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The Post-Crisis Overhaul of European Economic Governance: A Sociological Institutional Approach

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ABSTRACT

The financial crisis of 2007-2009 triggered a long reform process that led to an unprecedented centralisation of fiscal and macroeconomic policymaking in the European Economic and Monetary Union (EMU) and the abandonment of the pre-existing model of weak economic coordination. The reform of European Economic Governance (EEG) between 2010 and 2013 comprised three major legislative initiatives, the Six-Pack, the Two-Pack and the Fiscal Compact. This thesis examines the post-crisis institutional evolution of the EMU's economic pillar asking how the Eurozone member states decided to proceed to the post-crisis overhaul of the framework of Economic Governance. To answer this question, the thesis turns to the unique social environment of the Eurozone examining the social constitution of actor preferences. Following the theoretical framework of Sociological Institutionalism, the thesis focuses on the evolution of EMU's system of meaning, namely the "Sound Money" economic policy paradigm, to explore the endogenous aspect of policy change. The central argument is that the emergence of institutions-based discipline as a core economic policy belief of the post-crisis EMU legitimised the strengthening of economic coordination as an organisationally superior form. Through the use of process tracing and organisational discourse analysis, the adopted policy arrangements are linked to particular mechanisms creating new meaning within the EMU. The analysis of EMU's social environment relies extensively on primary data collected through the method of elite interviewing of high-ranking officials participating in the influential Economic and Financial Committee. The thesis primarily contributes to the literature on the post-crisis fiscal governance of the EMU by advancing a sociological account of change that prioritises structure over agency.

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LIST OF ABBREVIATIONS

AGS	Annual Growth Survey
ALDE	Alliance of Liberals and Democrats for Europe
AMR	Alert Mechanism Report
BEPGs	Broad Economic Policy Guidelines
BICC	Budgetary Instrument for Convergence and Competitiveness
CAP	Corrective Action Plan
CJEU	Court of Justice of the European Union
CM	Correction Mechanism
COREPER	Committee of Permanent Representatives
CSRs	Country-Specific Recommendations
DBPs	Draft Budgetary Plans
DG	Directorate-General
DG ECFIN	Directorate-General for Economic and Financial Affairs
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs (Council Configuration)
ECON	Committee on Economic and Monetary Affairs (European Parliament)
EDP	Excessive Deficit Procedure
EEG	European Economic Governance
EERP	European Economic Recovery Plan
EFC	Economic and Financial Committee
EFSSF	European Financial Stability Facility
EIP	Excessive Imbalance Procedure
EMS	European Monetary System
EMU	Economic and Monetary Union
EP	European Parliament

EPP	European People's Party
EPPs	Economic Partnership Programmes
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ESM	European Stability Mechanism
EU	European Union
EWG	Eurogroup Working Group
FCC	German Federal Constitutional Court
IDRs	In-Depth Reviews
IMF	International Monetary Fund
MAP	Macroeconomic Adjustment Programme
MIP	Macroeconomic Imbalance Procedure
MoU	Memorandum of Understanding
MTO	Medium-Term Objective
NRP	National Reform Programme
QE	Quantitative Easing
RQMV	Reverse Qualified Majority Voting
RSMV	Reverse Simple Majority Voting
S&D	Socialists and Democrats
SCPs	Stability and Convergence Programmes
SDP	Significant Deviation Procedure
SGP	Stability and Growth Pact
SI	Sociological Institutionalism
TEC	Treaty establishing the European Community
TEEC	Treaty establishing the European Economic Community
TEU	Treaty on European Union
TF	Task Force on Economic Governance
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability, Coordination and Governance on the Economic and Monetary Union

DECLARATION

I, the author, confirm that the Thesis is my own work. I am aware of the University's Guidance on the Use of Unfair Means (www.sheffield.ac.uk/ssid/unfair-means). This work has not been previously been presented for an award at this, or any other, university.

CHAPTER 1

INTRODUCTION

1.1 Setting the Stage

1.1.1 A Background of Crises

The financial crisis of 2007-2009 was a historic event that shaped the global political economy in the following decade. The 2007 collapse of the subprime mortgage market in the United States led to the loss of confidence in the creditworthiness of the American and the European banks (Allen and Moessner, 2010; Lapavistas, 2013: 271-281). Uncertainty about the exposure of the banks to the subprime assets increased the perceived counterparty credit risks in the banking sector. The banks responded by hoarding liquidity, thereby drying up the liquidity of the financial markets. The collapse of the investment bank Lehman Brothers in September 2008 shocked the financial markets exacerbating the concerns about the solvency of other financial institutions. Due to the interconnectedness of the financial system the problems were quickly transmitted to Europe. The International Monetary Fund characterized the crisis as “the most dangerous financial shock in mature financial markets since the 1930s” (International Monetary Fund, 2008a: 1).

The financial crisis challenged the economic orthodoxy that had been established after the demise of the Bretton Woods system in the early 1970s and the globalisation of finance in the 1980s and the 1990s (Tooze, 2018: 1-22). The grave effects of the crisis in the financial markets on the real economy, manifested in the fall of the economic activity and the rise of the unemployment, questioned the wisdom of neoliberal policies. Deteriorating living conditions for large segments of the population fueled large-scale dissatisfaction with the ruling elites. Movements such as the “Occupy Wall Street” in the United States or the “Indignados” in Spain (both in 2011) expressed rising popular anger with the handling of the crisis (Flesher Fominaya, 2017; Karampampas, Temple and Grasso, 2019). For the rest of the decade, one country after the other plunged into severe political crisis. The “anti-establishment” rhetoric became very popular with the electorate destabilising many political systems in the United States and the

European Union. Unconventional politicians rose to power by promising the unravelling of parts of the neoliberal economic consensus.

The economic policy response of every major economy to the financial and economic crisis was an event equally significant to the crisis itself. From the “American Recovery and Reinvestment Act” of 2009 to the Japanese “Abenomics” policy package of 2012, the recovery efforts of the governments after the financial crisis have drawn significant academic attention as scholars sought to inform future generations about useful policy lessons (Ido, 2017; Shibata, 2017; Romer, 2009; Auerbach et al., 2010). This should come as no surprise as many policymakers around the world started to review the work of Lord Keynes on the Great Depression of the 1930s to find ways to address the 2007-2009 crisis (Giles, Atkins and Guha, 2008). Given that the European Union is a major world economy in terms of its share of the world GDP, every part of its crisis response deserves to be studied in detail. The European Economic Governance reform (EEG) together with the EU’s regulatory initiatives on financial markets and securities, the “Banking Union” regulatory package of 2013-2014 and the various monetary policy programmes of the European Central Bank between 2008 and 2015 constituted the European Union’s crisis response to the financial crisis and thereby its study illuminates the reaction of a leading economic actor to the most significant economic event of our times (Trichet, 2010; Buckley, Howarth and Quaglia, 2012; Quaglia, 2013; Howarth and Quaglia, 2016; Lombardi and Moschella, 2016).

The Economic Governance reform of 2010-2013 is particularly interesting as it took place in a dramatic period for the European Economic and Monetary Union (EMU). Apart from responding to the global financial and economic turmoil, the Eurozone had to deal with its first existential crisis from 2010 until 2015. The sovereign debt crisis was triggered in the spring of 2010 when the credit rating agencies downgraded the Greek sovereign debt leading to the country’s suspension from the sovereign bond markets (Tooze, 2018: 321-345; Sandbu, 2015: 48-76). Initially, the Eurozone member states hesitated to provide financial assistance to the Greek state but backed down as Greece was facing imminent bankruptcy in May 2010 (Pisani-Ferry, 2014: 77-84; Papaconstantinou, 2016: 74-113). The establishment of an ad hoc financial assistance mechanism to Greece failed to appease the financial markets. A domino effect was underway and a few months later Ireland and Portugal were obliged to request financial assistance. In the summer of 2011, Greece started discussions on a second loan that culminated in a second request for financial assistance in February 2012.

The management of the debt crisis created extreme tensions between member states, stimulated domestic political opposition towards the European Institutions and challenged the cohesion of the Eurozone on multiple occasions. Greece faced expulsion from the Eurozone in May 2010, in September – October 2011 and again in July 2015. In November 2011 the democratically elected governments of Italy and Greece were effectively overthrown under the intense pressure of other European governments and the European Institutions with their prime ministers being replaced by unelected technocrats, who had served as high ranking EU officials (Dinan, 2012; Rosenthal, 2012; Spiegel, 2014). The unpopular provision of financial assistance has even tested the German commitment to the EMU. Angela Merkel, the German Chancellor, had to use dramatic terms to gain the support of the German parliamentarians to the financial assistance arrangements: “[t]he euro is much, much more than a currency (...) the euro is the guarantee of a united Europe. If the euro fails, then Europe fails” (Der Spiegel, 2011). The crisis began to scale down in July 2012 when the President of the European Central Bank (ECB), Mario Draghi, famously declared that the Bank was “ready to do whatever it takes to preserve the euro” (Wilson, Wigglesworth and Groom, 2012). This commitment almost immediately calmed the financial markets (Tooze, 2018: 422-446). The crisis abated in 2015 when the ECB engaged in a large-scale purchase of government bonds by spending 2.6 trillion euros (Ewing, 2018; Jones, 2015). Given the adverse political and economic conditions within the EU due to the raging sovereign debt crisis, the achievement of consensus on the issue of the European Economic Governance legislative reform is impressive.

