estonian experience, the structural deficit rule was characterised as being complex, constantly debated, triggering diverging assessments from different actors involved in the budgetary process and giving additional bargaining power to the finance ministries (Ibid). All in all, the comparative analysis also illustrated that the more severe the experience of the crisis, the greater was the pressure for the government to reform budgetary processes (III).

Turning to the second research question – which institutionalist traditions highlighted in the Europeanization literature have, based on conducted case studies, an explanatory power to unveil the impact of the EU’s economic and fiscal policy on member states’ budgetary processes?

Europeanization literature relies upon various new-institutionalist approaches and theoretical concepts in order to explain countries’ responses to the pressures from the EU level and, provided a good starting point for examining the various national effects on budgetary processes. However, the research showed that none of the new-institutionalist streams alone were not sufficient to explain the domestic impacts of the EU level fiscal policies.

Case studies showed that policy actors, while responding to pressures coming from the EU level, and facing opportunities and constraints when transposing the EU level requirements to the national level, were not always opting for minimizing alternatives when designing national level policies. In other words, going for the “easiest” or “cheapest” solution available. Alternatively, there were examples when domestic change was better explained through the process of socialization and diffusion of collective ideas and norms or through the prism of path-dependency or layering. We could not yet identify any concrete patterns that would follow different EU level measures and their impacts on budgetary processes. Rather, our case studies and the following synthesis of the findings indicated that in many ways the impacts of the EU level rules on the

budgetary processes of the member states need a **case-by-case in-depth analysis** that would take thoroughly into account the context surrounding the reforms – be it national or policy specific. Moreover, in many cases the concrete impact of a specific measure on national budgetary processes was influenced by multiple interrelated motives. For example, the Estonian government decided not to adopt the “easiest” alternative when designing the national Fiscal Council nor did they create the weakest institution possible. Instead, the Fiscal Council was designed as an independent body, supported in its activities by the Bank of Estonia. Yet, the bureaucratic agents were still creating possible new veto point into the budgetary process as an ally for themselves, to guard fiscal discipline. Moreover, existing institutional setting and path dependence provided much clearer explanations why the Fiscal Council was attached to the Bank of Estonia, rather than any other existing body. **(II)** This clearly illustrates the need to look into the explanatory perspectives from different strands of institutionalist research simultaneously, since none of the analytical lenses alone provided a complete explanation. Similar conclusions emerged when looking at implementation of the structural deficit rules or establishment of the MTBF-s.

In addition, based on the case studies, the thesis points to additional context specific factors that have had impacts on national budgetary processes and hence, might deserve more attention in future research. Namely, the nature and complexity of the rules can provide actors (in our cases, MoF-s) with additional arguments in the budgetary negotiations and, the crisis experience can reinforce power asymmetry in the Europeanization process and bring an additional level of coercion into the picture.

As the generalizability of case study research used in this thesis is rather limited, further research can be envisaged at least in two directions. First, in order to evaluate better the impacts of the EU’s economic and fiscal governance framework on the budgetary processes of the member states, more in-depth case studies on the various policy elements of the whole set of EU’s economic and fiscal policy measures would be necessary. Moreover, it would be extremely interesting to examine holistically the combined impacts of the multiple policy instruments of the latest EU level fiscal and economic policy reform packages, in order to identify the synergies and interlinkages between the various policy elements. It would also be insightful to explore how different policy elements (also in terms of their coerciveness) can mutually reinforce or influence each other. Secondly, in order to analyse in-depth how budgeting in the EU member states has changed, it would be necessary to analyse more systematically and with a broader trajectory, what the impacts of these various EU level rules have been. This analysis could incorporate the possibility for a varying explanatory power of different theoretical perspectives at different time-periods. Finally, to draw more comprehensive conclusions in terms of the Europeanization literature, a larger number of comparative case studies should be conducted to test the findings.

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Abstract

Europeanization and the influence of the EU's economic and fiscal policy reforms on national budgetary processes

Fiscal discipline in the European Monetary Union (EMU) has been in the heart of the EU's economic and fiscal policies and has historically been seen as a core ability of the member states to maintain sustainable public finances and address macroeconomic imbalances (Barbier-Gauchard et al, 2021). Likewise, over time there has been a growing belief in the idea that strict fiscal rules limiting the discretion of political actors can ensure fiscal discipline (Doray-Demers and Foucault, 2017). After the global financial crisis in 2008–2010, the European Union stepped up its efforts to cope with the aftermath of the crisis by addressing the sovereign debt problems and enhancing the promotion of fiscal discipline in the member states. As a direct consequence, starting from 2011 the governance framework of the European Union's economic and fiscal policy went through several changes. The Stability and Growth Pact – the core of the EU's fiscal governance framework – was reinforced by the Six-Pack, the Two-Pack, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, and the rules were firmly grounded into the European Semester process.

Although it has been more than 10 years since the latest major changes were made to the EU's legislative framework, research into the institutional consequences of these reforms is still emerging. On one hand, there are studies that criticise the enforcement of the SGP (e.g. Schmidt, 2020) or the lack of democratic legitimacy of the framework (Bremer and Bürgisser, 2022; Csehi and Schulz, 2021), whilst other studies (e.g. Genschel and Jachtenfuchs, 2018 in Van der Veer, 2021) argue that it interferes and centralises control over the “core state powers”. In terms of budgetary processes, the existing literature rather focuses on the role of national parliaments (Steinbach, 2019; Majone, 2014; Jancic, 2016; Verdun and Zeitlin, 2018; Hallerberg et al, 2018; Csehi and Schulz, 2021) or on the specific core elements of the SGP reforms (Eyraud and Wu, 2015; Raudla et al, 2018; Raudla and Douglas, 2021; Raudla and Douglas, 2022). The European Semester and its ability to trigger policy change in the member states has also received considerable attention in the academic literature (e.g. Darvas and Leandro, 2015; Mariotto and Franchino, 2020; Efstathiou and Wolff, 2019; Mariotto, 2022; Bokhorst, 2021; Verdun and Zeitlin, 2018).

However, in the Europeanization literature, there is a lack of qualitative studies on the effects of the latest EU's economic and fiscal governance reforms on the budgetary processes of the member states. Due to the increasing role played by the EU in the economic and fiscal policy-making, understanding and explaining the developments in the fiscal governance, whether in a single country or EU as a whole, has become increasingly important both empirical, as well as in theoretical terms.

The purpose of the thesis is to build on the existing knowledge on Europeanization in order to explain and better understand the empirical implications the different EU's fiscal and economic policy measures have had on member state's budgetary processes. The thesis aims to attain the set objectives through in-depth case studies, focusing on a limited number of member states (Estonia, Portugal, Finland and Austria).

The main research question addressed is: How have the EU level reforms in economic and fiscal governance from 2011–2013 influenced budgetary processes in the member states and how to explain the outcomes. More specifically, the following research questions were addressed:

- How has the creation of national fiscal councils, the introduction of the structural budget deficit rule, the requirement to adopt medium term expenditure frameworks and the revamped European Semester shaped budgetary processes in the member states?
- Which institutionalist traditions highlighted in the Europeanization literature could have, based on conducted case studies, an explanatory power to unveil the impact of the EU's economic and fiscal policy on the member states' budgetary processes?

To answer the research questions, the thesis is built up as a comparative synthesis of empirical findings from the articles and the case studies. The articles were based on in-depth empirical case studies, all touching upon various elements of the EU's fiscal governance framework. Qualitative research design was chosen since it allows to investigate research questions more in-depth, hence allowing to understand the impacts at the national level together with context dependent knowledge (Yin, 2009; Yin, 2012). Moreover, as establishing causality in Europeanization research – e.g. to what extent different changes at the national level are genuinely triggered by EU-level policies – remains a challenge (Radaelli and Exadaktylos, 2009), adopting the case study approach can help to overcome this bias.

The analysis demonstrated somewhat significant changes in the budgetary processes in all of the studied countries triggered by the EU level reforms. However, the concrete impacts vary and it is not clear if the EU level reforms have always led to desirable shifts in the core budgetary processes of the member states. While Europeanization literature provided a good starting point for examining the various national effects on budgetary processes, the research showed that none of the new-institutionalist streams alone was sufficient to explain domestic impacts of the EU level fiscal policies. Rather the thesis indicated that in many ways the impacts of the EU level rules on the budgetary processes of the member states need case-by-case in-depth analysis that would take thoroughly into account the context surrounding the reforms and explore perspectives from different strands of institutionalist research simultaneously.

Lühikokkuvõte

Euroopastumine ja Euroopa Liidu majandus- ja fiskaalpoliitika reformide mõju riikide eelarveprotsessidele

Eelarvedistsipliini hoidmine Euroopa rahaliidus (EMU) on olnud ELi majandus- ja eelarvepoliitika keskmes ning seda on ajalooliselt peetud liikmesriikide peamiseks võimeks säilitamaks riigi rahanduse jätkusuutlikkus ja tegelemaks makromajandusliku tasakaalustamatusega (Barbier-Gauchard et al, 2021). Samuti on aja jooksul kasvanud uskumus, et ranged eelarve-eeskirjad, mis piiravad poliitiliste osalejate kaalutusõigust, tagavad piisava eelarvedistsipliini (Doray-Demers ja Foucault, 2017). Pärast ülemaailmset finantskriisi aastatel 2008–2010 suurendas Euroopa Liit oma jõupingutusi kriiside tagajärgedega toimetulekuks, tegeledes riigivõla probleemidega ja tõhustades eelarvedistsipliini edendamist liikmesriikides. Selle otsese tagajärjena on Euroopa Liidu majandus- ja eelarvepoliitika juhtimisraamistikku alates 2011. aastast sisse viidud mitmeid muudatusi. Stabiilsuse ja kasvu pakti – ELi eelarvejuhtimise raamistiku tuumikut – tugevdati 6-pakti, 2-pakti ning majandus- ja rahaliidu stabiilsuse, koordineerimise ja juhtimise lepinguga ning reeglite koordineerimiseks loodi Euroopa poolaasta protsess.

Kuigi viimastest suurematest muudatustest ELi õigusraamistikus on möödunud juba üle 10 aasta, on nende reformide institutsionaalsete tagajärgede uurimine alles algusjärgus. Ühelt poolt on uuringuid, mis kritiseerivad stabiilsuse ja kasvu pakti jõustamist (nt Schmidt, 2020) või raamistiku demokraatliku legitiimsuse puudumist (Bremer ja Bürgisser, 2022; Csehi ja Schulz, 2021), samas kui teised uuringud (nt Genschel ja Jachtenfuchs, 2018 viidatud Van der Veer, 2021) väidavad, et raamistik sekkub liigselt ja tsentraliseerib kontrolli riikide põhipädevuste üle. Eelarveprotsesside vaatest keskendub olemasolev kirjandus siiski pigem kas rahvusparlamentide rollile (Steinbach, 2019; Majone, 2014; Jancic, 2016; Verdun ja Zeitlin, 2018; Hallerberg et al, 2018; Csehi ja Schulz, 2021) või stabiilsuse ja kasvu pakti üksikutele elementidele (Eyraud ja Wu, 2015; Raudla et al, 2018; Raudla ja Douglas, 2021; Raudla ja Douglas, 2022). Euroopa poolaastale ja selle võimele käivitada liikmesriikides poliitilisi muutusi on akadeemilises kirjanduses samuti palju tähelepanu pööranud (nt Darvas ja Leandro, 2015; Mariotto ja Franchino, 2020; Efstathiou ja Wolff, 2019; Mariotto, 2022; Bokhorst, 2021; Verdun ja Zeitlin, 2018).

Siiski puuduvad euroopastumise kirjanduses kvalitatiivsed uuringud, mis keskenduksid ELi majandus- ja fiskaaljuhtimise reformide mõjudele justnimelt liikmesriikide eelarveprotsesside vaatest. ELi kasvava rolli tõttu majandus- ja eelarvepoliitika kujundamisel on muutunud üha olulisemaks nii empiirilisel kui ka teoreetilisel mõista ja selgitada vastavaid arenguid, olgu see siis üksiku riigi või ELi kui terviku vaatest.

Käesoleva doktoritöö eesmärk on olemasolevatele euroopastumise teadmistele tuginedes selgitada ja paremini mõista ELi erinevate fiskaal- ja majanduspoliitiliste meetmete mõju liikmesriikide eelarveprotsessidele. Doktoritöö püüab seatud eesmärki saavutada juhtumiuuringute kaudu, keskendudes piiratud arvule liikmesriikidele (Eesti, Portugal, Soome ja Austria).

Peamine analüüsi suunav uurimisküsimus on: kuidas on ELi majandus- ja fiskaaljuhtimise reformid aastatel 2011–2013 mõjutanud liikmesriikide eelarveprotsesse ning kuidas neid riigipõhiseid mõjusid selgitada. Täpsemalt käsitletakse töös järgmisi uurimisküsimusi.

- Kuidas on riiklike eelarvenõukogude loomine, struktuurse eelarvepuudujäägi reegli kehtestamine, keskpika perioodi kuluraamistiku vastuvõtmise nõue ja uuendatud Euroopa poolaasta mõjutanud liikmesriikide eelarveprotsesse?
- Millised euroopastumise kirjanduses keskmes olevad institutsionaalsed lähenemised omavad läbiviidud juhtumiuuringute põhjal piisavat seletavat jõudu hindamaks ELi majandus- ja fiskaalpoliitikate mõjude tulemusi riikide eelarveprotsessidele?

Uurimisküsimustele vastamiseks on doktoritöö üles ehitatud erinevate juhtumiuuringute tulemuste sünteesina. Kokku viidi läbi 3 põhjalikku empiirilist juhtumiuuringut (kaks Eesti kohta ning üks võrdlev uuring Austria, Portugali ja Soome kohta), mis kõik puudutasid ELi majandus- ja fiskaalpoliitikate raamistiku erinevaid elemente. Kvalitatiivne uurimismeetod lubab uurimisküsimusi põhjalikumalt analüüsida, võimaldades seega täpsemalt mõista riigisiseseid mõjusid koos ümbritseva kontekstiga (Yin, 2009; Yin, 2012). Kuna euroopastumise uurimisel on põhjuslike seoste tuvastamine – ehk see millisel määral on erinevad muutused riiklikul tasandil tõepoolest tingitud ELi tasandi poliitikest – äärmiselt keeruline (Radaelli ja Exadaktylos, 2009), aitab kvalitatiivne meetod neid raskusi paremini ületada.

Analüüs näitas, et ELi tasandi reformide tõttu on eelarveprotsessid kõigis uuritud riikides mõnevõrra siiski muutunud või mõjutatud. Kuid konkreetne mõju on riigiti erinev ja ei ole selge, kas ELi tasandi reformid on alati toonud kaasa riikide eelarveprotsessides soovitud muutused. Kuigi euroopastumise kirjandus annab hea lähtepunkti erinevate siseriiklike mõjude tuvastamiseks eelarveprotsessides, näitasid tulemused siiski pigem seda, et ükski institutsionaalne suund ei olnud eraldiseisvalt piisav selleks, et selgitada kõiki ELi tasandi majandus- ja fiskaalpoliitikate mõjusid. Pigem vajab EL reeglite mõjude analüüs riikide eelarveprotsessidele paljuski siiski juhtumipõhist süvaanalüüsi, mis võtaks põhjalikult arvesse reforme ümbritsevat spetsiifilist konteksti ja uuriks samaaegselt erinevate institutsionaalsete uurimissuundade vaatenurki.

Appendix: Publications I-III

Publication I

Keel, K. (2021). The impact of EU's macroeconomic and fiscal surveillance measures on the budgeting process of Estonia. *Halduskultuur: The Estonian Journal of Administrative Culture and Digital Governance* 21(2), 22–42.

The Impact of the EU's Economic and Fiscal Policy Measures on the Budgeting Process of Estonia

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Abstract

After the global financial crisis in 2008–2010, the governance framework of the European Union's economic and fiscal policy has undergone several changes. The Stability and Growth Pact – the core of the EU's fiscal governance framework – has been reinforced by the "six-pack", the "two-pack", the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, and the rules are grounded in the European Semester process. After 10 years since the initial major changes were introduced into the EU's legislative framework and given the current times of fiscal uncertainty as well as ongoing discussions on revising and improving the Stability and Growth Pact rules once again, it is of utmost importance to understand the impacts these past reforms have had on member states in the first place. The paper serves two purposes. First and foremost, the main goal of the paper is to build on the existing knowledge on Europeanization in order to bring into one single framework a whole set of different policy measures and their potential impact on the member state's budgeting processes. Secondly, the theoretical discussion is followed by an empirical case study of Estonia. The case study not only illustrated and mapped out potential impacts that the EU's economic and fiscal governance measures can have on a national budgetary process and demonstrated the potential degree of domestic change in response to these various policy measures, but also provided preliminary insights in the possible mediating factors that could additionally influence domestic adaptation.

Keywords: europeanization, fiscal policy, economic policy coordination, budgeting, EU, European semester, fiscal council

1. Introduction

After the global financial crisis in 2008–2010, the governance framework of the European Union's (hereinafter: EU) economic and fiscal policy has undergone several changes. The Stability and Growth Pact – the core of the EU's fiscal governance framework – has been reinforced by the "six-pack"¹, the "two-pack"², the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, and the rules are grounded in the European Semester process.

Although it has been already 10 years since the initial major changes were made in the EU's legislative framework, the research into the institutional consequences of these reforms is still emerging (e.g. see Catania 2011; Quaglia 2013; Popescu 2015; Ioannou et al. 2015; Calmfors 2015; Barnes et al. 2016; Bauer and Becker 2014; Claeys et al. 2016; Eyraud et al. 2017; Raudla et

¹ Six-pack stands for the package of five regulations and one directive aiming at strengthening the economic and fiscal governance in the EU and the euro area: Regulation 1175/2011 amending Regulation 1466/97; Regulation 1177/2011 amending Regulation 1467/97; Regulation 1173/2011; Directive 2011/85/EU; Regulation 1176/2011 and Regulation 1174/2011.

² Two-pack stands for two regulations: Regulation 473/2013 and Regulation 472/2013.

al. 2018a; Raudla and Douglas 2020, Haas et al. 2020; Verdun and Zeitlin 2018; Karremans 2021; Horvath 2018; Crespy 2020). Given the current times of fiscal uncertainty as well as ongoing discussions on revising and improving the Stability and Growth Pact rules once again, it is of utmost importance to understand the impacts these past reforms have had on member states in the first place. Furthermore, as budgeting is one of the core processes in the public sector and widely considered a core state competence, the Europeanization literature lacks studies that would address if, how and to what extent all these various changes interact and can affect the budgeting processes. Due to the increasing role played by the EU in the economic and fiscal policy-making of the member states, understanding these impacts is extremely important.

This paper serves two purposes – first and foremost, the main goal of the paper is to build on the existing knowledge on Europeanization in order to bring into one single framework a whole set of different policy measures and their potential impact as well as the degree of potential domestic change (as a dependent variable). Moreover, the paper also discusses possible domestic independent variables that can influence, trigger and explain the impact on the budgeting processes. Finally, the developed framework is tested on a single case study for an in-depth analysis. The case study is needed to test the theoretical framework and analyze in depth domestic independent variables, but it can also provide valuable information on actual policy outcomes. This paper follows Estonia, focusing on the time period when the reforms were implemented in the first place. Hence, the research questions addressed in the paper are the following: 1) What are the different theoretical possibilities of the EU's economic and fiscal governance framework to influence national budgeting processes? 2) Have the reforms had any impact on the budgeting process of Estonia? 3) How can we explain these influences (or lack thereof)?

The paper proceeds as follows. To begin with, based on the existing literature on Europeanization, a theoretical framework for analyzing the potential domestic impacts of the EU's economic and fiscal governance measures is developed. The framework will cover both coercive policy measures (e.g. coming from Fiscal Compact or from the secondary EU law) as well as policy coordination measures (e.g. the European Semester). Although currently there is no distinct framework that brings these various (legislative as well as "softer") policy measures all together – especially in terms of their potential impact on domestic budgeting process – several Europeanization studies address the influence of different EU governance patterns (e.g. Wallace 2010; Bache et al. 2011; Knill and Lenschow 2005; Knill and Lehmkuhl 2002; Kahn-Nisser 2015; Radaelli 2003; Knill et al. 2009), the mechanisms of Europeanization (e.g. Börzel and Risse 2003, 2007; Featherstone and Radaelli 2003; Graziano and Vink 2007, 2013; Risse et al. 2001; Börzel 2002; Börzel 2005 Knill 2005; Haverland 2000; Knill and Lehmkuhl 2002) and different categories of how to operationalize the term "domestic change" (e.g. Radaelli 2004; Börzel and Risse 2003).

Secondly, the theoretical discussion is followed by an empirical study of Estonia. Estonia provides an interesting case in terms of budgeting process and fiscal policies since Estonia has been praised as the role model for fiscal conservatism (Raudla and Kattel 2011). This has mostly been driven by the fundamental belief that balanced budgets (and low debt) help to ensure macroeconomic stability (ibid.). Therefore, the potential misfit between domestic processes and the new EU level requirements can be presumed to be moderate. Nevertheless, until 2014 and before the implementation of the Fiscal Compact, Estonia did not have a fiscal

rule stipulating budget balance or a deficit target in their domestic legislation (Raudla et al. 2018b). Moreover, as the Estonian budgeting process can be characterized as containing a small number of veto points and being highly centralized, with the minister of finance having historically extensive agenda setting and negotiating powers (Raudla 2010) we could assume these three aspects would interplay and trigger additional reforms in the area of budgeting processes. Furthermore, research on the implementation of the European Semester suggests that Estonia might have a better implementation record of the country-specific recommendations than other member states (Haas et al. 2020). Therefore, in light of the research questions, Estonia could be seen as having favorable conditions for Europeanization to occur and providing a good case for helping to illustrate the potential impacts EU's economic and fiscal governance framework could have on the national budgeting process. The sources of data were semi-structured interviews that were conducted a few years after the implementation of the various measures as well as the analysis of policy documents, including the relevant country-specific recommendations addressing fiscal policies and the budgeting process. The findings of the empirical analysis, discussion and conclusions are presented in the final section of the paper.

2. Theoretical discussion

Since the mid-1990s, a growing number of studies have analyzed whether, how and under what conditions EU influences its member states and beyond – starting from affecting domestic policies and institutions to reshaping beliefs, identities, norms and collective understandings (Börzel and Risse 2007; Pollack 2010; Graziano and Vink 2013). In light of these questions, Europeanization has quickly become a central concept in the EU studies (Börzel and Panke 2013, Wach 2015). Although in the broadest sense Europeanization refers to some kind of interaction between the EU and its member states, the precise definition and the scope of the concept remains debatable (Radaelli 2003; Wach 2015; Börzel and Panke 2013).

Börzel and Risse (2009) conceptualize such interaction as a two-way process consisting of so-called "top-down" (downloading) and "bottom-up" (uploading) Europeanization. In later years some scholars have incorporated top-down and bottom-up processes into one single concept (Wach 2015), emphasizing the need to apply a circular approach in research (ibid.). However, bearing in mind the addressed research questions, this paper takes the top-down process on Europeanization. Europeanization as a top-down process targets the question of *how* the EU influences domestic policies, institutions and processes (Sanders and Bellucci 2012, in Börzel and Panke 2013; Wach 2015), both in the member states and the EU candidate or neighboring countries (Balkir et al. 2013). It also allows having an in-depth view on the mechanisms of Europeanization (e.g. what triggers and influences domestic change). Hence, Europeanization is defined as follows:

Europeanization refers to multiple ways European-level processes, policies, or institutions influence domestic policies, politics and polity (Börzel and Risse 2000).

2.1 The potential impact of different EU governance patterns

Although the EU's influence on various national policies is probably one of the most studied fields in the Europeanization literature (Featherstone 2003; Graziano and Vink 2013) the EU's impact on domestic institutions and policy-making processes has so far received less attention (Börzel and Risse 2007, Knill et al. 2009). On the one hand, there are signs that domestic institutions have managed to stay resistant to the pressures of Europeanization (Anderson 2002, 818; Schmidt 2006). On the other hand, it has been argued that – at large – member states still react to the demands by the EU (Kassim 2003).

To begin with, it is important to understand that institutional adjustment in response to Europeanization can differ considerably from one country to another (Featherstone and Radaelli 2003; Graziano and Vink 2007, 2013). Moreover, interaction between the EU and the domestic institutions may vary (Wallace 2010), depending on the policy field and policy instrument used (Bache et al. 2011). Hence, examining how different modes of EU policy-making can influence domestic processes and policies is necessary to serve the purpose of this paper. The paper relies greatly on the work by Knill (2005) and his co-authors on distinguishing between different types of EU governance patterns – mainly because the governance framework of the EU's economic and fiscal policy consists of different types of policy instruments.

Knill and Lenschow (2005) argue that the EU's potential to evoke change varies with the particular governance pattern applied. To be more precise, they distinguish between coercion, competition and communication (Knill and Lenschow 2005). Moreover, all these patterns entail different incentives and behavioral rationalities that guide domestic responses and actors' behavior (ibid.). National policy-makers play a central role in this model, as they tend to follow certain general rationalities to respond to EU requirements (ibid.).

Coercive governance in general refers to legally binding legislation at the EU level (often having clear and pre-defined procedural obligations or organizational structures with a sanctioning potential), leaving little or no discretion to the member states (Knill and Lenschow 2005). This can be, for example, a requirement to create a new organization or a body (ibid.). It can therefore be expected that when coercive governance is used, member states are under a rather high compliance pressure, which in turn can influence domestic institutional arrangements, organizations and national administrative styles (ibid.). In response to these pressures member states often try to minimize domestic adaptation costs. Hence, the response to the requirements coming from the EU level is persistence-driven, which in turn can lead to incremental and gradual adjustments, as domestic change could be reduced only to the unavoidable changes necessary to comply with the EU rules (ibid.).

In the case of *governance by competition*, the influence of the EU's regulative policies on domestic institutions, processes and policies is considered to be more indirect since the measures can entail only few legally binding rules, leaving member states with broad institutional freedom to choose how to comply with the rules (ibid., 585). The domestic change is encouraged by creating a common general framework and "rules of the game" at the EU level. Therefore, pressure for domestic change is considered to arise from the need to re-arrange or improve domestic practices, institutions or processes in order to achieve common EU-level objectives (ibid.). It has been argued that this triggers a higher potential

for fundamental and profound national reforms, since the persistence-driven incentives of policy-makers are constrained (ibid.).

The third and final type of governance targets domestic institutions by *communication*. Here, instead of legally binding legislation, the emphasis is on developing best practices and a common exchange of information (Knill and Lehmkuhl 2002; Knill and Lenschow 2005, 587). The approach originates from the concept of mutual learning (Rose 1991) and includes, e.g., the open method of coordination. Former studies have indicated that by using a communicative type of policy instruments, member states can react strategically – they try to balance between justifying domestic processes vs. publicly opposing *any* domestic change (Kahn-Nisser 2015, 4; Voegtle et al. 2011). This, in turn, can lead to institutional change (Knill and Lenschow 2005; Trubek and Trubek 2005; Borrás and Jacobsson 2004, 201) because states realize excessive resistance to change could eventually lead to even stronger compliance pressure. Therefore, it has been argued that most likely some incremental change in domestic arrangements (triggered by peer pressure) could take place (Knill and Lenschow 2005). Other studies on the so-called "soft" EU policy measures support the argument (e.g. Franzese and Hays 2006; Trubek and Trubek 2005; Borrás and Jacobsson 2004). Additionally, more recent studies addressing the EU's macroeconomic policy coordination as well as focusing on the European Semester have indicated that the introduction of the European Semester has opened the door to new ways of investigating EU policy coordination (Haas et al. 2020). For example, the actual implementation record of various country-specific recommendations diverge greatly among the member states (see, e.g., Haas et al. 2020; Verdun and Zeitlin 2018; Crespy 2020). Moreover, through the new enhanced policy coordination, ministers of finance increasingly have to negotiate and explain the direction of their policies at the EU level (Karremans 2021). On the one hand, this can reduce the room for national political alternatives (ibid.) but on the other hand, policy measures that are based on communicative governance can also give member states opportunities to present already existing processes and policies as new (Radaelli 2003, Scharpf 2003). Furthermore, European policy pressures and domestic politics can often work simultaneously and in parallel in national budgetary policy-making (Verdun and Zeitlin 2018; Karremans 2021).

Table 1: Governance patterns, actors' incentives and potential domestic change:

Governance pattern	EU-level measures	Actors' incentive for domestic change	Domestic institutional change
Coercion	Clearly defined procedural obligations or institutional structures	Persistence-driven (minimalize change)	Incremental adjustments of existing processes and practices
Competition	Common general framework and rules of the game	Performance-driven (improve domestic practices, institutions, processes)	Higher potential for fundamental and profound reforms
Communication	Mutual learning, peer-pressure and common exchange of information	Legitimacy-driven (justification of domestic arrangements)	Moderate or incremental changes, depending on the presence of a leading model and pressure to conform

(Source: based on Knill and Lenschow 2005)

In terms of domestic change, Knill (2005) has also argued that Europeanization can trigger an *institutional*, *strategic* or *cognitive* impact. The *institutional impact* of Europeanization entails primarily the adoption of legally binding rules or concrete institutions in order to regulate specific policies or processes (Knill 2005). This can be seen as the clearest form of how the decision-making process on the EU level can prompt domestic change (Knill and Lehmkuhl 2002). Secondly, Europeanization does not only induce immediate institutional change (Knill 2005), but EU rules can also influence domestic processes indirectly, altering the "rules of the game" (Knill and Lehmkuhl 2002). In those cases, the *strategic impact* of Europeanization takes place. These influences are more limited and change domestic opportunity structures – i.e. shifting the distribution of power and resources between domestic actors (ibid. 2002; Börzel and Risse 2000, 2003). Finally, Europeanization can also have *cognitive impacts*. In this case, the EU does not define concrete institutional demands but rather induces domestic adaption even more indirectly (Quaglia 2006, 161) – changing ideas, beliefs and expectations (Knill 2005).

2.2 Factors influencing domestic change

Knill and Lenschow's distinction of the EU's different governance approaches and corresponding actors' incentives to change is indeed useful since it helps to classify different EU fiscal and economic policy measures into broad categories and analyze the motives behind policy-actors' behavior. However, as they put it themselves, it requires a careful in-depth analysis to fully understand the domestic impacts of a certain policy. Hence, the triggers for domestic change need further elaboration in order to understand why the impact of Europeanization can differ from one member state to another and why some countries experience stronger

pressures to comply with the EU rules (irrespective of their coerciveness). Those factors most probably go beyond than just actors' own incentives for domestic change.

A considerable amount of literature on Europeanization shares a common suggestion that Europeanization must be inconvenient, meaning the level of domestic change depends on the "misfit" between EU and domestic institutions, policies or processes (Börzel and Risse 2000; Radaelli 2003; Risse et al. 2001. Cowles et al. (2001), Heritier (2001) but also Börzel and Risse (2003, 2007) argue that the "fit" between the EU and the domestic level provides an explanation why the impact of Europeanization differs from one state to another and why some states experience stronger adaptational pressure. Hence, the lower the compatibility between European and domestic processes, policies, and institutions, the larger the potential changes (Börzel and Risse 2003, 2007). At the same time, if the misfit between the EU requirement and existing policies is too large, the policy actors are likely to resist actual changes, or changes may be difficult to materialize in the actual practices (Börzel and Risse 2003, 2007). Therefore, they argue that transformation most probably takes place when the misfit between domestic arrangements and EU requirements is *moderate* (Börzel and Risse 2003, 2007).

However, adaptational pressures do not trigger domestic change automatically (Graziano and Vink 2013). The adaptational pressures and range of influence, coming from external rules or commitments strongly *depends on domestic institutional factors* (Börzel and Risse 2003; Bache et al. 2011; Graziano and Vink 2013). Thus, even if EU rules prescribe specific instruments and institutions, they may not necessarily lead to considerable changes to the policies. Instead, and as already explained above, the actors could be motivated in the persistence of existing routines and attempt to minimize the impacts of EU rules on actual practices (Knill and Lenschow 2005). These arguments stem from the perspective of rational-choice institutionalism, which emphasizes opportunities and constraints domestic actors might face. Whether EU pressures lead to, e.g., a domestic redistribution of power, depends on the capacity of actors to use the opportunities and dodge the constraints (Börzel and Risse 2000, 2007). Whether the actors are capable of utilizing the presented opportunities is argued to be dependent on the amount of veto points and the facilitating institutional structure (Börzel and Risse 2007). Firstly, veto points in the state's institutional structure can restrain or complicate domestic adoption (Haverland 2000; Heritier 2001): the more widely the power in the national decision-making process is distributed and the more various actors have their say in deciding the policy direction, the harder it is to find consensus to undertake changes (Börzel and Risse 2003). This is mainly because strong and multiple veto points in the domestic decision-making process provide actors with entry points to block unwanted changes. On the other hand, a smaller number of veto points can ease the adaption (Bentzen 2009). Furthermore, it has been argued that changes in the domestic decision-making processes may favor actors directly connected with the international negotiations or institutions (see also Moravcsik 1998, 2001). Therefore, it can be expected that Europeanization can strengthen the executive power instead of parliamentary power (Kassim et al. 2000; Börzel and Risse 2007).

The second dominant stream of literature in the Europeanization research follows the *constructivist perspective* that emphasizes the importance of reshaping existing domestic norms and collective understandings (Kelley 2004, 428; Börzel and Risse 2007; Checkel 2007) that, although they are deeply rooted, are nevertheless not fixed (Bentzen 2009). Hence, policy designers are likely to analyze similar policies in other countries, either with the goal

of emulating a "normative ideal" or with the goal of (positive or negative) lesson-drawing (Rose 1991). Therefore, Europeanization can lead to domestic change through the process of socialization and collective learning, resulting in the development of new identities and/or ideas (Börzel and Risse 2003). Learning from other states and a diffusion of ideas and norms can broaden the choice of alternatives considered by the actors in the domestic policy-making process in order to solve various policy problems (Knill 2005). Börzel and Risse (2000) have argued that the existence of "change agents" influences the likelihood of change in norms or beliefs.

2.3 Conceptualizing the degree "domestic change"

Finally, after establishing that Europeanization can trigger different kind of domestic impact and discussing what domestic institutional factor can influence the process, it is also useful to map out the possible degree of domestic change, in order to draw a holistic view on the possible influences the EU's economic and fiscal measures can have. For the purposes of operationalization and measurement the categories of domestic change introduced by Radaelli (2003) and Börzel and Risse (2003) are highly valuable. Based on the different degrees of domestic change, Börzel and Risse (2003) have distinguished between absorption, accommodation, transformation and inertia. *Absorption* refers to the situation where a member state conforms to the European requirements, without substantially changing existing processes, policies or institutions. In case of *accommodation*, Member States indeed adjust existing processes, policies and institutions, but their essential features remain unchanged, leaving the degree of domestic change modest (Börzel and Risse 2003). The level of domestic change is most apparent in case of *transformation*. In that case member states replace existing institutions, policies or processes with new, noticeably different ones or adjust them to the degree that their essential structures change considerably (ibid., 14). *Inertia* does not always refer to having no domestic impact at all but can also indicate that the impacts of Europeanization materialize over the long term (Featherstone and Radaelli 2003). Inertia can also indicate that existing domestic processes and institutions already comply with the EU demands. Continuing from the work of Börzel (1999), Cowles et al. (2001), Heritier (2001) and Knill (2001), Radaelli has also considered *retrenchment* as a fifth situation. In the event of retrenchment, policy divergence might take place (Radaelli 2003).