1.1.2 A Historic Integration Process

The 2010-2013 reform of European Economic Governance is significant for the development of European integration as it is an inextricable part of the Union’s most advanced integrative project: the Economic and Monetary Union. Historically, the first references to economic coordination appeared in the Treaty of Rome (TEEC, 1957) reflecting the underlying Keynesian view on state interventionism that prevailed in the domestic economic policies of the governments of the era. The first blueprint on the Economic and Monetary Union, the so-called Werner Report of 1970 (Werner, 1970), promoted the centralisation of economic policies up to a certain extent. Monetary unification would evolve in parallel with the centralisation of fiscal policies. For some time, the principle of parallelism was abandoned as member states decided to coordinate only in the field of monetary policy with the creation of

the European Monetary System (EMS). The Maastricht Treaty that determined the legal structure of the EMU and the transition of the member states towards it promoted the gradual unification of national monetary policies in combination with the limited coordination of national fiscal policies in the form of the convergence criteria. The imbalanced institutional design of the EMU, which was the product of the Maastricht Treaty, was finally complemented by a “Stability and Growth Pact” in 1997 at the request of Germany. The Pact sought to transform the restrictions included in the convergence criteria into permanent obligations of the final stage of the EMU. The provisions of the Pact proved difficult to implement and, as a result, the Pact underwent a substantial reform in 2005. The European Economic Governance reform amended the Stability and Growth Pact for a second time becoming part of the long chain of EMU-related institutional developments. Three legislative initiatives stand out: the Six-Pack of 2011, the Fiscal Compact of 2012 and the Two-Pack of 2013.

1.1.3 Unprecedented Constraints on National Democratic Politics

Apart from emerging within a significant global and regional historical context, the reform of the European Economic Governance is highly relevant due to its effects on the domestic economic policies and the democratic politics of the Eurozone member states. Whereas the Stability and Growth Pact focused exclusively on the surveillance of national fiscal policies imposing constraints on the level of national deficit and debt, the EEG extended EU-level surveillance to the national macrostructural and macrofinancial policy fields. Before the reform, the latter were only part of a learning and benchmarking coordination process at the EU level. With the reform the “soft law” instruments were replaced with “hard law” regulations involving financial sanctions. In parallel, the fiscal monitoring undertaken by the EU became much more detailed, concentrating on the feasibility and the effectiveness of underlying fiscal policy decisions rather than sticking to the examination of the headline fiscal targets. Member states undertook the obligation to establish national correction mechanisms leading to the automatic adoption of measures in cases of significant deviations from prudent fiscal policy. Most importantly, the new reform created a system of EU-level policy guidance shaping the design of national fiscal and structural policies. Member states failing to incorporate the guidance into their national policies were faced with sanctions. As a result, the reform of the Economic Governance between 2010 and 2013 created new constraints on the economic

policymaking of member states. The increased complexity of the new rules makes it much more difficult for national decision-makers to devise EMU-compatible policies.

The reformed Economic Governance framework poses some formidable challenges to national democratic politics. National politicians are obliged to accept an unforeseen level of intrusion of the EU Institutions into the national democratic procedures. According to the new legislation, the governments are expected to send their budgetary plans to the Commission for assessment before they present them to national parliaments. The Commission can even demand the revision of the plans otherwise the member state can face sanctions. The case of the Italian budget of 2019 vividly exposed the constraints on national democratic procedures brought about by the Economic Governance reform. The unprecedented rejection by the Commission of the Italian budgetary plans became a headline issue in the last months of 2018 (Brunsden, Khan and Johnson, 2018; Brunsden and Khan, 2018). The Italian government had to spend several weeks negotiating with the Commission an acceptable compromise while the national parliament was effectively sidelined. Given the centrality of fiscal policy for the implementation of every government's political manifesto, this episode made clear the far-reaching effects of the new Economic Governance reform on the national political systems.

1.2 The Research Puzzle

This thesis seeks to uncover the underlying reasons behind the overhaul of the framework of European Economic Governance after the eruption of the financial crisis and the Eurozone debt crisis. In other words, the thesis asks how the economic coordination of the Eurozone became more centralised after the twin crises. The question is pertinent as the Maastricht blueprint of the EMU promoted a largely asymmetric institutional design. The sudden attempt to enhance the 'E' of the EMU after 2010 was unexpected as the Stability and Growth Pact had undergone a major reform in 2005.

In 2008 Eurozone policymakers remained confident about the suitability of the structure of European Economic Governance. A few months before the fall of Lehman Brothers that marked the escalation of the financial crisis, the European Commission had issued a report for the ten years of the EMU in which it hailed the success of the euro and acknowledged the contribution of the European fiscal framework. The Commission was noting that “[f]iscal policies have supported macroeconomic stability in EMU (...) [t]he reform of the SGP in 2005

not only contributed to greater discipline, but also promoted a more sustainable correction of excessive deficits” (Commission, 2008a: 4). The Commission concluded that “[t]he euro area has developed a sound structure of economic governance” (Commission, 2008a: 5). On 7 October 2008, a few weeks after the collapse of Lehman Brothers, the Economic and Financial Affairs configuration of the Council (ECOFIN) expressed its trust in the European fiscal framework. The ministers underlined that “[t]he 2005 reformed Stability and Growth Pact is the adequate framework and should be fully applied” (Council of the European Union, 2008a: 2). Based on the above paradox, the primary research question of this thesis can be formulated as follows:

Given their previous unwillingness to promote the strong coordination of economic policies, how did the Eurozone member states decide to proceed to the post-crisis overhaul of the European Economic Governance with the adoption of the Six-Pack, the Two-Pack and the Fiscal Compact between 2010 and 2013?

Looking at the global response of economic policymaking after the crisis could offer a way forward. Indeed, the financial crisis was a major shock for economic policymakers. The crisis led the governments around the world to change the course of their economic policies. A Keynesian turn was recorded as many governments adopted expansionary fiscal (and monetary) policies to fight the economic recession. Considering fiscal policy, many Eurozone countries followed suit by incurring fiscal deficits to stimulate their economies (Armingeon, 2012; Saha and von Weizsäcker, 2009). In that sense, the Eurozone countries followed a general trend in post-crisis economic policymaking. However, the various stimuli packages of the Eurozone countries were adopted at the national, not the EU level. Also, the Keynesian turn of European fiscal policies proved to be temporary (Blyth, 2013a: 53-56). At the same time, in the monetary policy field the European Central Bank did not follow the American Federal Reserve and the Bank of England in the purchase of sovereign debt bonds at that stage and insisted on the use of less radical policy instruments. It seems that the idiosyncratic characteristics of the Eurozone proved to be resilient. So, general economic policy trends cannot sufficiently explain the drive towards the enhanced centralisation of economic policymaking in the context of the EEG reform. A different direction would be to examine thoroughly the effects of the financial crisis on the Eurozone’s political economy and its particular institutional design.

The existing literature can be divided in three distinct branches attempting to answer the question on the underlying reasons behind the overhaul of European Economic Governance in different ways. A number of authors attempted to explain the reform of European Economic Governance as a result of political economy developments in the Eurozone. Those scholars focused on the power restructurings taking place within the Eurozone in the aftermath of the financial crisis and their effects on the institutional framework of the EMU. For Bulmer and Paterson (2013) and Bulmer (2014) EEG reform was the outcome of the dominance of German ordoliberal beliefs within the Eurozone after the crisis due to the country's strong economic position and its role as the region's (reluctant) hegemon. Matthijs and McNamara (2015), Matthijs (2016) and Matthijs and Blyth (2018) adopted a constructivist perspective emphasising the role of ideas as a power resource. They underlined Germany's role in renaming a crisis of the financial sector and private banking as a crisis of public spending. In turn, this created social division between northern and southern member states and legitimised the turn to the ordoliberal policy of austerity-cum-reform and the rejection of alternatives. The EEG reform was about the tightening of fiscal rules in line with the German ordoliberal doctrine.

The critical political economy dimension was far from absent. Oberndorfer (2014), Jessop (2014b), Ryner (2015) and Bieling, Jäger and Ryner (2016) followed a neo-Gramscian perspective highlighting the crisis as a crisis of the neo-liberal post-Fordist, or finance-led, accumulation strategy. They understood crisis management as the attempt of the transnational hegemonic bloc to protect EMU's ordoliberal hegemonic project against the re-emergence of the statist accumulation strategy. The EEG reform was seen as an authoritarian effort to constitutionalise the sharp return to austerity and the termination of fiscal stimulus. Bulmer and Joseph (2016) adopted a similar perspective but underlined the contestation between rival hegemonic projects emerging from the domestic level. The scholars linked the rejection of part of the EEG reform by the UK with the existence of incompatible domestic projects. Radice (2014) also saw the EEG reform as a way to protect ruling elites from the return of active macroeconomic management but followed the Open Marxist theoretical tradition emphasising the existence of mechanisms of depoliticisation seeking to legitimise a major transfer of income and wealth from labour to capital. Lapavitsas (2019) perceived the reform as a means of preserving the core-periphery hierarchy within the Eurozone, thereby protecting the interests of German capital.

The approaches employing political economy perspectives deserve merit for their attention to wider social contexts. By engaging in the analysis of the system of interstate relations and the

broader structure of social power relations they link the legislative reforms within the EMU with the activity of economic forces operating in modern capitalist societies creating ideational and material power imbalances among states and social classes. However, by focusing on issues of power and hegemony their analyses promote a reductionist view of the EMU's institutional setting. Overlooking the role of the EU institutions results in incomplete explanations of the EEG reform. These contributions fail to explain why the particular arrangements were adopted instead of others. The complexity of the adopted institutional arrangements underlines the need for a closer examination of the role and the interaction of the EU institutions.

Apart from the authors relying on political economy perspectives, a second strand of the literature examined the EEG reform through the lens of European Integration Theories. By doing so, authors from this perspective linked the policy developments with familiar European integration drivers. Those scholars began with the analysis of political economic developments but acknowledged the significance of the formal European institutional setting. Niemann and Ioannou (2015) focused on the functional interdependencies between fiscal and monetary policies within the EMU and the emergence of functional pressures after the financial crisis. Their neo-functionalist account pointed to the role of transnational organised interests, the financial markets and the European Parliament in sustaining a spillover mechanism that brought the EEG reform. Schimmelfennig (2015a) highlighted the importance of national preferences arising from national political economy concerns and bargaining power among member states due to asymmetrical interdependence. By adopting a liberal intergovernmentalist approach, he perceived the wider management of the euro crisis as an effort of the northern solvent states -especially Germany- to pass the burden of adjustment to indebted southern countries. In this context, the EEG reform was just a way to strengthen the credibility of member state commitments. In contrast, Puetter (2016) underlined the existence of problems in domestic preference formation, which was in line with a pattern established after the Maastricht Treaty. His New Intergovernmentalist account stressed the continued significance of deliberation and consensus as the guiding norms in European Economic Governance proven by the centrality of bodies, such as the Eurogroup or the Economic and Financial Committee. For Puetter, EEG reform was an endorsement of the pre-existing euro area governance architecture with more ambitious goals and more intensive processes.

The literature relying on European integration theories attempts to partially cover the missing institutional dimension by combining the analysis of political economy dynamics with the

examination of the institutional features of the Union affecting decision-making. The relevant scholars engage in a valuable effort to integrate the analysis of the EEG reform into the study of the broader course of the European integration. However, the theoretical approaches that they employ belong to the macro analytical level focusing on European integration drivers such as functional pressures, economic interdependence and ideational convergence of leading elites post-Maastricht. Those drivers can provide useful insights on the broad direction of the integration project but fail to take on board the idiosyncratic features of the historical period and the policy setting. The EMU constitutes a unique institutional construct with features that do not resemble any other major economy, while the financial crisis marked an atypical period in the history of European integration. The theoretical and analytical concepts included in the integration theories appear to be rather crude leading to oversimplified accounts of a multifaceted institutionalisation procedure.

A third branch of the literature relied on New Institutionalism to explain the changes in the framework of European Economic Governance. Those scholars concentrated on the study of the particular institutional arrangements of the European economic policy sub-system to analyse the interaction of the actors and explain integrative steps (see Bulmer, 1993). Chang (2013) acknowledged that the reason behind the reform was the desire of the member states to increase the credibility and efficiency of fiscal coordination through the delegation of authority to supranational institutions. Her Rational Choice Institutional account explained the shape of the EEG reform as a struggle of the member states to limit agency drift by the supranational institutions via control mechanisms. Torres (2013) employed the same rationalist framework to explain the strategic behavior of the European Central Bank by exploring its interaction with the European Parliament to shape the EEG reform. He found that the drive behind the Bank's strategic action was the perceived threat to its independence forcing it to act as the "guardian of the EMU". Salines, Glöckler and Truchlewski (2012) and Verdun (2015) adopted a historical institutionalist approach promoting an incremental and path-dependent explanation of the EEG reform. They identified particular arrangements as processes of layering, copying or redirection that did not challenge the economic rationale of the original Stability and Growth Pact. A different historical institutionalist approach was advanced by Yiangou, O'Keefe and Glöckler (2013). Their account followed a distinct tradition within historical institutionalism acknowledging the emergence of gaps in the institutional design of the EMU, such as the inadequate market discipline or ineffective fiscal governance. The authors claimed that the resistance of the ECB to engage in large-scale purchasing of government bonds in combination

with sunk costs and institutional barriers restricted the policy options of the governments forcing them to promote the reform of the Economic Governance. Schimmelfennig (2014) has advanced a similar argument stressing that EEG reform was an unintended consequence for the governments.

The approaches based on the above variants of New Institutionalism offer detailed explanations of the EEG reform as they pay particular attention to the institutional setting of the EMU. However, their analyses are limited to the constraining effects of the formal institutional structure. Rationalist accounts adopt a functionalist underlying reasoning for the delegation of authority from member states to the EU institutions. In this way, they overemphasise the desire of the member states to enhance the credibility of commitments, which is treated as given. The functional supremacy of enhanced fiscal coordination is not self-evident especially in the context of crisis-hit economies. It should be recalled that other major economies employed fiscal stabilisation policies and monetary stimulus. Therefore, the general economic environment is not enough to explain the homogenisation of actor preferences. In contrast, historical institutionalists downplay the functionalist dimension of delegation acknowledging the emergence of gaps and focus on the constraining role of formal institutions over time. At the same time, they give disproportionate weight to past policy decisions and policy lock-ins setting institutional barriers to (certain kinds of) reform. Hence, they tend to exaggerate the rigidity of the institutional framework and belittle the ability of the governments to exert substantial control over the supranational institutions. Governments, however, can influence the EU institutions in various ways including through political appointments and by applying political pressure on them via the adoption of common approaches in Council meetings. The explanation of the EEG reform as an incremental policy adaptation is equally problematic as the adopted policy arrangements differ significantly from the previous fiscal framework of the Eurozone.

A few scholars employed a different New Institutional approach concentrating on the effects of informal institutions. Crespy and Schmidt (2014) and Schmidt (2014) promoted a discursive institutionalist account focusing on the communicative discourse of EU leaders towards their publics, the markets and their counterparts. They stressed the effectiveness of the ordoliberal framing of the Eurozone crisis by the German leader, which led the French leader to embrace austerity in defiance of the Keynesian macroeconomic tradition of France. EEG reform was pursued to increase the credibility of the German government with the German people through the tightening of the European fiscal framework. Warren, Holden and Howell (2017) have also

employed discursive institutionalism but concentrated on the framing performed by the Commission. They noted that the Commission's narrative of a crisis resulting from fiscal profligacy impeded more radical reform initiatives. The new EEG framework remained close to the SGP.

The scholars relying on Discursive Institutionalism acknowledge that the preferences of policymakers are not the outcome of exogenous factors but emerge as a result of the actors' interaction within the institutional setting. Indeed, they make a valuable effort to uncover the construction of the decision-makers' preferences within the EMU. While they take into consideration the content of policy ideas, they are primarily interested in the analysis of discursive interactions within the formal institutional environment. This allows them to move beyond structural constraints and account for the role of agency in the legislative process. Admittedly, the focus on the discursive framing of issues by actors provides a dynamic element to their analyses. However, due to their emphasis on agency, discursive institutionalists downplay the structural dimension. This is a significant limitation of the discursive explanations given the complexity of the Eurozone's institutional environment.

This thesis shares with the discursive institutionalist explanations the concern with the endogenous origin of actor preferences and the ideational constitution of actor interests but chooses to follow a different analytical path. Instead of giving weight to agency it prioritises structure: the thesis seeks to unveil the effects of the Eurozone's social legitimacy on the construction of actor preferences. In contrast to the discursive approaches, the thesis gives much more weight to the content of ideas than their discursive use by actors via framing. In other words, this thesis takes the ideas of the Eurozone's social environment seriously and tries to explain the legislative reform as a result of the change in the content of economic policy beliefs. In view of the above, the research question can be reformulated in the following way:

Given the Eurozone Member States' previous unwillingness to promote strong coordination of economic policies, how can change in the Eurozone's socially constructed norms and economic policy beliefs explain the form of the post-crisis European Economic Governance?

1.3 The Argument in Brief

The central argument of this thesis is that in the aftermath of the financial crisis there was a significant change in the underlying economic policy beliefs of Eurozone’s decision-makers legitimising a large-scale legislative reform of the framework of European Economic Governance. The post-crisis resurgence of Keynesian ideas led to the erosion of the belief in fiscal discipline and its replacement by the concept of “constrained discretion”, namely a combination of the monetarist objective of long-term fiscal sustainability with the Keynesian short-term necessity of stabilising the economy through the use of discretionary fiscal expansion. In turn, the emergence of the causal belief of constrained discretion led Eurozone policymakers to adapt their thinking on the implementation of the economic policy mix. Fiscal rules were considered to be overly rigid to promote a smooth consolidation of public finances without destabilising the national economies. Eurozone policymakers gradually recognised institutions-based discipline as the most appropriate way to implement their preferred combination of long-term fiscal constraint and (limited) fiscal discretion. In this context, the legislative reform of 2010-2013 can be best understood as an attempt to strengthen independent EU-level institutions, particularly the Commission, to guarantee the implementation of discipline-cum-discretion.

My analysis begins with the identification of the underlying economic policy beliefs of Eurozone’s policymakers before the financial crisis. I draw on Kenneth Dyson’s seminal work and call the collection of the particular set of economic ideas the “Sound Money paradigm” (1994; 2000). I move beyond Dyson’s analysis and unveil the logical interconnections of the distinct economic beliefs by tracing their emergence in the economic literature. In this way, I provide a more complete account of the Sound Money paradigm identifying eight distinct beliefs and presenting their hierarchical linkages. I show how the pre-crisis organisational structure of the Eurozone can be adequately explained with reference to the above beliefs.

The financial crisis was a major shock that severely undermined some parts of the Sound Money paradigm in the eyes of the Eurozone elites. Price Stability, the monetarist cornerstone of the pre-crisis EMU, was found to be insufficient to guarantee overall stability. The Keynesian economic thinking provided some important insights to Eurozone policymakers regarding the origins of the crisis and the appropriate way forward. Price Stability had to be complemented by two equally significant principles: Financial Stability and Economic Stability. The latter opened the way for the acceptance of the Keynesian fiscal expansion for a

limited time period to achieve economic stabilisation. The combination of short-term fiscal discretion with long-term fiscal constraints, a concept that can be described as “constrained discretion”, replaced the Sound Money belief of fiscal discipline. By the end of 2008, the European Commission was urging governments to employ Keynesian fiscal expansion to stabilise their economies.

The full implementation of the logic of constrained discretion had important effects on other Sound Money ideas. Reorienting fiscal policies towards long-term sustainability proved to be a difficult exercise for Eurozone policymakers. The design of Fiscal Exit strategies in the autumn of 2009 unveiled the incompatibility of the Eurozone’s rigid fiscal rules with the adoption of smooth consolidation paths protecting the stabilisation of economies. The Sound Money belief of rules-based discipline was replaced by the idea of institutions-based discipline. EU-level institutions would be employed to offer guidance to national governments for the designing of appropriate fiscal policies taking into account macroeconomic imbalances and placing particular emphasis on medium-term fiscal objectives.

The post-crisis adjustment of the Sound Money paradigm led to the adaptation of the organisational structure of the Eurozone. The first part of the European Economic Governance reform, namely the Six-Pack, was a genuine attempt to align the Eurozone’s policy arrangements with the institutions-based economic belief. The Six-Pack advanced the centralisation of the budgetary procedures together with the integration of fiscal and structural surveillance and the prioritisation of prevention. In contrast, the Fiscal Compact initiative emerged as a result of the coercive pressure of the German political system to partially reverse parts of the Six-Pack related to the centralisation of fiscal coordination. The institutions-based belief led policymakers to defend the Six-Pack reform by amending the German proposals. The third part of the European Economic Governance reform, namely the Two-Pack, was a further response to the German challenge. The institutions-based belief drove Eurozone policymakers to consolidate the centralisation of fiscal coordination to protect it from future challenges.