Table 2: Degree of domestic change

transformation	accommodation	absorption	inertia	retrenchment
Replacing existing institutions, policies or processes with new, noticeably different ones or noticeably adjusting them	Adjusting the existing processes, policies and institutions, without changing their essential features	Conforming with European requirements, without substantially changing existing processes, policies or institutions	No domestic impact at all (in the long run still can lead to domestic change)	Actively resisting domestic change

(Source: based on Radaelli (2003); Börzel and Risse (2003))

fiscal governance framework – was reinforced by the Six-Pack³, the Two-Pack⁴, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The six-pack came into force in December 2011, and it consisted of six new legislative acts. The package was introduced to strengthen the Stability and Growth Pact, with stronger financial sanctions and more focus on debt. It also included a directive on requirements for national budgetary frameworks. The six-pack was soon after followed up by the Fiscal Compact (as a part of the Treaty on Stability, Coordination and Governance), which was signed in 2012 and entered into force on 1 January 2013. The Fiscal Compact required from the contracting parties (out of the 27 Contracting Parties to the TSCG, 22 are formally bound by the Fiscal Compact⁵) to lay down balanced budget rule in their domestic legislation. In 2013, the EU's fiscal governance framework was strengthened even further. The adoption of the two-pack reinforced budgetary surveillance and coordination for Eurozone countries. The main elements introduced with the two-pack included additional measures to strengthen the budgetary surveillance in the Eurozone – e.g. giving the European Commission monitoring and assessing powers of the Euro area members' draft budgetary plans, introducing a common budgetary timeline, additional rules on structural deficit and, finally, strengthening the national fiscal councils (European Commission 2013a). Furthermore, the European Semester introduced in 2010 plays a vital part in the EU's renewed fiscal and economic governance framework, as it brings together under a single annual policy coordination cycle a wide range of EU governance instruments (Zeitlin and Vanhercke 2018), including those that are set by the Stability and Growth Pact. The aim of the semester is to ensure that member states coordinate ex-ante their budget and economic policies, even before the national budget plans are prepared (European Commission 2010).

All in all, it can be concluded that the governance framework of the EU's economic and fiscal policy consists of different types of policy measures, giving member states both concrete institutional models and measures where such a direct enforcement mechanisms are not in place, leaving the member states more flexibility and room for maneuver.

4. Estonia

The case selection for this paper was based on numerous considerations. Estonia has been praised as the role model for fiscal conservatism (Raudla and Kattel 2011). This has been driven by the fundamental belief that balanced budgets (and low debt) help to ensure macroeconomic stability (ibid.). Moreover, the budgeting process in Estonia has been characterized as containing a very small number of veto points and being highly centralized, with the minister of finance having historically extensive agenda-setting and negotiating powers (Raudla 2010).

Budget procedures in Estonia are put into practice in accordance with the State Budget Act. The Act lays out the requirements for the form and structure of the annual budget as well as the roles and responsibilities of the legislature and executive in the budget process. The State Budget Act was thoroughly reformed in 2014 and the changes introduced were mainly triggered by the changes in the EU's fiscal governance framework (Explanatory Memorandum

3 Six-pack stands for the package of five regulations and one directive aiming at strengthening the economic and fiscal governance in the EU and the euro area: Regulation 1175/2011 amending Regulation 1466/97; Regulation 1177/2011 amending Regulation 1467/97; Regulation 1173/2011; Directive 2011/85/EU; Regulation 1176/2011 and Regulation 1174/2011.

4 Two-pack stands for two regulations: Regulation 473/2013 and Regulation 472/2013

5 The 19 Euro area Member States plus Bulgaria, Denmark and Romania, who chose to opt in; Communication from the European Commission C(2017)1200 – The Fiscal Compact: Taking Stock.

of Draft Budget Law 2013).

One of the main elements in the renewed economic and fiscal governance measures was the requirement to establish an *independent institution to monitor national fiscal policies*. In terms of governance patterns, this was clearly a legally binding coercive measure. Prior to the EU requirements, Estonia did not have such a national Fiscal Council. Hence, the requirements brought in considerable adaption pressures to create such an institution. With the new State Budget Act, enacted in early 2014, a national Fiscal Council was established and attached to the Central Bank (Explanatory Memorandum of Draft Budget Law 2013). Already during the negotiations at the EU level Estonia did not support a requirement to establish such an institution. One of the problems seen by the Estonian Ministry of Finance was that the evaluation of fiscal policies could become difficult and more complex due to the additional opinions presented by the new Council (Interview A). The interviews also indicated that without the external pressure and EU level legislation, Estonia would not have created the Fiscal Council (Interviews A, B and C). However, Estonian government nevertheless decided not to adopt the minimizing alternative when designing the Fiscal Council (Raudla et al. 2018a), even though the Ministry of Finance had extensive veto and negotiating powers in deciding on the creation and design of the new institution. The most minimizing alternative would have been to attach the body to the Ministry of Finance (an option that would have been acceptable and was actually considered) (Interview A). Instead, the Fiscal Council was created as an independent body, supported in its activities by the Bank of Estonia (*ibid.*). According to the interviews with the officials from the Ministry of Finance, the Fiscal Council was attached to the Central Bank in order to avoid the creation of a completely new institution, which would also have required additional resources for organizing its work (Interview A). In practice, however, the Fiscal Council sees itself as an independent institution to whom the Central Bank only provides additional background information and office space for organizing their work (Interview C). Moreover, the creation of the Fiscal Council has clearly added a new actor to the budgeting process. The Fiscal Council evaluates the prognoses of the Ministry of Finance; they also have, on their own initiative, evaluated and commented on the draft annual state budgets (Interviews A and C).

Therefore, the creation of the national Fiscal Council shows both *institutional and strategic impacts* of Europeanization on the budgeting process. Hence, even though a strictly coercive measure was imposed, with a clearly defined institutional structure, the policy makers did not follow persistence-driven motives and did not opt for minimizing alternatives. Moreover, the choice of policy makers cannot exhaustively be explained by the amount of veto players (there were no additional actors involved in the process) nor by the prevailing norms and ideas (there was overall skepticism about the additional value of the institution; Interview A). Furthermore, the Fiscal Council has also slightly shifted the power and resources between the actors in the budgeting process – but interestingly enough, the Fiscal Council has increased its own authority in the process, e.g. through media and by providing the Cabinet and the Parliament additional background materials (Interviews A and C). We would have expected from the policy designers not to create an institution that would undermine their own powers. The degree of domestic change can be categorized as accommodation, as a new institution was created and visible changes in the domestic budgeting process have taken place, nevertheless the fundamental features of the existing budgeting process have still (at large) remained unchanged.

The second observable change in the Estonian budgeting process is connected with the *European Semester*, which can be viewed as a governance pattern targeting domestic institutions by communication rather than coercion. However, the timeframe provided by the European Semester has had its impact on the Estonian budgeting process. More specifically, it has shifted the drafting and adoption of the national Budget Strategy.⁶ As the European Semester requires member states to present their national reform programs and stability programs jointly by April, starting from 2011, Estonia had to bring forward the domestic deadline for adopting its state Budget Strategy (Interview A). Before the introduction of the European Semester, the state budget strategy was adopted by the Cabinet in May (Kraan et al. 2008). Thus, the EU-imposed rule provided moderate pressure to change the domestic timelines in the budgeting process. However, the process itself has mostly remained the same because the stability program in practice is actually considered to be the reflection of the national Budget Strategy – the main difference lies only in the format of how the EU collects its data (Interviews A and B). Moreover, the role of the Parliament has remained unchanged throughout the process, (Interview D). Drafting and approving the national Budget Strategy only includes negotiations between the Ministry of Finance and spending ministries about their plans (Kraan et al. 2008). The negotiations primarily take place first between officials from the Ministry of Finance and the relevant spending ministry (exchange between the relevant minister and the Minister of Finance to discuss the more controversial issues), and any unresolved issues are resolved at the Cabinet level (ibid.). Therefore, the Cabinet is involved in the preparation of the State Budget Strategy on several occasions before it is approved in the Government in April. Parliament, however, never has (from 2003) and still does not approve or formally even discuss the document (Interview D). The EU-level requirements have therefore not changed the internal power relations. Thus, it could be argued that a slight *institutional impact* of Europeanization can be observed with incremental adjustments to the existing practises and process in order to conform with the EU's timeline. Concerning the degree of domestic change, absorption seems most adequate: although Estonia conformed to the requirements presented by the European Semester, substantial changes to existing processes, policies or institutions did not take place.

The third essential measure introduced in the new EU economic and fiscal governance framework was the requirement to *legislate structural deficit rule* in domestic legislation, prescribed by the Fiscal Compact. Again, this was clearly a coercive measure. Before the Fiscal Compact, Estonia did not have such a requirement in their legislation. Estonia adopted the structural budget *balance* rule with the new State Budget Act (Explanatory Memorandum of Draft Budget Law 2013). Remarkably, the new State Budget Act established a stricter rule than prescribed by the Fiscal Compact. It stated that the structural budget position has to be in *balance* or in *surplus*, going clearly beyond the minimum EU requirements.⁷

Whilst already the report from the Organisation for Economic Co-operation and Development (OECD) on the Estonian budgeting process highlighted the highly conservative fiscal policy (e.g. balanced budget as a norm; Kraan et al. 2008), the structural budget balance rule was clearly introduced to the national legislation due to the Fiscal Compact. As expressed by one official in the Ministry of Finance:

⁶ The Budget Strategy determines the main directions of the state fiscal policy and records the general objectives of the Government, which are intended to be implemented during the budget strategy period, as well as the funds planned for the implementation. The budget strategy is prepared each year with regard to at least the next year and the following three years (State Budget Act).

⁷ According to the Fiscal Compact the annual structural balance should not exceed -0.5% of GDP.

If there had not been the Fiscal Compact then probably yes, Estonia would have preferred to continue with the nominal balance (Interview B).

Concerning the impact on the national budgeting process, these influences are also quite interesting. Following the theoretical framework outlined in section 2, one could argue that *strategic and cognitive impacts* have taken place. On the one hand, after the adoption of the structural budget balance rule, the authority and influence of the officials in the Ministry of Finance has indeed increased, as could be expected following the theoretical framework. Based on the interviews, this is mainly due to the complexities in calculating, explaining and evaluating the structural budget position (Interviews A and D). On the other hand, the focus on structural budget balance has also brought in additional actors to the domestic budgeting process: namely the Fiscal Council and the European Commission. This is also caused by the complexity of calculating the exact cyclical position of the budget. During the past few years, the Ministry of Finance and the European Commission have evaluated the cyclical position of the Estonian annual budget somewhat differently. Consequently, it has allowed the Fiscal Council to enter the debate and gain additional visibility in the process (Interviews A, B, C and D). Still, it cannot be argued that the introduction of the structural balance rule profoundly transformed the domestic budgeting process in Estonia as the discussions and evaluations of nominal balance are still on the table when the annual state budget is prepared (Interview A). However, the focus has strongly shifted towards the structural balance. Furthermore, according to the officials in the Ministry of Finance, thorough discussions on the structural balance clearly emerged only after the EU started to observe the structural positions of the member states' budgets (Interviews A and D). Concerning the degree of Europeanization, we can categorize it as accommodation.

In order to analyze the domestic impact of the measures on the EU's economic and fiscal policy governance framework that are aimed at facilitating communication (e.g. assessing and comparing member states in the European Semester process and annually evaluating the draft national budget plans), we have to look at the recommendations given by the European Commission to Estonia in the Annual Growth Surveys (AGS) and the Alert Mechanism Reports (AMR) and the corresponding country-specific recommendations. Based on the documents from 2011 to 2015 (European Commission 2012; European Commission 2013a; European Commission 2013b; European Commission 2014) it can be concluded that, in light of the domestic budgeting process, no substantial institutional, strategic or cognitive impact has emerged so far. Although the officials from the Ministry of Finance track the developments in the AMR, the national domestic data is still considered to be more relevant and more up to date than that coming from the EU level (Interview B).

Regarding the annual evaluation of the draft national state budget, the EU-level processes are slightly stricter than in the case of AMR and AGS. Estonia has presented its draft state budget to the European Commission since 2013. According to the evaluations by the European Commission until 2015, Estonia generally complies with the Stability and Growth Pact (European Commission 2013b, European Commission 2014). Nevertheless, some impact on the domestic budgeting process can be observed, since these evaluations have had a disciplinary purpose for the actors involved (Interview A). Hence, the annual evaluation of the draft national state budgets have had *strategic and cognitive impacts* on the budgeting process. The strategic impact derives again from the fact that the Ministry of Finance and the European Commission

calculate the cyclical position of the Estonian annual budget somewhat differently, allowing the Fiscal Council to mediate the debate. The cognitive impact refers to a more consensus-oriented domestic budgeting process, as the evaluation by the European Commission has given the officials from the Ministry of Finance additional means to put pressure on politicians to follow fiscal discipline (Interviews A and D).

Finally, regarding multilateral surveillance in the committees, due to Estonia's reputation as a country with excellent fiscal discipline, Estonia has gotten far less attention in the committee procedures than other member states (Interview A). Nevertheless, between 2012 and 2015 Estonia has received country-specific recommendations (CSRs) addressing the budgeting processes. For example, in 2012 Estonia was recommended to preserve a sound fiscal position by implementing budgetary plans as envisaged, ensuring the achievement of the MTO by 2013 at the latest, and compliance with the expenditure benchmark. Moreover, Estonia was also recommended to complement the planned budget rule with more binding multiannual expenditure rules within the medium-term budgetary framework, continue enhancing the efficiency of public spending and implement measures to improve tax compliance (similar recommendations were also given in 2013 and 2014) (D'Erman et al. 2021). In 2015, Estonia was once again recommended to avoid deviating from the medium-term budgetary objective in 2015 and 2016 (ibid.). According to the officials from the Ministry of Finance, there have indeed been some discussions concerning the Estonian structural budget position in the committee. However, since the officials have not publicly opposed to the committee opinions or the recommendations, only few other member states have taken the floor (Interviews A and B) and actually engaged in the peer-pressure exercise. Thus, multilateral surveillance in the committees has not had any considerable impact in the context of the national budgeting process, thus Estonia has not really needed to thoroughly justify its national arrangements in the Committees so far. Interestingly, however, the official assessment of the implementation of the CSRs does not fully reflect the lack of strong peer pressure. During 2012-2015, it has been assessed that Estonia has made either some progress, substantial progress, considerable improvement or no progress at all when it comes to the implementation of the relevant CSRs (D'Erman et al. 2021). For example, in 2012 it has been evaluated that:

Estonia has made substantial progress in implementing the budgetary plans mentioned in the CSR. However, no progress has been registered so far on the fiscal framework issue. The medium term objective was achieved in 2012, one year before the deadline. The temporary deviation from the MTO in 2013 is not significant and a structural surplus is forecast to be reached from 2014 onwards. The government is expected to fulfil its commitment under the Treaty on Stability Coordination and Governance and to adopt the structural budget balance rule in time. However, the authorities are not planning to introduce an expenditure rule (ibid.).

Regarding the 2013 CSR implementation the assessment was the following

Some Progress: The draft 2014 Budget was adopted as planned, however, the deterioration of the growth outlook and the lowered fiscal targets compared with the previous programme could pose a risk of a significant deviation from the Medium Term Objective in 2014 and 2015. The State Budget Act entered into force on 23 April 2014, hence the commitments made under the Treaty on Stability, Coordination and Governance have broadly been met. The new law includes a 4-year expenditure ceiling

but this is not binding within the medium-term budgetary framework. No progress on introducing a multiannual expenditure rule (ibid.).

In 2014 it was concluded that Estonia had made a considerable improvement in the fiscal framework in general: "Estonia's strengthened fiscal framework has become fully operational in 2014. No progress on addressing the recommendation related to the fiscal framework: no measures were taken to complement the budget rule with more binding multiannual expenditure rule" (ibid.).

To conclude, the domestic impacts of the main measures in the EU's renewed economic and fiscal policy governance framework can be illustrated as follows:

Table 4: Domestic impacts on the Estonian budgetary process

	EU level measure	Impact	Degree of domestic change in the case of Estonian budgeting process
Europeanization	European Semester	Institutional	absorption
	Creation of national Fiscal Council	Institutional	accommodation
		Strategic	
	Structural deficit rule	Strategic	accommodation
		Cognitive	
	Assessing and comparing Member States in the European Semester process	no influence	inertia
	Annual evaluation of the draft national state budgets	Strategic	absorption
		Cognitive	
Multilateral surveillance in the committees	no influence	inertia	

(Source: based on author's synthesis of empirical findings)

5. Discussion and conclusion

All policy actors who were interviewed for the case study considered the overall impact of EU-level measures on the budgeting process of Estonia to be rather significant (Interviews A, B, C and D). Based on the case study, it can be concluded that across different EU-level measures, the impact of Europeanization and the degree of domestic change varies. The empirical study indicates a *slight domination of the strategic impact of Europeanization*. However, the degree of domestic change ranges from inertia to accommodation, and any real transformation of the budgeting process cannot be observed.

Moreover, the creation of the Fiscal Council, the adoption of structural budget balance rule

and the impacts of the European Semester in general follow the expectations proposed by the theoretical framework. However, based on the existing Europeanization literature, we would expect that domestic changes would have been reduced only to the unavoidable changes necessary to comply with the EU rules. Yet, our case study did not completely confirm the latter – as the creation of the Fiscal Council and the adoption of structural budget balance rule clearly illustrated.