1.4 A Sociological Institutional Approach

The explanation of the post-crisis European Economic Governance reform advanced in this thesis is distinctive. The thesis focuses on the Eurozone’s unique social environment and examines its effects on the constitution of actor preferences. While existing accounts based on

political economy perspectives and European integration theories adopt a macroscopic analytical lens, my thesis embraces a meso-level approach paying attention to the idiosyncratic characteristics of the Eurozone's institutional structure. In contrast to the rationalist versions of New Institutionalism, however, my research concentrates on the endogenous origins of preference formation: rather than considering actor preferences as exogenously given, this thesis seeks to uncover their social construction through the Eurozone's social processes. Also, my research differs from the endogenous account advanced by discursive institutionalists on the prioritisation of agency over structure. Their primary concern with the communicative skills and the discursive abilities of actors downgrades the role of the knowledge structures within the Eurozone. My research points to the rich cultural environment of the Eurozone guiding the activity of the actors. The existence of complex economic policy beliefs within the Eurozone means that policy actors are embedded in cognitive frames. While the activity of actors is taken into account the primary focus is on structure, not agency. In view of the above, the explanation of European Economic Governance advanced in this thesis is an original contribution to the field as it is based on the thorough examination of the evolution of Eurozone's underlying economic policy beliefs during the period 2010-2013.

The analysis of the Eurozone's economic policy beliefs is based on the theoretical framework of Sociological Institutionalism. The framework has evolved from organisational theory in sociology. This version of New Institutionalism turns to culture and cognition to understand the structure of organisations. Actors are embedded in systems of meaning that socially constitute their preferences and identities. Organisational change is seen as a fundamentally social process. Actors seek to conform to the social legitimacy of a given organisation and endorse socially appropriate policy arrangements. It follows that the analysis of organisational change requires the thorough examination of social processes within the organisation. The sociological institutionalist framework leads the research to the investigation of mechanisms creating new meaning within the organisations.

To examine the evolution of the Eurozone's system of meaning I employ a microinstitutional approach. My thesis focuses on an underresearched body of the European system of Economic Governance, the Economic and Financial Committee (EFC). The latter is the successor to the Monetary Committee, which was established in 1958. The EFC brings together senior officials from national finance ministries, central banks and the European Commission combining economic policy expertise and political awareness. Formally established by the Treaty, the EFC is the main preparatory body of the Economic and Financial Affairs configuration of the

Council (ECOFIN). Previous research has underlined its significant role in the achievement of consensus within the Council (Puetter, 2006; Grosche and Puetter, 2008). In my research I treat the secretive group of EFC participants as a distinct social environment and engage in a thorough investigation of the social mechanisms that lead to the creation and dissemination of new meaning.

My research strategy is qualitative. The thesis is developed as a single case study. Two main research methods are employed: process tracing and discourse analysis. The former enables the sequential analysis of empirical events and the formulation of intermediate predictions about expected observable evidence. In turn, this facilitates the identification of causal mechanisms. Discourse analysis is used to examine the construction and conveying of meaning through language. The relevant texts were collected through extensive documentary and archival investigation. The empirical research involved the conduct of elite interviewing. I approached 36 potential participants and conducted 21 interviews in 8 EU member states. The participants included EFC members, EFC alternate members, members of the ECOFIN, members of the Committee of Permanent Representatives (COREPER), officials assisting with the preparation of EFC meetings. This method led to the generation of a significant number of original texts containing meaning and enabled the detection of events that had not been recorded in official documents unveiling crucial parts of causal mechanisms.

The contribution of this thesis is not limited to the literature on the post-crisis European Economic Governance. The findings of my thesis underline the centrality of the EFC for EMU decision-making. My research provides original empirical evidence of the far-reaching effects of the EFC internal discussions on the general direction of the Eurozone. In this way the thesis provides a better understanding of the function and the role of an EU body that has received little attention from the academia. Additionally, the analytical approach that is advanced in this thesis expands the literature of EMU-related sociological institutionalism. The thesis shows that the explanatory scope of the theory is considerably wider than previously perceived as it is proved that sociological institutionalism is not only valuable for explaining major shifts, such as the transition from Keynesianism to Monetarism (McNamara, 1998), but also less radical transformations occurring within the same policy paradigm.

The research results of this thesis have some important implications for the post-crisis political economy accounts of the EMU. A number of scholars has detected an ordoliberal turn of the institutional framework of the EMU after the financial crisis (inter alia: Blyth, 2013a;

Nedergaard and Snaith, 2015; Matthijs, 2016; Bonefeld, 2017). As a byproduct of the main research findings of this thesis, the research process has produced evidence that weaken the “ordoliberalisation” hypothesis. Indeed, the economic policy belief of institutions-based discipline appears to be incompatible with some fundamental requirements of ordoliberalism, such as the consistency of economic policy, the self-limited state and the liability of economic agents. As a result, it is shown that the reform of European Economic Governance deviated from the ordoliberal doctrine. In so doing, it enriches the work of the scholars of the Walter Eucken Institut that have reached similar conclusions by examining the fields of monetary policy and financial assistance (Feld, Köhler and Nientiedt, 2015).

In view of the above, this thesis will interest a diverse audience of scholars focusing on European political economy, European public policy and the domestic politics of European Union member states. In parallel, the thesis carries lessons for policymakers participating in EU-level negotiations on fiscal and economic matters as well as national parliamentarians of EU member states discussing and adopting national budgets. The turmoil of the financial markets, the Greek debt crisis and the financial assistance arrangements got headline attention but the changes that have taken place away from the public eye are of equal importance. This research unveils a crucial aspect of the management of the financial and Eurozone crises by detecting the quiet but substantial shift from a rules-based approach to discipline to an institutions-based approach. The findings of this thesis underline the fact that the discussions and the decisions of the European Council are in reality the tip of the iceberg of the developments in the area of European Economic Governance. This thesis alerts interested scholars and decision-makers to the profound influence of the EU-level preparatory bodies on the direction of European public policy. In particular, those interested in understanding and interpreting the policy decisions in the field of the EMU must be prepared to move beyond the analysis of the decisions of the political level and open up the black box of the EFC.

1.5 Outline of the Thesis

The thesis is organised in eight chapters. Chapters 2-4 include the theoretical and methodological foundations of the thesis and its placement within the relevant literature. Chapter 2 begins with a historical overview of the empirical developments covering the period from the Treaty of Rome to the adoption of the Two-Pack in 2013. The Chapter then proceeds to the review of the literature on the alternative explanations for the post-crisis reform of

European Economic Governance. The Chapter presents their theoretical underpinnings and discusses their strengths and weaknesses in addressing the research puzzle. Chapter 3 presents the theoretical framework and the analytical approach of the thesis. The Chapter provides a thorough description of Sociological Institutionalism including its ontological and epistemological foundations. The Chapter introduces the analytical model of the thesis operationalising the application of the sociological institutionalist approach in the case of the post-crisis European Economic Governance reform. Chapter 4 delineates the research strategy of the thesis. The Chapter establishes the research design of the thesis as a qualitative inquiry based on the methods of process-tracing, discourse analysis and elite interviewing. This is followed by a detailed description and operationalisation of the applied methods and the examination of their compatibility with the overall research design.

Chapters 5-7 provide the analytical insights of the thesis based on the processing of the empirical material. Chapter 5 outlines the Eurozone's pre-crisis system of meaning, namely the Sound Money paradigm, by identifying its eight constitutive economic policy beliefs and tracing their intellectual origins. Subsequently, the Chapter focuses on the immediate effects of the financial crisis on the Sound Money paradigm by exploring the weakening of particular policy beliefs as a result of the sudden resurgence of the Keynesian economic ideas. Chapter 6 examines the post-crisis adaptation of the Sound Money paradigm. The Chapter looks at the Fiscal Exit strategies of 2009 and traces the erosion of the rules-based discipline belief. It then turns to the EFC discussions of 2010 and detects the emergence of an alternative cultural belief: institutions-based discipline. Input from interviews and evidence within relevant documents prove the existence of a sociological generalisation of meaning mechanism. Chapter 7 explores the effects of the adjustment of the Sound Money paradigm on the organisational level of the Eurozone. The Chapter detects the impact of the institutions-based discipline belief on the content of the formal negotiations and their final outcome. The Chapter's three parts correspond to the three major reform initiatives: the Six-Pack, the Fiscal Compact and the Two-Pack. The last part covers the interaction of the financial assistance arrangements and the EEG reform as the specialised arrangements of the assistance mechanisms were incorporated in the EU legislation in the context of the Two-Pack.

The Conclusion summarises the main findings of the thesis emphasising the links between the theoretically predicted mechanisms and the empirical evidence. The Chapter sets out the contribution of the thesis to the field of the post-crisis Eurozone economic governance, the Sociological Institutional literature on the EMU and the literature on the preparatory bodies

of the ECOFIN. It also explores the implications of this thesis on the Political Economy literature of the EMU by looking at the state of Ordoliberal ideas. Finally, the Conclusion states the limitations of the thesis and explores future research trajectories taking into account the evolving COVID-19 developments.

CHAPTER 2

EXISTING EXPLANATIONS OF THE REFORM

Introduction

The literature on the reasons behind the post-crisis reform of the European Economic Governance has increased exponentially over the past few years. This fact proves that scholars have quickly realised the significance of the policy developments and tried to provide answers by using a variety of theoretical lenses. In this Chapter, I review their work and examine whether their approaches offer a sufficient answer to this thesis' research question. Before I proceed to the analysis of the different explanations, I provide a short overview of the historical evolution of European Economic Governance to establish the necessary empirical background.

This Chapter puts forward the argument that the existing explanations are unable to provide an adequate answer to this thesis' research question: why did the Eurozone member states decide to proceed to the particular overhaul of the European Economic Governance between 2010 and 2013? The majority of the contributions uses macroscopic lenses to analyse the reform focusing either on broader social contexts or on historical integrative drivers. These accounts appear to overlook the particularities of the EMU's institutional setting leading to insufficient explanations of the legislative developments. Another strand of the literature is more attentive to the effects of the institutional framework on policymaking by focusing on the constraining dimension of the formal institutions. These accounts fail to acknowledge that the EMU constitutes a distinct social environment with constitutive effects on actor preferences and identities. Admittedly, a few contributions attempt to cover this "endogenous" dimension of policy change but end up providing limited explanations as they only analyse the ideas and discourses of particular agents. In view of this, the chapter argues that a sociological institutionalist explanation concentrating on the effects of Eurozone's culture on decision-making is missing from the literature on the reform of the EEG.

The contributions based on political economy approaches seek to analyse legislative developments with reference to broader social contexts. This macroscopic lens enables them to explore power asymmetries and the emergence of hegemonic leadership but leads them to

offer undetailed accounts of policy developments. The contributions relying on European Integration Theories are more attentive to the effects of the EU's institutional framework but appear to give disproportionate weight to historical integration drivers, which means that they neglect the idiosyncratic nature of the EMU. The rationalist new institutionalist explanations are naturally more attentive to the effects of the institutional setting but seem to focus on the constraining dimension of the formal institutions.

2.1 Historical Overview: The Evolution of European Economic Governance

2.1.1 Pre-Crisis Developments

European Economic Governance (EEG) or “reinforced coordination of economic policies” (Van Rompuy, 2010: 3) is an issue on the European agenda since the beginning of European integration. Elements of economic coordination are traced in the Treaty of Rome of 1957, which established the European Economic Community. Articles 104 and 105 of the Treaty enabled the coordination of economic policies as a way to assist Member States in their attempts to achieve an equilibrium in their balance of payments and confidence in their currencies (TEEC, 1957). With the conception of Economic and Monetary Union, economic policy coordination was linked to the progress of monetary integration and from that point on their evolution is interdependent. Evidence of this connection can be found in the initial EMU-related working documents of the Community, such as the Marjolin Memorandum of 1962 (Scheller, 2004: 17) and the Barre Report (Commission, 1969).

The first comprehensive roadmap to EMU was drafted by a High Level Group of experts under the then Luxembourg Prime Minister Pierre Werner and was presented to the leaders of the Member States in 1970. The so-called Werner Report aimed at establishing EMU in stages, included a timetable for their completion and specified which institutional arrangements were necessary at each stage. While the report stated that monetary unification and economic policy harmonisation should proceed in parallel (principle of parallelism), it treated the coordination of Member States' economic policies as a high priority issue indicating that “[t]he reinforcement of the coordination of economic policies during the first stage seems one of the principal measures to be taken” (Werner, 1970: 15). It even provided for a centre of decision for economic policy “in a position to influence the national budgets” (Werner, 1970: 13). The

reason for this prioritisation, according to the report, was that without the harmonisation of national economic policies there had been a serious danger of disequilibria, which, in turn, could have had serious ramifications for the realisation of the then incomplete Common Market. The Werner Plan was never put into action due to the rapidly changing international political and economic environment of the 1970s. EMU would prove to be “the biggest non-event of the decade” (Tsoukalis, 1996: 282).

The dismantling of the Bretton Woods international monetary system of fixed exchange rates severely affected Member States’ priorities regarding European integration (Tsoukalis, 1976). Being preoccupied with the stabilisation of their exchange rates, Member States created a mechanism, the so-called “Snake”, which enabled only limited currency fluctuations within narrow bands (European Commission, 2010a). Although elements of exchange rate management existed in the Werner Plan, Member States effectively broke away from the logic of the Werner Report by giving precedence to monetary coordination over the coordination of economic policies (Eichengreen, 1993). The Snake, though, failed to provide the much sought-after stability to all the participants due to its architectural flaws and other external factors, such as the instability of the dollar (Gros and Thygesen, 1998: 15-20). As a result, after a series of exchange rate crises Members started exiting the arrangement (McNamara and Jones, 1996).

Against this backdrop, for the rest of the decade discussions continued to revolve around the issue of exchange rate stability. The 1975 report of the Belgian Prime Minister, Leo Tindemans, on European Union (“Tindemans Report”) also reflected this rearticulation of integration priorities as it proposed the reshaping of the Snake, which it considered as the “starting point” of any integration process towards EMU (Tindemans, 1976). A notable exception was the so-called McDougall Report of 1977, ordered by the Commission, which provided a strong case for fiscal federalism containing radical elements such as redistribution policies, stabilisation functions and net financial transfers (Commission, 1977). At the same time, anxiety about exchange rate fluctuations was growing and had culminated in 1978 due to the renewed instability of the dollar and its side effects on Member States (Gros and Thygesen, 1992: 42).

A significant development occurred by the end of the decade. German Chancellor Helmut Schmidt and French President Giscard d’Estaing proposed a new arrangement at the European Council of Copenhagen in April 1978. The objectives of the Franco-German proposal were adopted in the following Bremen European Council and the final provisions were decided at the European Council of Brussels later in that year. The proposal aimed at the creation of the

European Monetary System (EMS) in 1979 so as to pursue “a zone of monetary stability in Europe” (European Council, 1978). At the centre of the EMS was the exchange rate mechanism (ERM), a system of fixed but adjustable exchange rates, while a newly created notional currency, the European Currency Unit (ECU), would function as the unit of account within the system. In sharp contrast to the provisions of the Werner Report, economic policy coordination was absent from the EMS arrangement (Gros and Thygesen, 1992: 51-52). Even if the EMS was seen as a “limited, defensive mechanism to improve monetary stability” (ibid) it confirmed the precedence of monetary integration over the integration of economic policymaking. In that sense, EMS resembled the Snake arrangement. Also, it appeared institutionally similar to the previous regime even though EMS was more flexible than the Snake enabling wider margins of fluctuation for participating currencies (McNamara and Jones, 1996; Bache, George and Bulmer, 2011: 143). However, contrary to the Snake, EMS proved to be a successful system as after a turbulent start it stabilised exchange rates of participating states’ currencies during the 1980s (Gros and Thygesen, 1992: 67-97; McNamara, 2005: 144-145).

The relaunching of EMU took place in 1988, nearly a decade after the establishment of the EMS and a couple of years after the signing of the Single European Act (SEA), in the context of a “euphoric atmosphere” (Delors, 2013). The Hanover European Council asked Jacques Delors, the President of the European Commission, to chair a committee that would prepare the roadmap for the realisation of EMU. The report of this Committee, the so-called “Delors Report”, was adopted at the European Council of Madrid in June 1989. The report shared the same definition of EMU with the Werner Report (Gros and Thygesen, 1992: 319; Dyson, 1994: 130) and revived the stages approach of the latter for its achievement. The report analysed the principal features of EMU at the final stage, included a description of the necessary institutional arrangements and listed the essential procedural steps for the transition. The Werner Plan’s principle of parallelism was restored: monetary unification would be accompanied by economic integration (Delors, 1989: 28; Dyson, 1994: 130-131).

Contrary to the Werner Report, however, the Delors Report avoided the high degree of centralisation of national fiscal policies and promoted a softened approach focused on medium-term guidelines for budgetary policies and binding rules limiting the size and the financing of national budget deficits (Gros and Thygesen, 1992: 317-319; Dyson, 1994: 130-131). Simultaneously, the committee proposed complete centralisation of monetary functions with the creation of a European System of Central Banks (ESCB) as an independent institution to design and implement the single monetary policy. The primary objective of the ESCB would

be to achieve price stability. The committee failed to agree on a timetable for the completion of each stage and had only indicated that the beginning of the first stage would be in July 1990. The report's main procedural proposal was quite clear, though: the convening of an Intergovernmental Conference (IGC) to negotiate Treaty changes enabling further transfer of powers to Communitarian institutions.

The Intergovernmental Conference began its workings in Rome in December 1990 and was terminated in Maastricht in December 1991 with the conclusion of the Treaty on European Union (TEU). The Delors Report formed the basis of the IGC's negotiations (Verdun, 1999: 311; McNamara, 2005: 145). Naturally, the IGC further specified the Delors blueprint by agreeing on the timetable of the transition and by settling pending institutional issues, such as the statute of the ESCB and its core institution, the European Central Bank or the authority of centralised monetary institutions during stage two. The IGC opted to pursue economic convergence before the introduction of a single currency. For this, on economic policy coordination certain convergence criteria were defined: a maximum 3 per cent of GDP budget deficit and a maximum 60 per cent of GDP for government debt. While the criteria appeared to be very strict following the spirit of Delors Report, in reality they contained escape clauses allowing for a degree of relaxation provided that the states were "moving in the right direction" (Bache, George and Bulmer, 2011: 405; Heisenberg, 2006: 241). To safeguard convergence, sanctions were introduced in the form of the "excessive deficit procedure" (EDP) bringing about restriction of lending from the European Investment Bank and imposition of fines. In a similar vein, though, escape clauses were included for exceptional circumstances or a continuous and substantial decline of the deficits (Dyson, 1994: 149).

On monetary policy, the convergence criteria referred to long-term interest rates no more than 2 per cent above the three best-performing states and two years of membership in the EMS without devaluing. Also, inflation had to be no higher than 1.5 per cent above the average inflation of the three best-performing Member States. Despite the existence of convergence criteria in the area of fiscal policy, the TEU fell short of promoting fiscal governance leaving responsibility for fiscal policy at the national level (McNamara, 2005: 156-158). Considering the degree of centralisation foreseen in the monetary area, though, it is clear that the TEU produced an imbalanced and incomplete institutional design of EMU.