On the one hand, the strategic impact of creating the national Fiscal Council indeed supports the logic deriving from the rational-choice institutionalism that Europeanization can influence domestic opportunity structures. Empirical evidence shows that the misfit between the EU-level requirements and the domestic budgeting process indeed gave the Fiscal Council new opportunities to pursue its interest and, to some extent, constrained the powers of the officials in the Ministry of Finance. On the other hand, despite the strong adaptational pressure, the Ministry of Finance was holding a solo veto power to design and limit the creation of the Fiscal Council as a completely separate institution. Nevertheless, when creating the Fiscal Council, policy makers clearly went beyond the minimum required by the EU legislation and decided not to locate the Fiscal Council within the Ministry of Finance (the EU legislation would have allowed such a solution). Thus, the arguments stemming from the rational choice institutionalism (e.g. actors' persistence-driven motives to minimize change) are not sufficient to explain these choices.

The Estonian case also demonstrates that there is a distinct connection between two measures coming from the EU's overall framework – the structural deficit rule and the annual evaluation of draft national state budget plans. The strategic impact of both measures seems to be mainly influenced by the fact that the Ministry of Finance and the European Commission calculate the cyclical position of the Estonian annual budget differently, hence allowing additional players, e.g. the Fiscal Council, to mediate the debate. Therefore, the complexity of the rule itself clearly is an important element in explaining these influences; however, it has not been identified in the Europeanization literature as an additional variable that could potentially explain domestic impacts. The cognitive impact of these measures can be explained by the fact that the annual evaluation of draft state budget plans has led to certain social and political pressures, which, in collaboration with the dominant ideology, has provided the Ministry of Finance additional arguments to push politicians to follow strict fiscal discipline. The latter follows well "the logic of appropriateness" approach.

Moreover, the domestic impacts of the structural budget balance rule (e.g. why Estonia chose to apply a more ambitious structural balance target than allowed by the EU legislation) can also not be explained by the arguments arising from the rational choice institutionalism. Based on the conducted interviews and the theoretical framework, it could be argued that applying a more ambitious structural balance target could be a strategic reaction to the annual evaluation of the draft national state budgets plans by the European Commission. As Estonia wants to hold its positive public image, it was hoped that the structural balance (rather than deficit) would provide additional safeguards in case the calculations by the Ministry of Finance and the European Commission would differ (Interview A).

All in all, Estonia has not only proven to be an empirically interesting case for studying the impacts of the EU's economic and fiscal policy measures but has also raised many additional questions about Europeanization as a theoretical framework. The case study not only illustrated

and mapped out potential impacts that the EU's economic and fiscal governance measures can have on a national budgetary process and demonstrated the potential degree of domestic change in response to these various policy measures but also provided preliminary insights in the possible mediating factors that could additionally influence domestic adaptation. Thus, the future research should go more in depth and look closely into additional explanations and arguments provided by the sociological, historical and discursive institutionalism when trying to explain these specific impacts and the factors influencing domestic responses. Additionally, the complexity of the rules imposed by EU and their possible domestic impacts could be an avenue that deserves more attention in terms of Europeanization literature.

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Interviews:

A: 4 May 2015, official in the Ministry of Finance

B: 4 May 2015, official in the Ministry of Finance

C: 8 May 2015, member of the Fiscal Council

D: 11 May 2015, former member of the Parliamentary Fiscal Committee, member of the Parliamentary EU Affairs Committee

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The Creation of the Fiscal Council in Estonia: Exploring the Explanations for Its Institutional Design

RINGA RAUDLA, KATI KEEL, AND MARI PAJUSSAAR

In this paper, we explore the creation of the fiscal council (FC) in Estonia, using the perspectives of different strands of institutionalism. Our analysis shows that the institutional design of the FC was influenced, in tandem, by principal-agent considerations, transaction costs, existing institutional configurations, path dependence, and normative concerns of the bureaucratic agents in charge of creating the new body. We conclude that in order to understand and explain the motives and factors involved in institutional design, the explanatory angles provided by rational choice, historical and sociological institutionalism should be viewed as complementary rather than contradictory.

INTRODUCTION

Fiscal councils (FC) have received growing attention both in the scholarly literature and in practice over the past years, especially after the occurrence of fiscal crises in many countries (Hagemann 2011; von Trapp, Lienert, and Wehner 2016). In the “rules vs. institutions” debate (e.g., Primo 2007; Wyplosz 2005), it has been increasingly argued that fiscal rules alone are not sufficient but should be complemented with “fiscal watchdogs” (Debrun and Kinda 2014). In essence, a FC is a “publicly-funded entity staffed by non-elected professionals mandated to provide non-partisan oversight of fiscal performance and/or advice and guidance . . . on key aspects of fiscal policy” (Hagemann 2011, 76). The core functions of FCs include the assessment

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or preparation of fiscal forecasts and the monitoring and evaluation of budgetary plans and fiscal outcomes (von Trapp et al. 2016). It is expected that having an independent body that monitors a government's fiscal policy can alleviate the informational asymmetries between the government and the electorate, increase the reputational costs to politicians of running deficits, curb the use of forecasts that are deliberately biased in an overly-optimistic manner and, through all that, facilitate commitment to budgetary discipline (Calmfors 2015; Calmfors and Wren-Lewis 2011; Debrun et al. 2013; Hagemann 2011). Currently, FCs are considered to be among the most "important innovations in the emerging architecture of public financial management" (von Trapp et al. 2016, 11). We can see a considerable growth in the number of FCs over the past decades. While in the mid-2000s, there were 12 FCs in the world, by 2016, their number had increased to 39 (Debrun, Zhang, and Lledo 2017).

The fastest growth in establishing FCs has occurred in the European Union (EU) countries, after the experience of the recent crises (von Trapp et al. 2016). In the attempt to address the sovereign debt problems and to promote fiscal discipline in the member states, the EU has, in the last years, adopted several reforms of the fiscal framework, including the mandate to create FCs at the national level. Specifically, the two-pack and the Fiscal Compact (or the Treaty on Stability, Coordination, and Governance) required all members of the Eurozone to create an independent body that monitors government's compliance with national fiscal rules and produces or endorses macroeconomic projections. Some of these countries already had equivalent institutions. FCs had been adopted in the Netherlands (1945), Austria (1970), and Belgium (1989). For most Eurozone countries, however, this requirement amounted to having to create a new institution (von Trapp et al. 2016).

In this paper, we explore how the FC was created in one particular country: Estonia. Analyzing the Estonian case, from the point of view of institutional design, is insightful for the following reasons. It allows us to examine a situation where actors *have* to create an institution but they do not see a *need* for it, since the problems such an institutional solution is supposed to address are perceived to not exist. As mentioned above, FCs are regarded as useful for enhancing fiscal discipline. Estonia, however, stands out among the EU countries as a poster-child of fiscal conservatism, reflected, for example, in the lowest level of public debt (10 percent of GDP) (Eurostat). Thus, in the eyes of the Estonian policy actors, the problem(s) the FC was supposed to address did *not* exist. Furthermore, not only was the creation of a FC considered to be

APPLICATIONS FOR PRACTICE

- When designing a fiscal council, it would be useful to take into account the contextual characteristics of the country, including the existing institutional landscape, the availability of analytical capacities for macroeconomic analysis, resource constraints, and the needs of the political environment.
- Attaching a fiscal council to the Central Bank can be a feasible solution if there are sufficient legal guarantees that the Central Bank does not interfere with the activities of the council.
- The analytical support provided by the Central Bank can strengthen the analytical capacities of the fiscal council and also shield the council from excessive political interference.
- Fiscal councils can, potentially, play an important role in facilitating fiscal discipline by decreasing the informational asymmetries between politicians and voters and by enriching the public debate on fiscal issues.

unnecessary in the Estonian context, the policy actors were actively *against* it during the negotiations over the EU legislation.

Thus, looking at the creation of the FC in Estonia allows us to explore a situation where policy actors do not see a *need* for an institution, do not *want* it but still *have* to create it. Our research question is: which factors influence institutional design under such circumstances? From the perspective of rational choice (e.g., Shepsle 1989), we would expect that the actors responsible for designing an institution in such a context would go for a “minimizing” alternative—opting for the “easiest” or “cheapest” solution available. In the Estonian context, this would have been to locate the FC within the Ministry of Finance (MoF). The EU mandate did, in fact, allow such a solution. The government, however, decided *not* to adopt the “easiest” alternative. Instead, the new organic budget law, enacted in 2014, foresaw that the FC would be an independent body, supported in its activities by the Bank of Estonia (i.e., the central bank of Estonia). Thus, we are interested in the kinds of motives that led the institutional designers to choose such a solution.

While empirically grounded and starting with a specific empirical puzzle, our paper also seeks to contribute to theoretical discussions on institutional design. Although one would expect the various streams of institutionalist research (i.e., rational choice institutionalism, historical institutionalism, and sociological institutionalism) to pay extensive attention to the question(s) of institutional design, this issue has attracted only limited attention in the existing literature, which appears to be more concerned about how institutions persist and what the impacts are rather than about how they come about in the first place (Olsen 1997; Peters 1999; Thelen 2009). Furthermore, when existing studies look at institutional design at all, they tend to focus either on a purely *voluntary* creation of a new institution or on a *coerced* imposition (e.g., Olsen 1997). In this paper, we will be focusing on a situation that is “in-between” those two polar opposite cases: where the designers *have* to create an institution but still have considerable *leeway* in how to do it. Given the increasing role played by the EU in the political lives of its member states, understanding institutional design in such circumstances is more important than ever.

Thus, on the one hand, our goals are to explore what the Estonian case can tell us about the various theoretical arguments on institutional design proposed by historical institutionalism, rational choice institutionalism and sociological institutionalism and to examine how useful their theoretical predictions are. On the other hand, we use the theoretical insights to better understand and explain the Estonian case.

THEORETICAL APPROACHES FOR EXPLORING INSTITUTIONAL DESIGN

Different institutionalist approaches define the term “institution” in different ways. In this paper, we proceed with a relatively straightforward definition, conceptualizing an institution as “a structural feature of the society and/or polity” (Peters 1999, 18). We are interested in the creation of a formal body. More specifically, we want to examine the creation of a *watchdog* by actors who will themselves be monitored by this institution in the future, in a situation where they *do not want* to create such a body *but have to*.

On the whole, institutionalist research has been more concerned with how institutions “constrain” behavior rather than with how actors actually create or design institutions (Olsen 1997; Peters 1999; Thelen 2009). Still, the existing body of institutionalist literature can provide some theoretical insights into how actors might proceed with creating a new institution. The different strands of institutionalism—rational choice institutionalism (RI), historical institutionalism (HI), and sociological institutionalism (SI)—point to various factors that are likely to play a role in designing a new formal institution. The main theoretical arguments used by RI for examining institutional design are principal-agent problems and transaction costs. For HI, the core notion for exploring institutional development is path-dependence, whereas SI focuses on prevailing norms and lesson-drawing (Hope and Raudla 2012; Peters 1999). In the following, we look at what these different theoretical approaches would predict about a situation where agents have to create their own watchdog, in a situation where they do not in fact see a need for such an institution.

Although RI focuses on the voluntary creation of institutions (Hall and Taylor 1996), its insights can be used for exploring how actors behave when they *have* to create an institution as well. The basic insight of RI is that actors behave instrumentally, driven by their strategic interests and affected by the expectations of how others behave (Shepsle 1989). Thus, when creating a new institution, the actors would be influenced by the expected value of that institution for them and attempt to choose the form that benefits them the most (Hall and Taylor 1996). More specifically, from the RI perspective, institutional design can be explored through *principal-agent* models and the concept of *transaction* costs (Aspinwall and Schneider 2000; Hall and Taylor 1996; Weimer 1995).

An agency relationship is established when a principal delegates some rights (e.g., rights to utilize foreseen resources) to an agent who is bound by a formal or informal contract to represent the principal’s interests (Eggertsson 1990). In the public sector context, the elected officials are usually considered to be the “principals” and bureaucrats their “agents” (Mitnick 1975) but this model can also be used for characterizing a much wider array of relationships: for example, the voters and politicians, heads of public organizations and their subordinates, ministries and agencies etc (Waterman and Meier 1998). The core problems in the principal-agent (PA) relations are goal conflict and informational asymmetry: the agent’s goals may be misaligned with those of the principal and, in the presence of informational asymmetry, agents may engage in opportunistic behavior, like shirking (Waterman and Meier 1998). In light of these insights, if “agents” are in a position where they can create a “principal” entrusted with the task to monitor them in the future, what would the PA model imply? From the RI perspective, given the agents’ opportunism and motives to maximize their self-interest (Dunleavy 1992; Miller and Moe 1983; Primo 2007; Williamson 1985), they would have incentives to create a weak watchdog, with limited powers and constrained opportunities for sanctions. Furthermore, given that agents generally benefit from informational asymmetries (Bendor, Taylor, and Van Gaalen 1987), they would attempt to create a principal with limited access to information, expanding their opportunities to “shirk.”

Another core insight of RI is that when considering, evaluating, and comparing different alternatives, institutional designers are likely to pay attention to the *transaction costs* associated

with creating each of them (Bartle and Ma 2001; Coase 1937, 1960; Williamson 1985). Transaction costs would refer to how costly it is to set up the body and what costs are associated with its operations (Bartle and Ma 2001; Epstein and O'Halloran 1997; Williamson 1981, 1985). From the perspective of RI, if policy actors *have* to create an institution they do not see a need for, they would be motivated to lower the transaction costs associated with the body (Hall and Taylor 1996; Primo 2007; Shepsle 1989). In addition to the costs of setting up and operations, the designers might be concerned with *political* transaction costs (Bryson and Ring 1990; Twilight 1994) and assess how different types of institutional designs might influence the costs of reaching political agreements in the future. In the public sector context, the actors in charge of creating an institution may, in fact, intentionally seek to *increase* political transaction costs—in order to secure “better” decisions (Bartle and Ma 2001) or to avoid departure from the status quo (Primo 2007).

For the most part, HI is relatively silent on institutional design and the creation of new institutions; it focuses more on how political institutions persist, after they have been formed (Hall and Taylor 1996; Peters 1999). However, it can still provide some useful insights about the potential constraints imposed on institutional designers. HI would emphasize the importance of existing institutions and policy trajectories in the creation of a new body (Hall and Taylor 1996; Steinmo, Thelen, and Longstreth 1992). One of the core concepts of HI is *path dependency*: when a government program or an organization embarks on a path there is an inertial tendency for those initial policy choices to persist (Hall and Taylor 1996; Pierson 1993, 2000). Previous institutional commitments and policy choices influence subsequent decisions and modes of interactions between the policy actors through lock-in and feedback effects (Hall and Taylor 1996; Peters 1999; Steinmo et al. 1992). Also, institutional choices made at one point in time can influence the power distribution, and through that, reinforce the existing path (Thelen 1999). In Offe's (1996) words, in the modern world, “designed” institutions are almost always “successor” institutions and cannot be built on a *tabula rasa*. Thus, when creating a new institution, the designers would be influenced by the existing configuration of institutions and would try not to depart from the existing policy arrangements too much. In addition, using the insights from Thelen's (2009) work on institutional change, we would expect the institutional designers to “layer” the new structure on existing ones (see also Bick 2016; van de Bovenkamp, Stoopendaal, and Bal 2017).

Sociological (or organizational) institutionalism (SI) has pointed to the importance of prevailing norms and values in molding the behavior of actors (Peters 1999). It argues that the “logic of appropriateness” influences behavior more than the “logic of consequentiality” (March and Olsen 1984, 1989) or the “logic of instrumentality” (Campbell 1998). Although the main focus of SI is on how institutions as norms *constrain* the behavior of actors, it can offer some insights about institutional design as well. We can expect that the logic of appropriateness limits the range of search for institutional alternatives and shape the design of the new body (Cyert and March 1963; Olsen 1997). Thus, in designing a new formal institution, the actors would not necessarily choose the “most efficient” form in terms of costs or the “weakest” form in terms of power (as RI would postulate). Instead, by following the “logic of appropriateness” and concerns with securing the social legitimacy of the new body, the designers would be influenced by existing norms and values in general and about specific normative expectations about how the

particular institution should (or could) look like in particular (Hall and Taylor 1996; Olsen 1997). They can be expected to use an existing template or a prescriptive model of the institution (Peters 1999; Hall and Taylor 1996).

SI has also pointed to how specific institutional forms have diffused *across countries* (Hall and Taylor 1996). From that perspective, institutional designers are likely to analyze similar organizations in other countries, either with the aim of emulating a “normative ideal” or with the goal of (positive or negative) lesson-drawing (Offe 1996; Rose 1991). When searching for and evaluating various alternatives, the experiences of other countries might provide insights about the functioning of a particular institutional solution and whether it can be transferred to one’s own country (Dolowitz and Marsh 1996; Rose 1993). Policy actors engaged in lesson-drawing can opt for copying or creating a hybrid or synthesis (by blending elements of institutions from different countries) (Rose 1993). They may also learn negative lessons about institutional solutions to be avoided (Rose 1991). In addition to “drawing” lessons, using other countries as models can be used for enhancing the legitimacy of a particular institutional solution chosen (Offe 1996).

THE CREATION OF THE FISCAL COUNCIL IN ESTONIA

In this section, we give an overview of the creation of the FC in Estonia in 2013–2014. Section Factors Influencing the Institutional Design of the Fiscal Council in Estonia follows with our analysis of the motives and factors that influenced the institutional design. As sources of data for the empirical analysis, we used policy documents, verbatim records of legislative sessions, and semi-structured interviews. We conducted 14 interviews with the main policy actors involved in the creation of the FC in 2014–2015 (including public officials from the MoF, the Bank of Estonia, and the parliament). The interviews were recorded, transcribed, and independently coded by each of the authors.