The Maastricht Treaty left many important issues related to the functioning of EMU unresolved. While it delivered a rather detailed monetary constitution for EMU, its fiscal

arrangements for the period starting after the introduction of the single currency were not so clear and well-elaborated (Heipertz and Verdun, 2004). An effort to make fiscal coordination more robust took place in the mid-1990s, before the beginning of the final stage of EMU. After a relevant proposal of German Finance Minister Theo Waigel and a one-year discussion in the ECOFIN's preparatory body a solution came out in the form of the Stability and Growth Pact (SGP). The Pact consisted of two Council regulations and a resolution of the Amsterdam European Council in 1997. Essentially the SGP was an attempt to render the convergence criteria related to fiscal policy permanent obligations of the Member States participating in the new regime (Bache, George and Bulmer, 2011: 409; McNamara, 2005: 153). The Pact institutionalised multilateral surveillance of national budgets as a mechanism to prevent the occurrence and persistence of excessive deficits and most importantly operationalised the Excessive Deficit Procedure, namely the sanctioning mechanism for non-compliant states (Wyplosz, 2006; Eichengreen and Wyplosz, 1998). As the "cornerstone of European economic policy coordination and surveillance" (Juncker, 2010), the SGP secured the rules-based character of economic integration (Heipertz and Verdun, 2004).

The full implementation of the Pact proved to be a difficult issue. The SGP underwent a major crisis just four years after the beginning of EMU's final stage (in 1999) and the Pact's entry into force. Germany and France were found to be in breach of SGP's deficit limits and the Commission recommended sanctions in November 2003. However, the ECOFIN Council failed to adopt the Commission's proposal with the required qualified majority opting instead for the suspension of the sanctions (Heipertz and Verdun, 2010: 128-153). The case was taken to the European Court of Justice (ECJ), which ruled the EDP suspension unlawful while asserting Council's right to enforce budgetary discipline (Heipertz and Verdun, 2010: 154-162). In the aftermath of this event the Stability and Growth Pact was revised in 2005. The Reformed Pact was based on relaxed definitions of "exceptional economic circumstances" and "other relevant factors" affecting the deficit enabling, thus, a wider catalogue of exceptions. Also, deadlines for correcting excessive deficits were extended, over-the-cycle targets were introduced, structural reforms and country-specific characteristics were taken into account (Heipertz and Verdun, 2010: 162-169). The added flexibility was aiming to render the Pact "more enforceable" (Juncker, 2010).

2.1.2 Post-Crisis Developments

The eruption of the crisis was quickly linked to the inadequacies of the SGP (Münchau, 2009) and EMU's policymakers did not hesitate to call for its strengthening (Chaffin, 2010). The discussion proceeded promptly and in March 2010 a summit of Euro Area Heads of State or Government decided on the strengthening of economic coordination and the effective revamping of the Stability and Growth Pact (Euro Summit, 2010). For this, the leaders asked the then President of the European Council, Herman Van Rompuy, to establish a Task Force that would propose concrete changes to the legal framework. In parallel, the European Commission formulated a pack of six legislative proposals, which were made public before the final report of Van Rompuy's Task Force. Eventually, the report endorsed most of the provisions proposed by the Commission (Hodson, 2011). These proposals, now called the "Six-Pack", were legislated in 2011 according to a fast-track process.

The Six-Pack comprised five Regulations and one Directive, all belonging to EU secondary law. The Pack amended the design of the SGP by including the evaluation of discretionary expenditure measures in multilateral budgetary surveillance and by extending the Excessive Deficit Procedure to states with high public debt (Buti and Carnot, 2012). Also, sanctions were strengthened and their imposition began at an earlier stage of the EDP. National ownership was enhanced through the introduction of national fiscal rules in national budget laws. An alert mechanism was established to identify macroeconomic imbalances and a macroeconomic imbalances procedure was foreseen as a sanctioning process. Coordination of economic and budgetary policies was strengthened by a more appropriate timing of the EU-level discussions on economic policy issues at the first half of the year (European Semester).

Beyond the Six-Pack, Member States agreed in December 2011 to sign an intergovernmental Treaty on Stability, Coordination and Governance in the EMU comprising the so-called "Fiscal Compact". Under the Compact's terms, Member States were obliged to transfer a set of rules related to the correct application of SGP's medium term objectives into their national legislations (balanced budget rule, debt brake). Additionally, the Treaty institutionalised the meetings of the Euro area heads of state or government, namely the Euro Summit. In 2013 the framework of Economic Governance was further complemented by a couple of new regulations: the Two-Pack. The latter enhanced the consistency of economic policy coordination by introducing the assessment of national draft budgetary plans by the

Commission and by rendering surveillance more stringent for Members that threaten the financial stability of the Eurozone or request financial assistance.

The conclusion of the reform of the Economic Governance in 2013 did not prevent the emergence of new plans for the further enhancement of economic coordination. Even before the adoption of the Two-Pack, the Commission had issued in November 2012 a “Blueprint for a Deep and Genuine EMU” indicating additional integrative steps towards greater intervention from the EU level in the national budgetary process and the establishment of a central EMU budget for stabilisation (European Commission, 2012a). A few days later, the presidents of the European Council, the European Commission, the Eurogroup and the ECB issued a report titled “Towards a Genuine Economic and Monetary Union” with similar suggestions (Van Rompuy, 2012). Building on the above documents, a June 2015 report of the presidents of the European Commission, the European Parliament, the European Council, the ECB and the Eurogroup entitled “Completing Europe’s Economic and Monetary Union” envisaged a Fiscal Union with a common macroeconomic stabilisation function and called for the immediate creation of an advisory European Fiscal Board as well as a Euro Area System of Competitiveness Authorities (Juncker et al., 2015). In May 2017, the Commission issued a reflection paper on the future of the EMU exploring different options for the establishment of the common macroeconomic stabilisation function (European Commission, 2017a). In December 2017, a Commission Communication provided more details on the content of the planned new budgetary instruments (European Commission, 2017b). A separate Communication discussed the role and potential functions of a “European Minister of Economy and Finance” (European Commission, 2017c). While the creation of a European Minister did not proceed, in June 2019 the Heads of State or Government of the Euro Area agreed on the establishment of a Budgetary Instrument for Convergence and Competitiveness (Euro Summit, 2019). In May 2020, the issue of the financing of the instrument was pending.

2.2 The Literature on the Post-Crisis European Economic Governance Reform

The explanations of the post-crisis reform of the European Economic Governance can be classified into three broad categories according to their theoretical foundations: a) explanations based on Political Economy approaches, b) explanations relying on European Integration Theory, and c) explanations building on New Institutionalism. I examine the explanations of each category in turn and present their theoretical underpinnings.

2.2.1 Explanations Based on Political Economy Approaches

Actor-Centred Constructivism

Matthijs and McNamara (2015), Matthijs (2016) and Matthijs and Blyth (2018) have put forward explanations of the EEG reform based on actor-centred constructivism. The approach, advanced by Mark Blyth (2002) and Nicolas Jabko (2006), emphasises the strategic use of ideas. Actor-centred constructivism, also referred to as “strategic constructivism”, combines the logic of consequentialism and the logic of appropriateness recognising that actors are purposeful but remain embedded in ideational structures (Matthijs, 2016: 378). Ideas become weapons and can be used as instruments to (re)shape institutions (Saurugger, 2013: 156-160). In this sense, ideas are considered to be a power resource (Blyth, 2002: 17-44).

In general, actor-centred constructivists argue that the adoption of the EEG reform is the result of the (re)consolidation of the German ordoliberal ideas within the EMU.¹ They begin their analyses by exploring the ordoliberal underpinning of the EMU manifested in the original SGP’s fiscal rules. They stress that the 2005 reform of the Pact and the weakening of the Excessive Deficit Procedure marked the retreat of the ordoliberal ideas within the Eurozone. The German elections of September 2009 are seen as a watershed moment denoting the German government’s shift to a more stringent position regarding the SGP rules. At this point, actor-centred constructivists explain how the entrepreneurial use of meanings by the German government enhanced its position in the negotiations. By framing the crisis as a crisis of fiscal profligacy and weak competitiveness, Germany legitimised social divisions within the Eurozone (northern saints as opposed to southern sinners) and eliminated alternative solutions, such as the Eurobonds (Matthijs and McNamara, 2015). The country’s insistence on the issue of “moral hazard” inevitably channeled the debate towards the national-level “austerity and reform” solution (see also Blyth, 2013a). Eventually, the return of the original ordoliberal ideas regarding fiscal policy led to the tightening of fiscal measures in the form of the Six-Pack, the Two-Pack and the Fiscal Compact.

Hegemonic Stability

Bulmer and Paterson (2013; 2019) and Bulmer (2014) have advanced an explanation of the EEG reform based on the Hegemonic Stability Theory (HST). The latter was introduced by Charles Kindleberger (1973) and became further developed by International Relations scholars seeking to explain the stability of international regimes (Keohane, 1980). The theory combines

realist and neo-liberal institutionalist elements: states are seen as rational actors pursuing their national interests but are in need of international regimes that provide collective goods. The basic idea behind the HST is that the stability of the world economy or indeed that of international regimes rests on one state functioning as the stabiliser (Kindleberger, 1981: 247).

Bulmer and Paterson argue that the post-crisis reform of the EEG is the result of Germany's hegemonic role within the EU that helped it to influence the shape of the policy response to the Eurozone crisis. The authors examine Germany's material resources and note that its strong economic position at the outbreak of the crisis enabled the country to provide public goods (in the form of credit) to other member states. France's relative economic decline during the same period was conducive to this development. Then the authors turn to the non-tangible aspect of hegemony: the ideas, norms and institutions that provide intellectual and moral leadership legitimising the hegemon in the eyes of the others (see Keohane, 1984). They detect the dominance of a particular set of beliefs that were fervently advocated by Germany: ordoliberal "sound money" ideas. In this context, the Six-Pack, the Two-Pack and the Fiscal Compact are seen as examples of the ordoliberal priorities of Germany (Bulmer and Paterson, 2019: 185).²

Neo-Gramscianism

A number of Neo-Gramscian theorists and other scholars concerned with Neo-Gramscian concepts have undertaken the analysis of the post-crisis reform of the European Economic Governance (Oberndorfer, 2014; Ryner, 2015; Bieling, Jäger and Ryner, 2016; Jessop, 2014b; Bulmer and Joseph, 2016). Being part of the Marxist theoretical tradition, Neo-Gramscianism is concerned with the class dimension of public policymaking. Stephen Gill (1998) and Bastiaan van Apeldoorn (2000; 2002) provided the theoretical groundwork for the application of the neo-Gramscianist perspective in the field of European integration. Inspired by the work of (and named after) Antonio Gramsci, the theory is particularly focused on the concept of hegemony, namely the institutionalisation of ideas and practices used by the ruling class to preserve the consensual subordination of the other classes. In contrast to the traditional Marxist approaches, neo-Gramscianism is not limited to the structuralist analysis of social relations of production within the capitalist economies but engages in the examination of political agency.