Negotiations Over the Design

The Estonian government was against the mandatory requirement to establish FCs in *all* Eurozone countries since they did not see a need for it in Estonia. As one of the interviewed officials noted, “During the EU negotiations we were the ones saying the loudest that this provision should not be obligatory for all member states” (Interview 12). All the interviewees argued that although many other countries in the EU might benefit from such an institution, it would be redundant in Estonia since the problems a FC is supposed to address (fiscal indiscipline and biased forecasting) did not exist here. First, it was emphasized that Estonia has not violated the fiscal rules of the EU. Second, it was stressed that the Estonian MoF in general (and the fiscal policy department in particular) has always been independent and not politically influenced in making the economic and fiscal forecasts (Interviews 6, 12, 13, 14). It was also noted that the MoF has emphasized openness and transparency: before publishing the prognoses, it contrasts them with those of other bodies, explicitly includes the comparisons in explanatory notes and if there are differences, explains why (Interview 6). Furthermore, before publishing its forecast, the

MoF organizes meetings with other institutions who also do prognoses and asks them for their opinions. Thus, as one of the interviewees put it, “if the MoF had a bias towards overly optimistic forecasts, it would come out” (Interview 12). Third, several interviewees felt that since there already are several external bodies (e.g., the IMF, the OECD, and the EC) monitoring and evaluating the forecasts and the budgetary policy, creating an additional body would be superfluous. In addition to the perception of redundancy, the objections to creating a FC were motivated by the desire not to “create any additional bureaucracy” and also fears of not having enough analytical competencies to man it (Interview 10).

The Estonian government was, however, not successful in pushing for the non-mandatory nature of FCs in the Eurozone. Once it became clear that this requirement would be included in the two-pack and the Fiscal Compact in 2013, the government first considered an option to just “declare” the Bank of Estonia (BoE) to be the “fiscal council,” implying that no new separate body would have to be created. Most of the interviewed officials noted that this would have been a good institutional solution, given that the BoE has the best macroeconomic competencies in Estonia, monitors the budgetary policy anyway, and it would not have required the creation of a “new bureaucracy.” The MoF and the BoE officials who had devised this plan, could not proceed with it, however, due to the objections from the European Central Bank (ECB). In October 2013, the Estonian MoF asked the ECB for an opinion on the draft law that declared the Bank of Estonia to be the “fiscal council.” The European Central Bank (2013) noted in its opinion that if the BoE were to become the FC, its monetary policy mandate and independence might become undermined, which is why this would not be an advisable institutional solution. For example, it was noted in the opinion that the role of the FC may force the BoE to disclose its view of the economic outlook according to principles that are different from those relevant for monetary policy purposes. The opinion of the ECB also emphasized that the formal mandate to scrutinize the government may affect the working relations between the BoE and the government, influence the public perception of the central bank and possibly undermine its independence. According to several interviewees, however, the claims of the ECB were not really justified. It was argued, for example, that since monetary policy is made by the ECB and not the BoE, there would be no conflict between monetary policy and fiscal policy even if the BoE took over the role of the FC (Interviews 10, 11, 12).

The Institutional Solution for the Fiscal Council in Estonia

Given the objections from the ECB, the Estonian government had to devise an alternative plan. Instead of “declaring” the Bank of Estonia to be the “fiscal council,” the new framework law on budgeting (the State Budget Act) and the amended law on the Bank of Estonia, adopted in early 2014, foresaw the creation of an independent body, in the form of a working group (or “advisory board”), composed of six members appointed for five years, which meets regularly and is supported in its activities by the BoE.

According to the law, the members’ “reputation must be unblemished” and they “must possess at least a Master’s degree in an economic specialization or an equivalent degree, and the experience required for the performance of the Council’s tasks.” Formally, the FC is considered

to be an *independent* advisory board. The Law on the Bank of Estonia emphasizes that “In performing its tasks, the FC operates as an independent body which accepts no instructions from the Bank of Estonia, the Government of the Republic or any other private or public body.” At the same time, the FC does have strong interlinkages with the BoE, which plays a significant role in its functioning. The Statutes of the FC, which detail the operational rules of the FC, are approved by the Supervisory Board of the BoE. The members of the FC are appointed by the Supervisory Board of the BoE at the proposal of its Governor. The financing of the FC is part of the budget of the BoE. The law stipulates, however, that the BoE has a right to ask the government to compensate it for the costs related to the FC (although so far the BoE has not done so). The reimbursement provision was pointed out by the European Central Bank (2013) as a requisite to guarantee the financial independence of the BoE. In response to ECB’s opinion, it was added to the legal framework governing the organization of FC. According to the Statutes of the FC, the BoE also provides it with the background information, rooms and technical equipment needed for its work, and any necessary administrative services. The Statutes also allow the FC to use employees of the BoE temporarily if it is necessary for the work of the FC and it does not seriously threaten its independence. Thus, although formally independent, the solution adopted in Estonia can be categorized as “attaching” the FC to the central bank.

The laws governing the work of the FC outline that its tasks are to assess the macroeconomic and financial forecasts and monitor compliance with the fiscal rules. In line with the OECD principles for independent fiscal institutions, the work of the FC is strongly aligned with the annual budget cycle (von Trapp et al. 2016). First, the FC evaluates the economic prognosis compiled by the MoF in March and August. Second, it gives an *ex ante* opinion about whether the stability program (i.e., the three-year fiscal plan that member states have to submit to the EU) and the State Budget Strategy (i.e., the four-year plan outlining the fiscal directions and main policy objectives of the government) are in compliance with the structural balance rule before these documents are approved by the government. Third, the FC assesses whether the previous year’s budget was in structural balance (in June) and hence whether the government has complied with the fiscal rule outlined in the organic budget law. The Statutes also require the FC to inform the public of its opinions on the observance of domestic fiscal rules and on the economic and fiscal forecasts used as a basis for fiscal policy. If the Government or the MoF disregard the opinions of the FC, they have to justify it publicly.

The Estonian Fiscal Council From a Comparative Perspective

There is considerable diversity in the institutional set-up and practices of FCs established in different countries (von Trapp et al. 2016). In the following, we look at the design of the Estonian FC from a comparative perspective.

While about a quarter of FCs are stand-alone bodies, others tend to be attached to the parliaments or the executive (Debrun and Kinda 2014). In the existing normative discussions, attaching a FC to a central bank has not been recommended since the views of the central bank might start influencing the positions of the FC (Calmfors and Wren-Lewis 2011; Debrun et al. 2013). Also, from a comparative perspective, “attaching” the FC to a central bank is a relatively unusual approach in

designing FCs, though not entirely unique: in Austria, the Central Bank provides staff for the Fiscal Advisory Council and in the Slovak Republic, funding for the Office of Budget Responsibility is provided by the National Bank (von Trapp et al. 2016). At the same time, as will be discussed in section Factors Influencing the Institutional Design of the Fiscal Council in Estonia in more detail, in the Estonian case, the Bank of Estonia has, in fact, the largest competencies in macro-economic analysis and can hence provide the FC with strong analytical support.

Independence is considered to be one of the core aspects of the institutional design of FCs (Calmfors and Wren-Lewis 2011; Debrun et al. 2013; von Trapp et al. 2016). A FC is considered to satisfy the internationally accepted criteria of independence if it is insulated from political interference by law, there are safeguards on its budget, there are sufficient numbers of technical and administrative staff, and the staff is commensurate to the tasks of the FC (Debrun and Kinda 2014; von Trapp et al. 2016). By all these standards, the Estonian FC can be considered to be fairly independent, especially in terms of legal independence and safeguards on the budget. As mentioned in section The Institutional Solution for the Fiscal Council in Estonia, the Bank of Estonia Act, which provides the legal framework for the FC, explicitly states that the FC is independent. Also, the process of appointing the members of the FC, as described above, is completely insulated from political influence. Placing the responsibility for the appointment of the members of the FC in the hands of the BoE can be conjectured to guarantee even stronger political insulation than is the case in most other countries, where the FC members are appointed by the government or the legislature (von Trapp et al. 2016). In addition, the law stipulates that “A member of the Council may be recalled before the end of his or her term if he or she accepts an employment or service position, or is party to an activity, which adversely affects, or may adversely affect, the independence of the Council.” As Debrun and Kinda (2014, 11) point out, one of the ways to safeguard the budget of the FC is to have it set by the central bank, and this is the case with the Estonian FC. In terms of the size of the FC, the number of the managing members of FCs in other European countries varies from 3 (in Hungary, the Slovak Republic, and Slovenia) to 27 (in Belgium) and technical and administrative staff from 0 (in Slovenia, Croatia) to 90 (in Belgium) (Debrun and Kinda 2014). In light of these numbers, the Estonian FC, with 6 members, is very much in line with most of the newer FCs in the EU, of which most have 3–7 members, whereas the support staff of 2 is on the lower end (though there are some FCs with no support staff at all) (Debrun and Kinda 2014). In our interviews conducted with the FC members, it was noted that, currently, the support and resources of the FC are commensurate with the tasks it has.

With regard to their *mandates*, FCs come in different forms. In some countries, they have very broad remits that, in addition to assessing compliance with fiscal rules and making positive and normative assessments of fiscal policy and forecasts, also include the preparation of macroeconomic and fiscal forecasts, the costing of reforms that affect public finances, and making long-term projections for public debt (Debrun and Kinda 2014; European Commission 2016; von Trapp et al. 2016). For example, in Austria, Romania, Serbia, Italy, and Ireland, FCs have been entrusted with all of these tasks, whereas in Luxembourg, Slovenia, and Germany, the remit is narrower (European Commission 2016). According to the European Commission (2016) database of independent FCs, the Estonian FC scores 53 in the index capturing the range of tasks, with 21 being the lowest score (Slovenia) and 90 the highest (the UK).

Another dimension on which FCs are evaluated is their *access to information*, which should be spelled out in legislation (von Trapp et al. 2016). As von Trapp et al. (2016) note, among the FCs in the OECD countries, 60 percent have this right guaranteed by legislation. The Estonian FC scores high on this measure. The law governing the work of the FC stipulates that “The Fiscal Council is entitled to receive, from any ministry or any institution in the government sector or from the Bank of Estonia, the information which it needs for the performance of its tasks.” In the interviews conducted with the members of the FC, they agreed that they have, so far, had complete access to all the information they have needed.

In terms of the *leadership* of the FC, the OECD principles recommend that the leader and the members should be selected on the basis of technical competence and merit, without reference to political affiliation (Calmfors and Wren-Lewis 2011; Debrun et al. 2013; von Trapp et al. 2016). Thus, ideally, its membership should include non-political actors (e.g., academics, policy experts, civil servants) (von Trapp et al. 2016). This is clearly the case in Estonia, where the law spells out these criteria explicitly (as described in section The Institutional Solution for the Fiscal Council in Estonia). The first FC of Estonia includes three academics, two are employees of the BoE, and one works in the private sector (although he was associated with BoE in the past). None of them have any affiliation with political parties and all are considered to be strong experts in their field. In addition, the OECD principles for independent fiscal institutions suggest that the head of the FC should be a full-time and remunerated position (von Trapp et al. 2016). Among the OECD countries, however, about half have part-time leaders (especially in smaller European countries) (von Trapp et al. 2016), which is also the case in Estonia. All the members of the FC in Estonia are remunerated, but taking into account the part-time nature of their work. According to the international principles for FCs, the term length and grounds for dismissal should be clearly spelled out in the legislation (Calmfors and Wren-Lewis 2011; Debrun et al. 2013; von Trapp et al. 2016). The Estonian FC clearly follows these criteria (as described in section The Institutional Solution for the Fiscal Council in Estonia).

Another dimension on which FCs can vary is the *channels of influence*. FCs are considered to be strong if they issue public reports, have high media impact, their budget forecasts are binding, the government has a formal obligation to consult the FC during the budget cycle, and the government has to either comply with the forecast of the FC or explain publicly why they are using a different forecast (Debrun and Kinda 2014; von Trapp et al. 2016). While all FCs release public reports and many have high media impact, preparing binding forecasts is relatively rare (Debrun and Kinda 2014). Thus, in terms of influence, the Estonian FC can be considered to be average. The Estonian FC publishes all its reports¹ and its activities have received extensive media coverage. Also, as noted above, according to the organic budget law, although the opinions of the Estonian FC on forecasts or compliance with the fiscal rules are not binding, the legal framework establishes the comply or explain principle: if the government or the finance ministry disregards an opinion or assessment of the FC, it has to justify it publicly.

Since its inception in 2014, the FC has, for the most part, endorsed the government’s fiscal plans and projections. A major change can be observed in 2017, however, after the formation of

1. The opinions of the FC are also available in English: <http://eelarvenoukogu.ee/publications>

the independent Estonia's first left-leaning coalition government in November 2016. In the spring of 2017, the FC has, in its opinions, been critical of the planned fiscal policy of the government and pointed out that if the budget plans are not changed, they would result in the violation of the structural balance requirement. In its April 2017 report, the FC noted that although the government's forecasts for economic growth and inflation are accurate, it does not agree with the MoF's estimates of the economic cycle (Eelarvenõukogu 2017). While the government claimed in its fiscal plans that the output gap for the next years is negative (and hence higher deficits are justified), the FC argued that this may not be the case since, despite relatively low economic growth, unemployment was below average and wage growth exceeded productivity growth and hence there was little evidence of underutilized resources. In addition, the FC noted that the planned structural deficits for the next three years are 0.5 percent of GDP, which violates the existing organic budget law that requires the budgets to be in structural balance or in surplus. It also pointed out that changing fiscal rules on such short notice—as the government planned to do in order to be able to run the structural deficits—would undermine the credibility of the rule and entail reputational risks for the government. In addition, the FC stated that even if the government changed the fiscal rule, the expected structural deficits would likely exceed 0.5 percent during the next years, given the incorrect assessments of the cyclical position. Alongside the official reports, published on its website, the members of the FC have published several media articles, echoing the same concerns as voiced in the official report (e.g., Eamets 2017; Varblane 2017) and journalists have reported extensively on FC's opinions as well. As a result, there has been considerable debate on fiscal and macroeconomic policies in the public sphere of Estonia and the FC has played a major role in triggering the public discussions. To what extent these debates are able to shape the actual fiscal policy and what the long-term impacts of the newly created FC in Estonia are, remains to be seen. It is, however, possible to analyze the factors that influenced the institutional design of the FC, which will be the focus of the next section.

FACTORS INFLUENCING THE INSTITUTIONAL DESIGN OF THE FISCAL COUNCIL IN ESTONIA

In this section, our goal is to explore how well the theoretical insights provided by the different types of institutionalism can explain the creation of FC in Estonia. In particular, to what extent can the designers' choices be understood with the help of the notions of principal-agent relationships, transaction costs, path-dependence, institutional layering, existing norms, and lesson-drawing?

Principal-Agent Perspective

As argued in section Theoretical Approaches For Exploring Institutional Design, from the perspective of RI, if agents are given the task of designing their own “principal” who would observe and monitor their work and evaluate it, they would have incentives to create a weak one.

Although the EU rules would have, in principle, allowed the establishment of a FC within the finance ministry, the Estonian policy-makers did not opt for that. Furthermore, they chose to “attach” the FC to an organization that is well-known for its capacities in macroeconomic analysis and forecasting, subjecting themselves to a potentially powerful principal, who has the authority (and also legitimacy) to call into question the macroeconomic forecasts and the chosen course of budgetary policies.

How can we explain the empirical puzzle that the policy-makers in Estonia, in designing their own “watchdog,” created a potentially strong body rather than a maximally weak one? In order to explore the *principal-agent* perspective a bit deeper, we would have to take a closer look at which “agents” were in charge of designing the FC and what their motives were. As pointed out in the explanatory note to the new framework law for budgeting and confirmed by all the interviews, the most important role in the institutional design of the FC in Estonia was played by the *MoF officials*. When designing the provisions pertaining to the FC, they also consulted the Government Office and the BoE. Thus, MoF officials were designing a “principal” for both themselves but also for the elected officials in the government and parliament. Or, putting it another way, they were creating a situation where they would have another “principal” alongside the politicians. As “agents,” however, their motives with regard to the design of the FC were significantly more complex than “not wanting a body that would criticize them.” For several reasons, the MoF officials had, in fact, incentives to create a relatively strong FC.

First, the generally rather fiscally conservative MoF officials came to regard the FC as a potential ally against future governments that might be fiscally more profligate (Interviews 1, 6, 13). As was noted in one of the interviews, “We started to realize that the situation may change: other parties may come to power and pressure the MoF to be more biased” (Interview 13). In other words, the FC was viewed as an “insurance mechanism” to prevent future politicians from violating the fiscal rules and increasing spending too much. As Waterman and Meier (1998) have pointed out, when faced with multiple and competing principals with diverging goals, the agents would have an incentive to ally themselves with principals who most closely reflect their policy goals. Thus, in the context of designing a new principal for themselves, the Estonian MoF officials took into account in which form the FC would have similar goals to themselves. In other words, by designing the principal for themselves, they sought to “lock in” their current policy preferences. Furthermore, the bureaucratic agents of the MoF also provided the watchdog with an appointment mechanism that would minimize political influence and meddling—by stipulating that the board of the BoE (rather than any elected officials) appoints the FC (Interview 12). Also, the option of attaching the FC to the parliament was not considered desirable because then the body would have been “too closely involved with politics” (Interview 12).

Second, although the potential criticisms from the FC regarding economic forecasts and the compliance with the fiscal rule may put the MoF in the spotlight, the monitoring by the FC would also allow MoF officials to share the blame for mistakes (if they were to occur). This is especially true with regard to the structural balance requirement, the violation of which could be potentially costly in terms of the sanctions from the EU. Thus, according to the interviewed MoF officials, an additional check (by the FC) would help to improve the accuracy of decisions but also help to diffuse blame if the EU assessments vary from the local ones (Interviews 1, 2). As one of the

interviewees noted, the FC can aid the MoF in their discussions vis-à-vis the EC over diverging assessments of the structural budget position (Interview 9). In sum, while for elected officials, any criticism coming from the FC might be problematic, the MoF officials saw it as potentially helpful and useful and, therefore, designed the FC to be a relatively “strong” principal.

Transaction Costs

As discussed in section Theoretical Approaches For Exploring Institutional Design, in addition to the principal-agent relations, another core concept for RI in analyzing institutional design is *transaction costs*. In the case of creating the FC in Estonia, the motive of optimizing costs (including transaction costs) did play a considerable role in the institutional design. As several interviewees from MoF emphasized, they did not want to incur large costs in relation to the FC. The first reaction to the EU requirement—the idea of just “declaring” the BoE to be the FC—was very much driven by that consideration (it would have entailed no additional costs at all).