In general terms, Neo-Gramscians argue that post-crisis EEG institutionalisation is a crisis management method for the salvation of the neo-liberal post-Fordist, or finance-led, accumulation strategy and the support of EMU's particular ordoliberal hegemonic project.

Initially, neo-Gramscians concentrate on the post-Fordist neoliberal regime of capital accumulation and stress that it was much more prone to crises than its predecessor as the expansion of the American financial capital exacerbated over-accumulation (Ryner, 2015). The subordination of European to American capital did not make the Eurozone any safer than the U.S.A. and as a result the financial crisis of 2007 was transmitted to the EU. Neo-Gramscians explain that the crisis of the European financial capitalism was so deep that it re-opened the debate on the adoption of alternative accumulation strategies within the EU, as is evidenced by the creation of economic stimulus packages (Bieling, Jäger and Ryner, 2016: 63). However, the prospect of the reestablishment of an interventionist statist strategy was quickly dismissed, as a stricter mode of regulation was introduced. Neo-Gramscians then turn to the role of hegemonic leadership in this choice: they identify a transnational hegemonic bloc of social forces aiming at the protection of the interests of the dominant groups through the promotion of a hegemonic project.

In view of the above, the reform of the European Economic Governance is seen as a mechanism for the imposition of austerity and structural reforms as overarching features of the amended European mode of regulation.³ Indeed, the EEG reform reinforces German ordoliberalism, a version of neoliberalism, which is employed as an ideational framework that hinders the ascendance of rival hegemonic projects and enhances the hegemonic bloc. The institutional barriers are equally important as they set real constraints on national democratic systems justifying the characterisation of the reform as “authoritarian constitutionalism” (Oberndorfer, 2014).⁴ Some scholars are more skeptical about the success of the ordoliberal project within the EMU after the crisis as they detect the presence of various competing hegemonic projects (Bulmer and Joseph, 2016). For them, the UK’s non-participation in the TSCG (Fiscal Compact) is a manifestation of how domestic politics and adherence to alternative hegemonic projects can challenge a dominant project.

Open Marxism

Hugo Radice (2014) provides a different, yet equally critical, perspective being unconcerned about hegemony. Radice draws on the contributions of Open Marxists as he focuses on the intensification of labour’s exploitation and the management of the working class’ growing demand for redistribution, which is seen as a fundamental contradiction of capitalism (see Burnham, 1994; Bonefeld, 2005). For Open Marxists the EMU is a disciplinary mechanism of the working class using the depoliticisation of fiscal and monetary policies in order to force

labour to bear the burden of adjustment for capital's permanent crisis of productive accumulation (Bonefeld, 1998; 2001). Radice argues that the post-crisis EEG institutionalisation constitutes a mechanism of depoliticisation seeking to legitimise a major transfer of income and wealth from labour to capital. The substance of this depoliticisation is the removal of blame for the crisis from European finance to the working classes of the Eurozone member states, the promotion of austerity policies, as well as the prioritisation of creditor rights over working peoples' living standards. The particular instrument employed in the context of this process is the TSCG's structural deficit, which is ultimately enforced by the Court of Justice of the European Union. Hence, Radice reaches a similar conclusion with Neo-Gramscians: the reform's overarching purpose is to eliminate the threat of a return to Keynesian macroeconomic management.

Left Intergovernmentalism

Costas Lapavitsas (2019) advances a critical understanding of the EEG reform that can be described as left intergovernmentalist (Ryner, 2019: 122-129). Being inspired by the work of Arrighi (2010: 28-31), Lapavitsas seeks to transpose Gramsci's concept of hegemony from intra-state relations to inter-state relations. This theoretical input notwithstanding, the bulk of Lapavitsas' analysis remains within the confines of classical Marxism as it focuses on the structural features of the European economy.

Lapavitsas argues that the EEG reform is a mechanism for the preservation of German hegemony within the Eurozone. The author begins his analysis by exploring the development of capital accumulation within the Eurozone member states since the launch of the EMU (Lapavitsas, 2019: 40-49). He detects the creation of significant competitiveness gaps between the member states leading to the ascendancy of the German economy at the expense of the economies of the southern member states.⁵ The author notes that Germany's improved position is due to the relatively more effective suppression of labour by the capitalist class of the country. The economic weaknesses of the southern member states in combination with the economic strength of Germany established a core-periphery hierarchy within the EMU. Lapavitsas stresses that Germany's hegemony is conditional as it relies on the existence of the Maastricht institutional framework of the EMU (2019: 49-59). This framework guarantees Germany's competitive advantage: with the single monetary policy in the hands of the inflation-averse ECB and the national fiscal policies constrained by the provisions of the Stability and Growth Pact, the only remaining mechanism of adjustment left to the member

states is wage policy. In this context, the reform of the European Economic Governance is conceived as a tightening of the fiscal policy arrangements so that the Maastricht institutional framework could survive the Eurozone debt crisis (Lapavitsas, 2019: 70-79).

Asymmetrical Interdependence

Charlotte Rommerskirchen (2019) has promoted an explanation of the EEG reform that builds on Keohane and Nye's (1989) notion of asymmetrical interdependence but uses insights on collective action failure (Olson, 1965). Rommerskirchen's work is firmly embedded in rational choice theory following the logic of consequentiality (Rommerskirchen, 2019: 36). Actors are considered to be self-interested agents, but individual rationality is not conducive to collective rationality. Collective action failure is expected due to the existence of a latent group of actors with no incentives to act to achieve the collective good. In other words, the self-interested rationality of some actors leads them to free ride. The reform is linked to the realisation of the twin aspect of free riding within the Eurozone in the aftermath of the financial crisis. Apart from stability free riding, member states were also faced with the prospect of growth free riding. The EEG reform is perceived as a way to enhance the incentives of the member states to promote growth initiatives and avoid procyclical policies. These incentives, however, are considered to be weak and rather irrelevant as the only incentives that count are those which are externally imposed by the financial markets (market discipline).

2.2.2 Explanations Based on European Integration Theories

Neo-functionalism

Arne Niemann and Demosthenes Ioannou (2015) offer a neo-functionalist theorisation of the post-crisis reform of European Economic Governance. Neo-functionalism is considered as one of the overarching theories of EU studies and for many years has been treated as synonymous to integration theory (Rosamond, 2000). The theory was primarily developed by Ernst Haas and Leon Lindberg in the 1950s and 1960s and since then has been revised by many scholars including its founders (Haas, 1958 [2004]). Neo-functionalism is a pluralist theory, perceiving politics as a group-based activity (Bache et al., 2015: 10; Rosamond, 2000: 55). Actors are driven by rational self-motivation but are capable of learning and can shift their expectations

to different levels of government (Niemann and Schmitter, 2009: 47-49). The theory links political integration to economic integration.

Niemann and Ioannou argue that the post-crisis EEG institutionalisation is the outcome of functional pressures emanating from EMU's incomplete institutional structure. The two authors use the neo-functional concept of "spillover" to explain how those functional pressures emerged and how they triggered a pluralistic political process of aggregated pressure to national governments forcing them to change the institutional structure of the EMU. Initially the two authors trace increased functional interdependencies between fiscal and monetary policies within the EMU due to their different levels of integration (functional spillover). They underline that the crisis aggravated the functional pressures as there were no available crisis management tools, while alternatives to further integration were thought to entail great risks and costs, which made them unattractive. Also, they stress the salience of EMU's stability as the overarching objective in EU politics. The authors then move on to explore political pressures linked to political spillover. They suggest that in the context of the Six-Pack, BusinessEurope, an interest group, took the role of the policy entrepreneur arguing in favour of certain policy options, such as stricter automatic sanctions. Additional political pressures originated from financial markets that in the eyes of EU policymakers appeared as unitary actors urging them to increase their level of ambition in relation to institutional reform. The third stage of their analysis focuses on supranational institutions (cultivated spillover). Indeed, the European Parliament opposed the watering down of the legislation and defended the supranational dimension of the Six-Pack. Also, the ECB endorsed the deepening of EMU from the very beginning and was instrumental in advocating this position in the context of its interaction with fiscal authorities.

Liberal Intergovernmentalism

Frank Schimmelfennig (2015a) adopts a liberal intergovernmentalist approach to the reform of European Economic Governance. The theory of Liberal Intergovernmentalism was introduced by Andrew Moravcsik and is now considered to be the baseline theory of EU studies (Moravcsik, 1993; 1998). The approach is based on the realist notions of state actorness and state rationality but combines them with a pluralistic conception of domestic politics (Moravcsik and Schimmelfennig, 2009: 68-69; Moravcsik, 1993: 483-485). The theory links European integration with member states' attempt to manage increased economic interdependence.

Schimmelfennig argues that the post-crisis EEG reform is in line with the shared goal of the survival of the euro via the increase of Eurozone credibility but stresses that the new framework's institutional design has been deeply shaped by German national preferences due to the asymmetrical interdependence of member states within the EU. Following Andrew Moravcsik, he advances a three-stage analytical process focusing on national preferences, relative bargaining power and credible commitments. Beginning with the analysis of economic interdependence, Schimmelfennig notes that a breakdown of the euro would bring costs to both indebted countries and fiscally strong states leading to the convergence of state preferences towards the survival of the euro. However, state preferences diverged on the distribution of the burdens of adjustment with the fiscal position of each state determining its position. Solvent northern countries favoured national adjustment, while heavily indebted countries of the South preferred mutualised adjustment. Indeed, Germany and its other northern allies advocated the strengthening of the Stability and Growth Pact, the withdrawal of voting rights and the inclusion of automatic sanctions for high deficit countries, while France and its other southern allies called for soft adjustment policies and opposed harsh sanctions for all those in breach of deficit rules. Subsequently, Schimmelfennig turns to the analysis of state bargaining. He notes that state interdependence was asymmetrical enabling solvent states to shape the terms of integration in line with their preferences.⁶ This was particularly true for Germany, the bloc's largest economy and Eurozone's most creditworthy state, which was able to link financial assistance to the strengthening of monitoring and sanctioning of national budgets and the signing of the Fiscal Compact. The final stage of Schimmelfennig's analysis is institutional choice. He stresses that new and reformed institutions were required in order to enhance the credibility of member states' commitments to Eurozone stability. The EEG reform is seen as a remedy of the enforcement problems of the SGP. Solvent states sought to increase the credibility of the indebted states' commitment to fiscal discipline by strengthening non-majoritarian supranational institutions, such as the European Commission and the Court of Justice of the EU.