Also, the idea of *not* creating a new *stand-alone* institution, which persisted after the initial idea of declaring the BoE to be the Estonian FC had to be abandoned, was driven by the motive to save costs. The model that was opted for—a FC as a working group of experts that meets regularly and is supported by the BoE administratively and analytically—achieved that (Interview 12). This solution meant that the members of the FC would not be full time employees but would fulfil their obligations in addition to their regular jobs. It also allowed the institutional designers to claim that they were not “creating any additional bureaucracy” (which had been a strong motive in objecting to the creation of the FC in the first place). It was also noted that since the FC does not have that many functions, creating a whole new separate body “would not have made much sense” (Interview 13).

The interviewees from the MoF also explained that they did not want to create an organization that would have to start completely from scratch and first have to find rooms and support staff (Interviews 6, 12, 13). Thus, attaching it to an *existing* organization that could provide all those seemed like a better choice in terms of start-up costs. The idea was to allow the FC to “hit the ground running,” so that it would be able to provide evaluations as soon as possible (Interviews 10, 12).

Furthermore, several interviewees emphasized that if a new separate and full-time body had been created, the recruitment of members, given the limited pool of macroeconomic competence in Estonia, would have been highly challenging. Thus, the designers regarded finding the appropriate people with necessary skills as entailing significant transaction costs (Seo and Ryu 2012). Indeed, in a small country like Estonia, there are very few people who can do both macroeconomic and fiscal policy analysis (Interview 8). Thus, it was considerably more “expedient” to design the FC in the form of a working group rather than a full-time body. One of the interviewees also noted that if a whole separate body for making economic forecasting had been created, in a small country context it would have entailed staffing it with the people previously in charge of forecasting in the MoF and, thus, substantively nothing would have changed (Interview 12).

As mentioned in section Theoretical Approaches For Exploring Institutional Design, in addition to the costs associated with the setting up and operation of an organization, the institutional designers in the public sector may pay attention to political transaction costs (i.e., the costs of reaching political agreements in the future). In the case of the FC in Estonia, the designers were indeed motivated to increase the political transaction costs associated with reaching certain types of policy agreements in the future. As argued in section Principal-Agent Perspective, the fiscally conservative MoF officials viewed it as desirable that the FC might prevent the emergence of overspending in the future (by increasing the costs of deciding to run a budget deficit).

Existing Institutions and Path Dependence

The *existing configuration of political institutions* and their interlinkages played an important role in influencing the organizational solution of attaching the FC to the Bank of Estonia. As the interviewed officials noted, the MoF has had close cooperation and frequent contacts with the central bank for many years, in the form of joint seminars, meetings, outings, and informal discussions (Interviews 2, 3, 4, 5, 7, 10). As one of the MoF officials emphasized, among all the existing public sector organizations, when it comes to macroeconomic forecasting and fiscal policy discussions, the MoF cooperates most closely with the BoE (Interview 2). For example, in the past, when making economic forecasts, the MoF officials presented their prognoses to and asked for information and advice from the BoE officials. Thus, when attaching the FC to the BoE, the MoF officials could anticipate the kinds of informal interactions that might unfold in the future. They could expect that the good informal collaboration with BoE would spill over to the FC as well. Also, as one of the BoE officials noted, “Given that the MoF relies a lot on our advice and information in making their forecasts, it might be somewhat difficult for the FC to start criticizing the MoF” (Interview 5).

In addition to the existing informal interlinkages between the MoF and the BoE, the decision to attach the FC to the BoE was also influenced by the *path dependence* of how the capacities of macroeconomic analysis have institutionally evolved in Estonia. Given the institutional choices made in the early 1990s and the economic policy trajectories since then (see e.g., Hope and Raudla 2012; Raudla and Kattel 2011), the BoE has become the organization with the strongest capacities for macro-economic analysis (Interviews 1, 3, 4, 10, 11, 13, 14). As the interviewees put it, “Historically, the BoE has monitored the fiscal policy anyway, so it was a logical choice to attach the FC to the BoE”. (Interview 10) and “All other options were quickly eliminated” (Interview 13). For example, it was briefly considered to attach it to the parliament, but that would have also entailed the necessity to hire new analysts who would work for the council, since the parliament itself does not yet have such capacities (Interview 12). There were also some discussions about attaching the FC to a university or a commercial bank. These options were ruled out quickly, however, given that the former was viewed as not having enough “practical” experience and the latter lacking in specific knowledge about *the fiscal aspects* of FC’s work. In sum, in order to gain high quality analytical input for the work of the FC, its location in the BoE seemed like an “obvious”

choice for the institutional designers (Interview 12). All of the interviewees noted that the solution of attaching the FC to the BoE allows for the best utilization of the scarce analytical competences in a small country context where the number of specialists in macroeconomic analysis is limited.

The Existing Norms and Templates

In addition to the theoretical arguments of RI and HI, the insights of SI can also shed some light on the creation of the FC in Estonia. The “logic of appropriateness”—referring to considerations of the normative expectations about what a FC should look like—clearly played a role in the institutional design of the FC. As emerged from the interviews, even though the MoF officials had initially objected to the requirement to create a FC, once it became clear that it would be mandatory, they decided to do it “properly” (Interviews 2, 6, 12). As the interviewed MoF officials put it: “It is important that our solution looks correct to those outside” (Interview 12). “If we had attached the FC to the finance ministry, the question would have remained about how independent it really is” (Interview 6). In addition to being concerned with the notions of legitimacy of the new body, the institutional designers of the FC also followed the prevailing norm of “not creating additional bureaucracy.” Almost all the interviewees emphasized that this was an important motive in the institutional design of the FC—reflecting, in part, the generally favorable attitude toward curbing public spending and cutting the size of the public sector in Estonia (Raudla and Kattel 2011).

In addition to the formal (and informal) forms of cooperation between the MoF and BoE, our interviews indicate that the MoF and the BoE officials display intellectual and ideological affinity: the officials in both organizations support fiscally conservative policies and tend to take a critical view of public debt (Raudla and Kattel 2011). Thus, when considering the options for the FC, attaching it to the BoE was facilitated by the common values and principles these two organizations share. Hence, the MoF officials who drafted the provisions concerning the FC could hope that, when supported by the BoE, the FC would display fiscal conservatism in its value orientation as well.

At the same time, the international normative discourse on FCs and the examples of other countries had only limited impact on the design of the FC in Estonia. In the international discussions on FCs, arguments are often made for creating “new” separate bodies in order to better ensure their independence (Debrun et al. 2013). It is also argued that in case the government still chooses to attach the FC to an existing institution, the affiliation with the central bank is generally not considered advisable (Calmfors and Wren-Lewis 2011; Debrun et al. 2013). The designers of the FC in Estonia did not follow these general principles. With regard to drawing lessons from specific countries, given the relative newness of the concept of a FC and the fact that most other countries in the Eurozone designed that institution simultaneously, the opportunities for that were somewhat limited. As one of the interviewees explained, “Since everybody started creating that institution at the same time, there weren’t too many examples to draw upon. The countries that have had it for a while, have a much bigger and separate unit, which we did not want—so we didn’t have anybody to draw upon as an example” (Interview 12).

Thus, the MoF officials (and also counterparts from the BoE) responsible for drafting the legislative provisions on FC did take a look at some other examples but, for the most part, concluded that those were of limited value due to a very different context. Specifically, they looked at the examples of Sweden, Austria, Slovakia, Slovenia, and the Netherlands, where FCs existed already. In Austria and the Slovak Republic, the FCs are also attached to the central banks and, thus, gave the designers in Estonia some further confirmation of the feasibility of their idea. In addition, they examined the ongoing institutional designs in Latvia and Finland, where FCs were created at the same time. Latvia intended to create a whole new body, which was not considered desirable by Estonian policy-makers given their wish to avoid creating “new bureaucracy.” In Finland, the FC was attached to the National Audit Office (NAO) but in Estonia, the institutional designers did not view it as having sufficient macroeconomic competencies to undertake that role (Interviews 10, 13). Some specific lessons were learnt from the other examples. From the Swedish case, the designers concluded that the budget of the FC has to be protected from government interference (Interviews 8, 10). All in all, the policy actors considered it necessary to emphasize in the interviews that the overall goal in designing the FC was not to copy a specific model from anybody but to “create an own thing”: to design an institution that would most fit the Estonian context. Thus, although according to SI, replicating a model used by another country (which is seen as a “good” example) might be used to enhance the legitimacy of a chosen solution, this was not the case in Estonia.

CONCLUDING DISCUSSION

Reviewers of institutionalist research have complained that the existing studies have paid only limited attention to the questions of institutional design and how institutions come about (e.g., Hall and Taylor 1996; Peters 1999; Thelen 2009). Hence, in our paper, we sought to contribute to the discussions of how to use the insights of existing institutionalist approaches to examine the creation of a new institution. More specifically, we focused on the creation of a *watchdog* by actors who will themselves be monitored by this institution in the future, in a situation where they *do not want* to create such a body *but have to*. The creation of the FC in Estonia allowed us to look at how institutional design unfolds under such a scenario. The Estonian case also provided an opportunity to examine a situation where actors were obliged to create an institution but they did not see a *need* for it, since the problems an FC is supposed to address were perceived to not exist.

As our empirical analysis indicates, in order to understand and explain the institutional design of the FC in Estonia, one needs to draw on the explanatory perspectives from different strands of institutionalist research. None of the analytical lenses *alone* would be able to provide a complete explanation; instead, we have to resort to the theoretical arguments in tandem.

The proposition of rational choice institutionalism that transaction costs would play an important role in the creation of a new institution was clearly corroborated in the Estonian case. Not wanting to create a whole new separate institution that would imply significant costs for the state budget was an important motive behind the decision to create the FC in the form of a working group. The prediction of the basic principal-agent model, however, was not borne out:

although it would have predicted that the MoF would design the weakest watchdog possible, this did not take place. Instead, the FC is supported by significant analytical capacities of the BoE and has strong guarantees of independence. In order to understand these design choices, one has to look closer at the various types of principal-agent relationships unfolding in the case of designing the FC and the specific motives that the bureaucratic “agents” who were in charge of creating the FC had in the Estonian context. As our analysis shows, the fiscally conservative bureaucratic agents were concerned that future (left-leaning) governments might be more prone to overspending violating the structural balance rule; hence, having a stronger FC was viewed as a potential ally of the MoF in guarding fiscal discipline and a mechanism of “insurance” against future political principals who might be fiscally profligate.

In order to understand why the FC in Estonia was attached to the Bank of Estonia, rather than any other existing body, the arguments of HI—pointing to path dependence and the importance of the existing configurations of political institutions—provide the best explanatory lenses. Given the long-term cooperation between the MoF and the BoE in macroeconomic analysis and forecasting, continuing that cooperation was viewed as the most feasible solution. Also, because of the economic policy development trajectories in Estonia, the macroeconomic analytical competence is concentrated in the BoE and is very scarce in other organizations. Hence, the BoE was viewed as the most appropriate for supporting FC with analytical input.

Finally, reflecting the arguments of SI, the institutional designers in Estonia were concerned about how the solution opted for the FC would appear to the outsiders. They wanted to make sure that the created FC also “looks good”—in order not to damage the reputation of Estonia or to generate domestic discussions about the inherent legitimacy of the new institution. At the same time, it was felt that the opportunities for lesson-drawing were limited in creating the new body given that most other members of the EU were only in the process of creating their own FC and because of the perceived need to create a home-spun body that would fit the context of Estonia the best.

Thus, we can conclude that in future analyses of institutional design, just focusing on one stream of institutionalist analysis is likely to be insufficient. As Ostrom (1990) has emphasized, different institutional approaches should be viewed as complementary. Or, in the words of Peters (1999, p. 2), “Some eclecticism of approach is likely to pay greater intellectual dividends . . . than a strict adherence to a single approach.” As our empirical analysis in this paper shows, different strands can indeed open up different angles for analysis and questions to be asked. They can illuminate different aspects of how institutional design process unfolds and provide complementary explanations. Our empirical study certainly points to arguments to be made for seeking to synthesize the insights of different institutionalisms rather than (over)emphasizing their differences.

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LIST OF INTERVIEWS

- Interview 1: MoF official, 18.08.2014.
- Interview 2: MoF official, 09.09.2014.
- Interview 3: MoF official, 09.09.2014.
- Interview 4: MoF official, 10.09.2014.
- Interview 5: BoE official, 24.09.2014.
- Interview 6: MoF official, 04.02.2015.
- Interview 7: MoF official, 04.05.2015.
- Interview 8: BoE official, 08.05.2015.
- Interview 9: Member of Parliament, 11.05.2015.
- Interview 10: BoE official, 05.11.2015.
- Interview 11: BoE official, 09.11.2015.
- Interview 12: MoF official, 11.11.2015.
- Interview 13: 2 MoF officials, 17.11.2015.
- Interview 14: FC member, 18.11.2015.

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Publication III

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The Effects of Crises and European Fiscal Governance Reforms on the Budgetary Processes of Member States*

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Abstract

The goal of this article was to explore how the experience of the crisis and the fiscal governance reforms at the European level have influenced budget processes in member states. Drawing on the Europeanization, fiscal governance and public crisis management literature, the article first outlines a series of propositions about the kinds of shifts in the budget process that we would expect to ensue from the crisis experience and European reforms. The empirical part of our article explores the validity of those theoretical conjectures in three different member states: Portugal, Austria and Finland. We found that the crisis experience and European reforms have led to increased centralization of the budgetary process in all three countries. Although we would have expected Austria and Portugal to move closer towards the contracts approach of fiscal governance, this has not happened as the medium-term expenditure frameworks are not viewed as binding.

Keywords: crisis; fiscal governance; budgetary institutions; fiscal compact; Europeanization

Introduction

One of the core questions in governance research is: when and how do institutions change? Given the increasing importance attributed to budgetary institutions in the scholarly discussions and the growing significance of fiscal issues in the European context, it is worth exploring whether European countries have experienced changes in their budgetary institutions during the past decade. In this article we focus on those aspects of budgetary institutions that pertain to the budget process: the rules that govern the preparation, adoption and implementation of the budget (Hallerberg *et al.*, 2009). Members of the eurozone have faced two major shocks during this period: various crises (financial, economic and fiscal) and the reforms of fiscal governance frameworks at the European level, whereby the stability and growth pact has been reinforced by the two-pack, the six-pack, and the Treaty on Stability, Coordination and Governance (including the fiscal compact). In light of the existing studies on institutional change (for example, Kingdon, 1984; Schmidt, 2002), these two factors may induce changes in domestic budgetary processes as well. Thus, the core interest of this article is whether this has actually happened. Specifically, our research question is: what kinds of changes have experiences of the crisis and European-level reforms of the fiscal governance framework brought about in member states' domestic budgetary processes at central government level?

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Although an increasing number of studies have examined how fiscal governance reforms at the European level came about (Ioannou *et al.*, 2015; Laffan and Schlosser, 2016) and how to interpret their nature within the framework of EU integration (Dawson, 2015; Fabbrini, 2013; Schimmelfennig, 2015), there has been limited research on how these reforms have actually influenced budget processes and practices in the member states. While some studies have discussed the resulting increased role of the European Commission in EU economic and fiscal governance (Bauer and Becker, 2014) and the impacts of these reforms on national parliaments (Crum, 2018; Dawson, 2015; Hallerberg *et al.*, 2018), no comparative studies have systematically examined the effects of these reforms on the budgetary processes of member states. As the eventual impact of the European fiscal governance reforms depends on how they affect budgetary processes in member states, it is important to understand what kind of domestic changes they have triggered. It is worth noting, however, that in this article, we are not interested in the impact of the crisis experience and European-level fiscal governance reforms on fiscal *policy* itself but focus on the influence these reforms have had on *budget processes*.

The experiences of the crises provided the general setting into which the European-level reforms were inserted. As these two factors – crises and the European reforms – are closely intertwined it makes sense to examine their effects together. Drawing on the Europeanization, fiscal governance and public crisis management literature, the theoretical part of the article outlines a series of propositions about the kinds of shifts we could expect in the budgetary processes of member states. The empirical part explores the validity of those theoretical propositions in three different EU member states: Portugal, Austria and Finland.

The selection of cases was based on the following reasoning. As emphasized by Schmidt (2002), the changes produced by EU rules in the member states depend, among other things, on the countries' vulnerability to global as well as European economic forces and the existing legacies. All three countries are small and hence relatively vulnerable. At the same time, they experienced varying degrees of crisis: Portugal went through a deep fiscal crisis, which necessitated the involvement of the Troika, while Austria experienced a moderate fiscal squeeze and Finland an even milder one. They also represent different administrative traditions: Napoleonic (Portugal), Germanic (Austria), and Scandinavian (Finland). The sources of data for the case study countries included semi-structured interviews conducted with public officials (8–12 interviews per country) and policy documents.

The article is structured as follows. Section I gives an overview of the main changes in the fiscal governance framework at the European level. Section II outlines the theoretical propositions, which will be examined in the empirical analysis in section III, and the last section provides a concluding discussion.

I. Changes in the Fiscal Governance Framework at the European Level

The main recent changes in the fiscal governance at European level have been introduced by the six-pack, the two-pack and the fiscal compact. The six-pack (consisting of five regulations and one directive), enacted in 2011, was introduced with the aim of strengthening the stability and growth pact with stronger financial sanctions and a greater focus on debt. It also included a directive on national budgetary frameworks (including provisions that foresaw the adoption of medium-term expenditure frameworks [MTEFs]). It

introduced the reverse qualified majority voting for sanctions when member states violate EU fiscal rules (Bauer and Becker, 2014; Fabbrini, 2013). The six-pack also institutionalized an important reform that had been introduced as part of Europe 2020 – the European Semester. The aim of the semester process is to ensure that member states coordinate their budgetary and economic policies before national budget plans are compiled (Crum, 2018; Fabbrini, 2013).

The six-pack was followed by the Treaty on Stability, Coordination and Governance, which was concluded in March 2012 and entered into force on 1 January 2013. The Treaty was concluded between all EU member states except for the UK, the Czech Republic and Croatia. The fiscal compact, which constitutes a part of this intergovernmental treaty, is automatically applicable to eurozone countries, with the possibility of non-euro area EU member states being voluntarily bound by (as Bulgaria, Romania and Denmark have done). It required members of the eurozone to establish a general government structural deficit rule in their domestic legislation. The fiscal rule is taken to have been respected if the annual structural balance meets the country-specific medium-term objective and does not exceed a structural deficit of 0.5% of GDP. The compact also stipulates that a country may temporarily deviate from the fiscal rule but only in exceptional circumstances. The Treaty foresees that if the structural balance of a country deviates significantly from its medium-term objective an automatic correction mechanism will be triggered to correct these deviations (Bauer and Becker, 2014; Fabbrini, 2013; Ioannou *et al.*, 2015; Schweiger, 2014).

The two-pack (consisting of two regulations), adopted in 2013 and applicable only in the euro area, sought to amplify the measures entailed in the six-pack and the fiscal compact in order to strengthen the fiscal governance framework further and to reinforce budgetary surveillance and coordination in the eurozone. For example, it gave the Commission the power to monitor and assess the draft budget plans of the member states before they are adopted and to require revisions if the draft is viewed as violating the EU obligations. It introduced a common budgetary timeline (for example, requiring medium-term fiscal plans to be submitted by 30 April and annual draft budgets by 15 October each year) strengthened structural deficit rules, and set up a requirement to establish independent national fiscal councils that would monitor compliance with national fiscal rules (Dawson, 2015; Fabbrini, 2013; Laffan and Schlosser, 2016).

In sum, all these initiatives sought to strengthen ‘the credibility and enforceability of the EMU’s rules-based economic coordination regime’ (Laffan and Schlosser, 2016, p. 238) with ‘more rules, more sanctions, more regulatory control’ (Laffan and Schlosser, 2016, p. 241).

II. Theoretical Discussion

In the following, we first delineate the different models of budgetary processes that have been proposed by the literature on fiscal governance, followed by propositions about what kind of shifts in those processes might ensue from the experience of the crises and the reforms of the European-level fiscal frameworks. In order to develop these propositions, we synthesized insights from the Europeanization, fiscal governance and public crisis management literature. This allows us to develop a more nuanced framework than would be possible if we only relied on any one of these research streams alone.

Models of Budget Processes

Budget processes comprise formal and informal rules that guide the decision-making process in formulating, approving and implementing the budget (Hallerberg *et al.*, 2009; Raudla, 2010, 2014). In analyses of different kinds of budgetary institutions, a *centralized* budget process is often contrasted with a *fragmented or decentralized* budget process, also called the *fiefdom* model (Hallerberg *et al.*, 2009; von Hagen, 2002, 2008). As von Hagen (2002) emphasizes, the institutional elements of *centralization* may be relevant at all the different stages of the budget process: the planning and drafting of the budget by the executive, the adoption of the budget by the parliament and the implementation of the budget. The fiscal governance literature distinguishes between two models of centralized fiscal governance: the *delegation* approach and the *fiscal contracts* approach (Hallerberg, 2004; Hallerberg *et al.*, 2009 and Hallerberg and von Hagen, 1999). In the following, we describe the different forms that the preparation, adoption and implementation of the budget can take in the different models – first in the two types of centralized models and then in the decentralized version.

The preparation phase of the budget process can be characterized as centralized – also called top-down budgeting by the public budgeting literature (Kim and Park, 2006) – when it promotes the setting of spending and deficit (or surplus) targets at the outset of the annual budget cycle. In the delegation approach, the preparation phase of the budget procedure is characterized by strong agenda-setting powers of the finance minister vis-à-vis the spending ministers. The finance minister makes binding proposals for broad budgetary categories, negotiates directly with the individual ministries, approves the bids submitted to the final cabinet meeting and can veto budgetary issues in the cabinet. In the case of the contracts approach, at the beginning of the annual budget cycle the members of government (or coalition parties) negotiate multilaterally and commit themselves (either legally or politically) to a key set of budgetary parameters or fiscal targets (usually spending targets for each ministry) that are considered binding for the rest of the budget cycle. During the remaining part of the budget preparation process the minister of finance is responsible for evaluating the consistency of the budget proposals submitted by the spending ministers with the agreed targets (Hallerberg, 2004; Hallerberg *et al.*, 2009; Raudla, 2010, 2014; von Hagen, 2002, 2008).

In the adoption phase of the process, the delegation approach limits the rights of the legislature to amend the budget (to avoid major changes in the executive's budget proposal) and gives the executive (especially the finance minister) strong agenda-setting powers vis-à-vis the legislature. At the legislative stage the fiscal contracts approach entails the legislature voting on the total budget size before the approval of single provisions. It puts less emphasis on constraining legislative budgetary amendments and more on the legislature's role in monitoring the compliance of the executive's budget with the fiscal targets (Hallerberg *et al.*, 2009; Raudla, 2010, 2014).

At the implementation stage elements of centralization ensure that the adopted budget is in fact the basis for the spending decisions of the executive. Thus, implementation can be regarded as centralized when it is difficult to change the existing budget document or to adopt supplementary budgets during the fiscal year, when transfers of funds between chapters are forbidden or limited and when unused funds cannot be carried over to the next year's budget (Hallerberg *et al.*, 2009; Hallerberg and von Hagen, 1999; von Hagen, 2002). In the delegation approach, the ministry of finance (MoF) has strong monitoring

powers over the actual use of budget appropriations by the spending ministries and the authority to prevent and correct any deviations from the budget plan. For example, the MoF monitors and controls spending flows during the fiscal year, sanctions the disbursement of funds and approves transfers between budget chapters. It can also block expenditures and impose cash limits on line ministries. While the delegation approach emphasizes the need for managerial discretion by the MoF, allowing it to react flexibly to changing budgetary circumstances, the contracts approach is characterized by having contingent rules for dealing with unforeseen events (Hallerberg *et al.*, 2009; Hallerberg and von Hagen, 1999; von Hagen, 2002, 2008).

These two ideal types of fiscal governance are usually contrasted with the fiefdom approach to budgeting (Hallerberg, 2004; Hallerberg *et al.*, 2009), which is characterized by fragmented, uncoordinated and ad hoc decision-making in all phases of the budgetary process. A decentralized preparation phase entails a bottom-up approach to budgeting whereby the resulting budget is merely a sum of uncoordinated bids from individual ministries. At the adoption (or legislative approval) stage, the process can be described as fragmented when the parliament can make unlimited amendments to the draft budget submitted by the executive. In the implementation phase the line ministries have extensive flexibility in using and carrying over the funds and the MoF does not intervene (Hallerberg *et al.*, 2009).

The Effects of the Crises and Reforms of EU Fiscal Frameworks

A core argument of the Europeanization literature is that the level of domestic change depends on the degree of fit between the EU and domestic institutions, policies or processes (Börzel and Risse, 2003, 2007; Schmidt, 2002). The lower the compatibility between European processes, policies and institutions, the higher the adaptational pressure and the larger the potential changes (Börzel and Risse, 2003, 2007). At the same time, if the misfit between the EU requirements and existing institutions (including administrative traditions and corresponding practices) is too large, the policy actors are likely to resist actual changes or changes may be difficult to bring about in actual practices (Börzel and Risse, 2003, 2007). Budgeting is one of the core processes in the public sector and is often characterized by well-established practices and deeply entrenched procedures. Thus, even though the new EU rules prescribe specific instruments and institutions they may not necessarily lead to considerable changes in the budgetary processes. Instead, the budgetary actors prefer the persistence of existing routines (Knill and Lenschow, 2005) and attempt to minimize the impact of EU rules on their actual practices.

At the same time, given that the experience of crises provided a broader context of fiscal governance reforms at the European level, an interaction between the crisis experience and EU pressure may have rendered changes in domestic budgetary institutions more likely than would be the case in normal times. Indeed, from the critical juncture perspective, fiscal crises are often viewed as opening up opportunities for reforms, both in terms of policy but also with regard to administrative structures. In response to a crisis, it is easier for policy actors to discredit the status quo, argue for change and overcome resistance (Keeler, 1993; Kingdon, 1984; Schmidt, 2002). It is also argued that the deeper the crisis – that is, the more severe the fiscal pressures in a country – the bigger the opportunity for comprehensive reforms (Keeler, 1993; Raudla *et al.*, 2015) and the stronger the incentives of the policy

makers to undertake institutional changes to prevent its recurrence (Keeler, 1993). In light of those arguments, we would expect that countries that have experienced more dramatic crises are likely to have experienced more extensive changes in their budget processes than those for whom the experience of crisis was milder.

In terms of the general direction of the reform of budget processes, we can conjecture, based on the existing literature, that after experiencing a fiscal crisis, all phases of the budget process are likely to become more centralized than before (Hallerberg *et al.*, 2009; Raudla *et al.*, 2015). In order to deal with a crisis, organizations tend to move towards mechanistic structures and hierarchy-based procedures (Peters, 2011). Specifically, in the case of a fiscal crisis, if expenditure cuts are needed line ministries are unlikely to volunteer the cuts and hence a central coordinator is needed to impose them (Bozeman and Straussman, 1982; Raudla *et al.*, 2015). Once the centralized arrangements have been adopted in order to deal with the crisis, then, based on the notion of path dependence (Pierson, 2000), we would expect these institutions to persist beyond the acute phase of the crisis. The experience of a crisis may lock in a desire to prevent future crises by maintaining centralized budget processes (Hallerberg *et al.*, 2009). Fiscal governance reforms at the European level are likely to reinforce tendencies towards centralization (De Haan *et al.*, 2013; Hallerberg *et al.*, 2009; Hallerberg and Bridwell, 2008).

With regard to shifts towards a particular type of fiscal governance, the fiscal governance literature, on the one hand, and the literature on public crisis management and Europeanization, on the other, appear to point to somewhat diverging predictions about the effects of the crisis and EU rules.

The fiscal governance literature predicts that, given the nature of the European-level reforms, the budget processes in the member states may move towards the contracts approach (Ghin *et al.*, 2018; Hallerberg *et al.*, 2009). According to Hallerberg and Bridwell (2008) and Hallerberg *et al.* (2009), the previous reforms of the stability and growth pact encouraged a movement towards the contracts approach in the member states of the economic and monetary union. Hence, given the tightening of European-level frameworks, we would expect further movement towards the contracts approach in the member states. The MTEFs – adopted either by cabinet or parliament – represent the hallmark of the contracts approach, whereby the government binds itself to specific fiscal targets.¹ In other words, the requirement to adopt MTEFs can be expected to formalize the contracts element in the budget preparation process. The need to take into account a tighter fiscal rule – compliance with which would be monitored by an independent fiscal watchdog – can also be expected to encourage a shift towards the contracts approach.

On the other hand, drawing on the existing public crisis management and Europeanization literature, we can conjecture that the EU reforms and the crisis experience are likely to bring about a shift towards the delegation approach. In order to deal with the increased scarcity of resources and to avoid excessive and prolonged conflicts in the time-constrained budget process, the power of the guardian of the purse (that is, the MoF) vis-à-vis the spending ministries and the power of the executive vis-à-vis the legislature are likely to be strengthened (Raudla *et al.*, 2015). Pointing to stricter EU rules and surveillance is likely to give the MoFs more clout and bargaining power in preparing budgets system (vis-à-vis line ministries and other organizations). The MoFs can construe these

¹We use the term MTEF to cover both medium-term fiscal frameworks and medium-term budgetary frameworks.

demands as unavoidable and through that, strengthen their position as guardians (Moury and Standing, 2017; Raudla *et al.*, 2015). In the Europeanization literature it has also been argued that the strategic impacts of the EU may favour actors directly connected with the EU (Börzel and Risse, 2007). Hence, we would expect that the changes in the EU fiscal governance framework have strengthened the role of the executive and lessened the role of the national parliaments (Crum, 2018; Dawson, 2015; Moury and Standing, 2017), which is also characteristic of the delegation mode of fiscal governance. With regard to the implementation phase of the budget process, given the uncertainties created by the crisis conditions and also the higher likelihood of sanctions by the EU when a member state violates the prescribed fiscal rules, the finance ministries are likely to exert more extensive discretionary powers, which is characteristic of the delegation model.

III. Empirical Analysis

The empirical analysis examines the effects of the crisis and European-level fiscal governance reforms on the budget processes in Portugal, Austria, and Finland. Undertaking an in-depth qualitative analysis of these cases allows us to explore the plausibility of the theoretical propositions developed in section II.

As explained in the introduction, the strategy of case selection proceeded from the following considerations. We wanted to study countries that are relatively small and are members of the eurozone. At the same time, we wanted to cover variations in the severity of the experience of crisis by different countries and to include countries from different administrative traditions. As Table 1 shows, Portugal experienced the most dramatic fiscal crisis, while Austria and Finland experienced a moderate and a mild fiscal squeeze, respectively.

Table 1: GDP growth, public debt and budget deficit in Portugal, Austria and Finland: 2007–2017

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Portugal											
Real GDP growth rate (%)	2.5	0.2	−3.0	1.0	−1.8	−4.0	−1.1	0.9	1.8	1.6	2.7
General government gross debt (% of GDP)	68.4	71.7	83.6	96.2	111.4	126.2	129.0	130.6	128.8	129.9	125.7
Budget surplus (+)/deficit (−) (% of GDP)	−3.0	−3.8	−9.8	−11.2	−7.4	−5.7	−4.8	−7.2	−4.4	−2.0	−3.0
Austria											
Real GDP growth rate (%)	3.7	1.5	−3.8	1.8	2.9	0.7	0.0	0.8	1.1	1.5	3.0
General government gross debt (% of GDP)	65.0	68.7	79.9	82.7	82.4	81.9	81.3	84.0	84.6	83.6	78.4
Budget surplus (+)/deficit (−) (% of GDP)	−1.4	−1.5	−5.3	−4.4	−2.6	−3.3	−3.0	−2.7	−1.0	−1.6	−0.7
Finland											
Real GDP growth rate (%)	5.2	0.7	−8.3	3.0	2.6	−1.4	−0.8	−0.6	0.1	2.1	2.6
General government gross debt (% of GDP)	34.0	32.7	41.7	47.1	48.5	53.9	56.5	60.2	63.5	63.0	61.4
Budget surplus (+)/deficit (−) (% of GDP)	5.1	4.2	−2.5	−2.6	−1.0	−2.2	−2.6	−3.2	−2.8	−1.8	−0.6

Source: Eurostat

The sources of data for the case study countries included semi-structured interviews conducted with public officials (8–12 interviews per country) and policy documents. In each country we interviewed officials who are most directly connected with the budget process (current and former civil servants in the finance ministries, government offices and fiscal councils) and also the experts who analyse developments in fiscal governance. The interviews were conducted between May 2017 and April 2018 and lasted between 1 and 1.5 hours. The interviews were transcribed and independently coded by all authors in order to secure the validity of the interpretations. We are primarily interested in the perceptions of the public officials of the effects of the crisis experience and European-level reforms on national level budgetary processes.

Portugal

According to our interviews, by 2009, which is the starting point of our analysis, Portuguese fiscal governance could be characterized as having predominantly fiefdom elements in the preparation and adoption phases, and delegation elements in the implementation phase. Thus, the question for us is whether the experience of the crisis, the involvement of the Troika and the new EU rules brought about a change in this configuration.

Of the three countries analysed in this article, Portugal was most severely affected by the crisis. The combination of underlying domestic economic problems, global financial crisis and the contagion effect from Greece led to a situation in 2011 whereby the Portuguese government was no longer able to finance its increasing budget deficits. Due to the loss of confidence by the financial markets the risk premiums surged and Portugal had to request a bailout from the EU and the International Monetary Fund, in order to avoid defaulting on its sovereign debt. The memorandum of understanding signed with the Troika in May 2011 entailed a comprehensive reform programme, which also foresaw changes to budgetary institutions. The Portuguese government sought to avoid a second bailout and managed to exit the adjustment programme in 2014 (Magone, 2014).

The interviews indicate that the crisis experience, the adjustment programme and the European-level fiscal governance reforms resulted in the budget preparation process becoming more top-down, compared with the previously dominant bottom-up approach. As the interviewees explained, during the involvement of the Troika starting in 2011, a very strict top-down approach was adopted in order to compile the annual budget, as there was no other way to impose the consolidation requirements. This top-down approach persisted even after the programme was over. All interviewees also concurred that the experience of the crisis and the adjustment programme strengthened the role of the MoF in the preparation phase of the budget, with the recent European-level fiscal governance reforms continuing to reinforce it. It was noted that the reference to the European-level framework gives the MoF a focal starting point in drafting the budget proposal and gives it considerable clout in bargaining with line ministries. Furthermore, as some of the interviewees noted, given that the structural deficit target is highly complex it offers the MoF an informational advantage in budget discussions with the spending ministries. Thus, in the terminology of the fiscal governance literature, we can argue that the preparation phase has moved towards the delegation approach.

A considerable change in the formal rules governing the budget preparation process was the requirement to adopt a MTEF. This provision was introduced to organic budget

law in 2011. The MTEF is adopted for four years on a rolling basis, with the intention that the ceiling for the first year is binding and the ceilings for the remaining years are indicative (that is, guidelines, rather than compulsory targets). While there had been discussions about the necessity of such a reform before the crisis (see also Curristine *et al.*, 2008), it was the combination of the crisis experience and the Troika's demands that drove the point home and facilitated the adoption of the legal provisions pertaining to the MTEF. As several interviewees mentioned, by adopting the MTEF the Portuguese government anticipated the requirements that were later included in the EU-wide directives. However, despite the legal requirement to adopt a MTEF, Portugal has not moved towards a genuine contracts approach in the budget preparation phase. As all interviewees agreed, the ceilings in the MTEFs are not regarded as binding by the budget actors and it has become a symbolic paper exercise. As one of the interviewees put it, 'Honestly, I don't think anyone reads it' (Interview P3). As several officials explained, introducing the MTEFs during the crisis period had been problematic: after the first MTEF had been adopted for 2012 the expenditure ceilings had to be revised upwards due to the fact that the Portuguese Constitutional Court reversed several austerity measures (interviews P1, P2 and P8). The officials conjectured that as the MTEF almost immediately lost its credibility it was not taken seriously in the subsequent years. As one of them put it, 'In my view, you should not introduce such a change in the middle of the crisis of such magnitude. [...] We probably lost a good idea for many years. Timing is sometimes everything' (Interview P8).

With regard to the budget adoption phase, there have been no formal changes but the de facto role of the parliament has varied considerably during the past decade. According to the interviews, during the Troika involvement the parliament was very passive in the budget process, whereas since 2015 it has become considerably more active again. This is primarily due to the fact that the socialist government in power has been a minority government and has had to rely on the communists and the left bloc for support in passing the budget, often in the form of additional amendments to the budget, increasing expenditures. Thus, we can argue that while during the Troika programme the legislative phase was akin to the delegation model it has moved closer to the fiefdom model since 2015 due to the constellation of minority government and the ideological preferences of the dominant parties.

The implementation phase of the budget process has become more centralized as a result of the crisis experience, the Troika involvement and European-level fiscal governance reforms. The annual budget law in Portugal (consisting of over 40 000 line items) is more detailed than in any other OECD country. Before the crisis there had been discussions on reducing the level of line items and providing more flexibility for line ministries (see also Curristine *et al.*, 2008). As several interviewees mentioned, however, the crisis experience reinforced the need for more detailed control and stalled developments towards more aggregate budgets (Interview P4). The interviewees also noted that the crisis experience, the Troika, and the European-level fiscal governance reforms have strengthened the role of the MoF in the implementation phase (Interviews P2, P4 and P9). A number of instruments have contributed to this. First, the crisis experience drove home the need to create a single treasury account that would allow the MoF to better track and monitor the expenditures of the line ministries. Second, the arrears and commitments law that was required by the Troika (especially the International Monetary Fund) gives the MoF more extensive

powers to control the new financial commitments of the line ministries. Third, after 2015, the MoF has made an increasing use of frozen appropriations. This means that the MoF freezes a certain portion of the approved budgets of the line ministries and unfreezes them on a discretionary basis (if at all). While frozen appropriations had also been used in the past (see also Curristine *et al.*, 2008), they were discontinued during the adjustment programme as the Troika viewed this instrument as being too ad hoc. This instrument made a comeback after 2015, however. As mentioned above, because the parliament has moved closer towards a fiefdom approach the MoF has had to impose consolidation measures in the implementation phase in order to ensure compliance with the EU fiscal rules.

In sum, the crisis experience and European-level reforms induced the adoption of a delegation approach in the preparation phase, did not significantly affect the adoption phase and reinforced the delegation approach in the implementation phase. Although the crisis experience initially sparked the adoption of MTEFs, actually implementing them during the crisis was difficult and hence a contracts approach did not ensue, despite the European-level reforms encouraging it.

Austria

In 2009, the starting point of our analysis, the Austrian fiscal governance could be characterized as follows. The reforms that had been prepared in 2004–2009 – driven by domestic considerations rather than a crisis or external pressures – foresaw: (1) the replacement of the hitherto predominantly bottom-up approach in the preparation phase with a top-down contracts approach; (2) the introduction of elements of the contracts approach in the adoption phase by giving the parliament the right to adopt the MTEF as a law and equipping it with an independent parliamentary budget office; (3) the restriction of the hitherto prevailing delegation approach in the implementation phase by limiting detailed control by the MoF and giving more flexibility to the line ministries. Did the crisis and the European-level fiscal governance reforms aid the achievement of those shifts or not?

Our analysis shows that the crisis experience and the European-level fiscal governance reforms have reinforced a top-down approach and strengthened the MoF in the preparation phase of the budget process. In response to the European-level fiscal governance reforms, the Austrian government revised the existing Austrian stability pact (which had spelled out the Maastricht rules for the federal, state and local level) in order to break down the structural deficit targets among the different levels and to outline the sanctions associated with non-compliance. Thus, in putting together the budget proposal for the federal government, the structural deficit target of 0.35% of GDP is the yardstick that the MoF uses for compiling the budget proposal. As in the case in Portugal, the interviewees felt the tighter EU fiscal rules – especially the complexity of the structural deficit target – provide the MoF with additional arguments in budgetary negotiations with line ministries.

As part of budget reforms that had been planned since 2004, Austria enacted a MTEF for the federal level in 2009. As it had been planned for several years before the crisis (see also Blöndal and Bergvall, 2007), it cannot be argued that reform was triggered by the crisis. According to the organic budget law, expenditure ceilings are adopted as a law, on a rolling basis, and are binding at the level of five sectoral areas for the following four years (at the chapter level, of which there are 30, they are binding for the next year and

indicative for subsequent years). Thus, according to these formal provisions, we would have expected Austria to move closer to the contracts approach of fiscal governance. In reality, however, this has not happened as the expenditure ceilings are not regarded as genuine constraints on spending and the MTEF is usually revised several times a year. As the interviewees explained, introducing the MTEFs during the crisis made it challenging to stick to the expenditure ceilings. First, in order to stimulate the economy, the ceilings had to be revised upwards and later, in order to consolidate the budget during the excessive deficit procedure, they had to be revised downwards (Interviews A4, A9, A10 and A11). As a result, the credibility of the MTEF became undermined and the ceilings it entails are regarded as easily changeable. The interviewees noted that there were no political costs associated with changing the MTEFs. As one of them put it, 'It is not like in Finland where you have the political commitment to the expenditure ceilings and they are actually binding' (Interview A4).

While neither the crisis nor the European-level reforms have brought about significant changes in the adoption phase of the budget process, all interviewees agreed that these factors have influenced the implementation phase. The idea of the 2009 budget reform in Austria was to introduce ideal-typical top-down budgeting: in return for a stronger control over the budget aggregates by the MoF, the line ministries would be given more flexibility and freedom over its details. An important aspect of this increased flexibility was the freedom to carry over unused funds to the next calendar year, in order to prevent December fever. The line ministries first responded to that possibility by no longer engaging in December fever and building up reserves from unused funds. In the subsequent years, however, starting in 2013, when the ministries wanted to spend the accumulated reserves, the MoF blocked their access to these funds. All the interviewees argued that this was done in order to ensure compliance with the EU fiscal rules: their perception was that if the line ministries had spent the funds as they wished, the Austrian government would have deviated from the fiscal targets (the structural deficit rule in particular), and the MoF did not wish to return to the excessive deficit procedure. As a result of these restrictions, however, the line ministries started to engage in December fever again and refrained from building up considerable reserves.

In sum, in Austria, the crisis experience undermined the implementation of the MTEF despite the fact that the European-level reforms supported that instrument. Instead, the crisis encouraged the use of the delegation approach in the preparation phase. Neither the crisis nor the European-level reforms brought about significant shifts in the adoption phase. In the implementation phase the structural deficit rule was perceived (by the public officials) to interfere with implementing flexible carryovers, which amounted to bringing back elements of the delegation approach.

Finland

In the fiscal governance literature, Finland is considered to be a quintessential example of the contracts mode, with each coalition government adopting expenditure ceilings for the next four years that are considered to be binding and followed in the preparation, adoption and implementation of the annual budget. The commitment to multi-year spending limits – which emerged after the experience of the crisis in the 1990s – is not required by law but is based on informal consensus (Blöndal *et al.*, 2003; Hallerberg, 2004).

Although Finland did not experience a fiscal crisis as such, it did face a dramatic decline in GDP in 2009 and has experienced weak growth performance since then. As all interviewees concurred, spending limits were observed despite the economic recession. According to the officials interviewed in Finland, the 2009 crisis experience has not induced significant changes in the preparation, adoption and implementation phases of the budget process. European-level fiscal governance reforms, however, led to the enactment of a more formalized fiscal framework in 2014, which requires the approval of the general government fiscal plan in the preparation phase of the budget. It divides the structural deficit target between the central government, social security and local government sectors. Given that the EU fiscal rules (including the structural deficit target) pertain to the general government – rather than just central government – this has necessitated a broader look at public finances and a stricter coordination of the budgetary policies of different levels of government. As explained by the interviewees, however, this more formalized and legalistic approach to fiscal planning – which has been induced by the EU requirements – clashes with the more informal and consensus-based approach that has been prevalent in Finland. In light of such a consensus-based approach, the insertion of more formalistic elements is seen as problematic and alien to the existing system. As one of the interviewees explained, ‘Because of the EU obligations we had to introduce more legalistic elements to our framework, which is a trend I do not like. [...] I don’t think we get any value from this trend’. He added, ‘I guarantee that if you surveyed our ministers and asked them what the target for the central government balance is, they would not know it. [...] The budgetary discussions have not paid much attention to these structural deficit targets’ (Interview F5). Other interviewees noted that because the assessment of structural deficit is very uncertain, the government would be reluctant to anchor its policy to something that is so ambiguous (interviews F2 and F3).

In sum, while the crisis experience did not bring about considerable change in the budget processes, the European-level reforms led to the formalization of a hitherto informal contracts approach in the preparation phase, with no significant changes in the core budget processes themselves.

Discussion and Conclusions

In sum, our comparative analysis shows that – in line with the theoretical prediction – the more severe the experience of the crisis, the greater the pressure for the government to reform budgetary processes. Portugal, which had faced the most severe crisis, introduced extensive reforms of the budget process, while Finland, which had experienced only a mild fiscal squeeze, did not adopt any major reforms. In Austria, where the fiscal squeeze was moderate, the crisis did not trigger reforms that were as comprehensive as in Portugal, but it did influence the implementation of the reforms that had been enacted before the onset of the crisis. In both Austria and Portugal for the most part the European-level fiscal governance reforms reinforced the changes induced by the crisis experience, apart from the fact that the crisis made the implementation of MTEFs more challenging. In Finland, no changes of the budget process were triggered by the crisis experience but the European-level reforms did result in formal changes in the budget preparation phase.

As predicted in the theoretical discussion, the combination of the crisis experience and the European-level fiscal governance reforms have brought about increased centralization

of budgetary institutions in all three cases. Under the general notion of centralization, however, we can observe various shifts in the three countries.

Theoretically, we would have expected the European-level reforms to encourage movement towards the contracts approach in the domestic budgetary institutions of member states. In reality, however, the cases of Austria and Portugal indicate that the combination of the crisis experience and the European-level reforms has strengthened the role of the MoF in the budget process (both in the preparation and the implementation phase), which is more characteristic of the delegation approach. In both countries the effects of the crisis and the European-level reforms have been particularly pronounced in the implementation phase, which has become more centralized. In both cases the MoF has resorted to using more extensive discretion in order to ensure compliance with the EU fiscal rules. In both cases the countries also have administrative traditions that have, in the past, emphasized detailed control over the budget implementation by the MoF. Thus, when faced with countervailing demands the MoF could fall back on previous approaches and instruments that had been used in the past in order to re-exert its control.

In all three countries the crisis and European-level reforms have not induced major changes in the adoption phase of the budget. As the case of Portugal shows, the role of parliament in the budget process depends primarily on whether the government in power is a majority or a minority one. In the case of a minority government the legislature has more extensive leeway to change the budget and, in the case of Portugal, this has introduced elements of fiefdom mode in the adoption phase. The case of Portugal also shows that if, for political reasons, the legislature shifts towards the fiefdom mode, the MoF – which, in the end, takes the praise or blame for complying with the EU fiscal rules – can counteract the increased spending adopted by the parliament by utilizing more extensive discretionary powers (in the form of increased use of frozen appropriations) in the implementation phase. While such an approach has sought to ensure compliance with EU fiscal rules, it has certainly tilted the balance of power considerably towards the executive branch, and one could raise questions about the democratic legitimacy of such an extensive discretionary approach by the MoF.

All three cases show that although the crisis or the EU influence have led to the adoption of a formalized multi-year contracts approach in the preparation phase of the budget process, it has not taken root in the way intended. In Portugal and Austria the introduction of MTEFs in the midst of the crisis meant that they had to be revised and, as a result, their credibility was undermined, after which they became merely a symbolic paper exercise. In Finland, where functioning and home-grown multi-year spending limits (based on political consensus) had been in place already before the European-level reforms, the formalized general government fiscal plan approach with structural deficit targets – adopted in response to EU requirements – is perceived as an alien institutional layer that doesn't fit the existing approach.

Although in all three countries, the independent monitoring of fiscal policy was strengthened, by establishing the fiscal council in Portugal or by assigning new monitoring tasks to the existing bodies in Austria (the national debt committee) and Finland (the national audit office) – the interviewed officials in all three countries agreed that, overall, this had not brought about significant shifts in core aspects of the budget processes or induced a shift towards a contracts approach. Some of the interviewees in Austria and Portugal mentioned that the existence of the fiscal council

helps to reinforce the position of the MoF in budget negotiations, which is a characteristic of the delegation approach.

All three cases indicate that the underlying idea of the EU rules to foster the contracts approach in fiscal governance can be made more challenging by the fact that the focal yardstick used – that of the structural deficit – depends on complex computations and is difficult to assess accurately in real time. The interviewees in Austria and Portugal noted that the complexity of the rule can give additional bargaining clout to the finance ministries – which is a characteristic of the delegation approach. Furthermore, it can be argued that as different actors in the budget process (the MoF, the fiscal council and the European Commission) can point to diverging assessments of what the structural position of the budget can be predicted to be, the main aspect of the fiscal contract is ambiguous and constantly debated and contested. The influence of the structural deficit rule on the budget processes of the EU member states and on the powers of the different budget actors is a topic worth closer investigation in the future.

As we have looked at only three cases in this article, the generalizability of the findings to the other member states is limited but in light of our case studies, we can argue that further discussions are needed about the European-level fiscal governance frameworks. Although, overall, the commitment to fiscal discipline may have increased after the adoption of the six-pack, the two-pack and the fiscal compact, it is not clear that the reform package has necessarily led to desirable shifts in the core budget processes of the member states. The new European-level fiscal governance framework has not had the predicted impacts with regard to MTEFs. Instead, governments seem to muddle through to meet the stricter fiscal targets, but without fundamentally changing the budget processes towards the contracts approach. Furthermore, the need to comply with the EU fiscal rules have reinforced previous practices that the governments may have otherwise wanted to move away from, as exemplified by the increased use of frozen appropriations in Portugal. Our case studies also indicate that the attempts to prescribe increasingly more detailed institutional solutions to the member states may clash with the existing administrative traditions underlying a core process like budgeting and lead to undesirable side-effects. On the other hand, of course, it is important to keep in mind that in some member states, which previously had lacked good budgetary practices, the EU-triggered reforms have potentially made a positive contribution.

In this article our goal was to assess the overall impact of the crisis and European-level fiscal governance reforms on the core dimensions of budget processes of member states. In future research, however, more in-depth studies of the effects of the specific elements in the reform package (for example, the structural deficit target and fiscal councils) would be warranted. Although our interviews with public officials indicate that the fiscal councils may not have had considerable impacts on the core budget processes further studies could investigate this question more comprehensively (in terms of methodology used) and also take a closer look at their more nuanced impacts (for example, on the accuracy of fiscal forecasts, public discussions or visibility of fiscal policy). In this article we have focused only on developments at the national level. The European-level reforms are likely to have had significant repercussions for the fiscal interactions between the national and subnational levels of government and these should be explored in future studies.

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Interviews

Finland

Interview F1: Official of Finance Ministry, 17 May, 2017.

Interview F2: Official of Finance Ministry, 17 May, 2017.

- Interview F3: Official of Finance Ministry, 17 May, 2017.
- Interview F4: Official of Finance Ministry, 17 May, 2017.
- Interview F5: Official of Finance Ministry, 18 May, 2017.
- Interview F6: Official of the Parliament, 24 May, 2017.
- Interview F7: Official of Finance Ministry, 30 May, 2017.
- Interview F8: Official of Prime Minister's Office, 31 May, 2017.

Portugal

- P1: Official of Finance Ministry, 15 November, 2017.
- Interview P2: Former official of Finance Ministry, 16 November, 2017.
- Interview P3: Official of Finance Ministry, 16 November, 2017.
- Interview P4: Country expert, 17 November, 2017.
- Interview P5: Country expert, 17 November, 2017.
- Interview P6: Country expert: 17 November, 2017.
- Interview P7: Official of the Fiscal Council, 20 November, 2017.
- Interview P8: Former official of Finance Ministry, 20 November, 2017.
- Interview P9: Official of the Parliament, 21 November, 2017.
- Interview P10: Former budget official of a line ministry, 24 November, 2017.

Austria

- A1: Former official of Finance Ministry, 18 February, 2018
- Interview A2: Budget official of a line ministry, 4 April, 2018
- Interview A3: Official of Fiscal Council, 5 April, 2018
- Interview A4: Official of Finance Ministry, 5 April, 2018
- Interview A5: Official of the parliament, 6 April, 2018
- Interview A6: Official of the Prime Minister's office, 6 April, 2018
- Interview A7: Official of the Prime Minister's office, 6 April, 2018
- Interview A8: Country expert, 9 April, 2018
- Interview A9: Official of the Finance Ministry, 10 April, 2018
- Interview A10: Official of the Finance Ministry, 10 April, 2018
- Interview A11: Official of the Finance Ministry, 10 April, 2018
- Interview A12: Official of the Finance Ministry, 10 April, 2018
- Interview A13: Official of the Finance Ministry, 12 April, 2018
- Interview A14: Country expert, 30 April, 2018

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