New Intergovernmentalism

Uwe Puetter (2016) provides a new intergovernmentalist explanation of the reform of European Economic Governance. The author together with Christopher Bickerton and Dermot Hodson conceived the theory of New Intergovernmentalism (Bickerton, Hodson and Puetter, 2015a; 2015b). New Intergovernmentalism is an elitist approach focusing on national governing elites

and their interaction with their domestic constituencies. The theory links European integration with the transformation in the domestic politics within member states as a result of the developments in the European political economy.

Puetter endorses the new intergovernmentalist premise of a fundamental transformation of the European political economy in the post-Maastricht era leading to the convergence in the preferences of governing elites regarding the necessity of neoliberal economic policies (Bickerton, Hodson and Puetter, 2015: 707-709). Also, he accepts that the above development brought major disturbance in the preference formation process at the national level resulting in the strengthening of the commitment of the national executives to European policymaking in the face of increasing public contestation.⁷

Puetter argues that the EEG reform can be explained as an intensification of policy coordination between member states via deliberation. He finds that consensus-seeking and deliberation remain the guiding norms of economic governance given the centrality of the European Council, the ECOFIN, the Eurogroup and the Economic and Financial Committee in the decision-making process during the euro crisis negotiations. Puetter underlines that the above bodies are all consensus-oriented. Additionally, he stresses that the delegation of sovereignty to supranational institutions remained limited: the Six-Pack replicated the pre-existing decentralised institutional architecture of the Stability and Growth Pact framework but increased its ambition. The Commission did not acquire significant authority over the sanctioning of member states and the central governance mechanisms in the context of the newly established framework are the intergovernmental bodies, such as the Eurogroup. In this way, the “integration paradox”, a central tenet of New Intergovernmentalism, is confirmed: member states are willing to promote more integration but resist any attempt to promote supranationalism. The Fiscal Compact, an unorthodox governance mechanism established outside the Treaty framework, can also be seen in these terms.

2.2.3 Explanations Based on New Institutional Approaches

Rational Choice Institutionalism

Michelle Chang (2013) provides an explanation for the economic governance reform package based on the principal – agent approach of Rational Choice Institutionalism (RCI).⁸ The theory has its roots in neo-classical economics endorsing the perception of humans as utility-

maximizers, who act according to fixed preferences (Aspinwall and Schneider, 2000: 10-11). Strategic behaviour is a key element of the approach: actors can adapt their strategies in response to the activity and assumed strategies of other actors. As a new institutionalist variant, though, RCI places greater emphasis on the role of institutions and how they constrain the behaviour of actors by directing them to specific strategic calculations (Hall and Taylor, 1996: 945; Peters, 1999: 44; Bache et al., 2015: 26-28).⁹ Delegation of authority from member states to supranational institutions is explained in functional terms: institutions lower the transaction costs of policymaking by enhancing the credibility of the states' commitments and increasing the information available to them (Pollack, 2009: 131-132; 2003: 20-21).

Chang accepts that the member states' desire to increase the credibility of their commitments and the function of the EMU in the aftermath of the Greek crisis of 2010 led them to delegate authority to the Commission. She argues, however, that the member states quickly identified the risk of agency loss and skillfully employed control mechanisms during the institutionalisation process to restrict the authority of the European institutions. Drawing on the principal-agent framework she conceives the Van Rompuy Task Force as a "police patrol" control mechanism enabling member states to acquire information on the development of the Commission's Six-Pack proposals.¹⁰ Chang notes that the Task Force had limited success as it made few substantial changes to the Commission proposals, while the European Parliament bargained hard on a number of issues. For this, a second control mechanism was established: the Treaty on Stability, Coordination and Governance. The Treaty was complementary to the Six-Pack but bypassed the EU institutions during the institutionalisation phase as it was intergovernmental in nature. The Treaty remained outside the existing EU framework and was concluded among 25 parties (the UK and Czech Republic abstained). Chang underlines that these control mechanisms diminished the credibility and the efficiency of delegation in the case of the EEG reform, but this was a cost that member states chose to bear in order to prevent agency loss.

Francisco Torres (2013) also advances a rational-choice explanation of the post-crisis EEG reform. He argues that the strategic collaboration of the European Central Bank with the European Parliament shaped crucial aspects of the new legislation, most notably the provisions on the Reverse Qualified Majority Voting. Torres underlines that the Maastricht institutional design left the EMU with an incomplete structure. As the Eurozone crisis unfolded the ECB's perception of threat regarding its independence grew. In parallel, the Bank developed a sense of mission as the "guardian of the EMU". In reality, the Bank started to treat the sustainability

of the EMU as a distinct objective. In this context, the ECB became purposefully involved in other policy domains, notably fiscal policy, and pushed for a leap forward in the economic governance architecture, a goal shared by the European Parliament.

Historical Institutionalism

Salines, Glöckler and Truchlewski (2012), Yiangou, O’Keefe and Glöckler (2013), Schimmelfennig (2014) and Verdun (2015) have advanced explanations of the post-crisis EEG reform based on different versions of Historical Institutionalism (HI). The approach constitutes a distinct, influential but not entirely coherent body of thought with some of its proponents having a rather rationalist point of departure, while others choosing to distance themselves from rationalist reasoning (Aspinwall and Schneider, 2001: 12; Hall and Taylor, 1996: 957; Rosamond, 2000: 118-119). A basic common concept is that of “path dependence” (Bulmer, 2009: 308), which can be described as the idea “that the policy choices made when an institution is being formed, or when a policy is initiated, will have a continuing and largely determinate influence over the policy far into the future” (Peters, 1999: 63). While path dependence denotes HI’s attention to incrementalism, moments of more radical change are also included in HI analysis through concepts such as “punctuated equilibrium”, “critical junctures” or “unintended consequences” (Bulmer, 2009).

Salines, Glöckler and Truchlewski (2012) argue that despite EMU’s existential crisis, the institutional change of economic governance is incremental and path dependent: fiscal policy remains a national competence under stronger rule-based coordination. The authors are drawing on Streeck and Thelen’s historical institutionalist typology (2005).¹¹ They begin their analysis by depicting Maastricht’s fiscal framework: fiscal policies would remain under the control of national governments but would be subject to rules-based coordination on the EU level. The Stability and Growth Pact further specified the relevant procedures. The authors note that the financial crisis revealed the accumulation of major fiscal and macroeconomic imbalances exposing the existence of gaps in the institutional design. Subsequently, they turn to the analysis of the reforms. They identify elements of “redirection” (or conversion) in the Six-Pack legislative package as the new arrangement brings changes to the focus and enforcement tools of the SGP, while it leaves SGP’s basic features unaltered. For instance, the surveillance gradually places more emphasis on public debt and sustainability, while financial sanctions apply earlier in the process. Also, they find elements of “layering”: the structure of macroeconomic surveillance resembles the preventive-corrective arms of the SGP, while the

Excessive Imbalance Procedure (EIP) of the new framework can be seen as a copy of the Excessive Deficit Procedure. As a result, the authors are convinced that no fundamental shift is taking place within EMU leading towards a more centralised model. While Salines, Glöckler and Truchlewski admit that incremental processes can also bring transformative change, they insist that the EEG reform is no such case: it can be better described as reproduction by adaptation rather than gradual transformation.

A similar approach is advanced by Amy Verdun (2015), who also draws on Streeck and Thelen's theoretical framework, arguing in favour of a path-dependent explanation of gradual change stressing that only limited sovereignty over fiscal policy was transferred to EU institutions. Verdun, however, clearly identifies the sovereign debt crisis as a critical juncture, which is not incompatible, in her view, with more gradual transitions (2015: 222). Like Salines, Glöckler and Truchlewski, she detects layering in the case of the Six-Pack and the Two-Pack but finds the existing typology insufficient for the analysis of the Fiscal Compact. For this, she moves on to propose the type of "copying", in which institutions are established by "borrowing in some way from earlier institutions", as the most appropriate analytical means (2015: 232).

In contrast, Yiangou, O'Keefe and Glöckler (2013) reject the incremental explanation. They argue that the post-crisis reform of European Economic Governance is path-dependent, determined by a particular initial choice: ECB's monetary financing prohibition. Following Paul Pierson's version of the approach (2000; 2004), they draw their attention to the original EMU institutional framework and its gaps. Initially, Yiangou, O'Keefe and Glöckler analyse the initial design of the EMU stressing the centrality of the price stability principle that led to the legal prohibition of the monetisation of deficits and the obligation by the member states to internalise fiscal policy failures ("own house in order" principle). Then, the authors move on to explain the emergence of gaps between EMU's original design and EMU's real function by identifying a number of unanticipated consequences, such as the ineffectiveness of market discipline and the increased contagion of fiscal problems via the banks-sovereigns channel. Subsequently they evaluate the possible alternatives to fill the gaps. A Eurozone break up would involve significant reputational sunk costs as well as major economic injury. A second alternative, the relaxation of the ECB's interpretation of monetary financing prohibition faced formidable institutional barriers (amendment of EU primary law) and the resistance of supranational actors (the ECB). They conclude that the reform of the EEG geared towards the enhancement of policy credibility was the only remaining option for the governments.

Frank Schimmelfennig (2014) follows a similar line of argument also based on Pierson's approach. In this contribution and in contrast to his later work already reviewed, Schimmelfennig sees the Euro crisis as a "heavily discounted or unintended effect" (2014: 328). However, apart from the familiar historical institutionalist concepts of sunk costs, institutional barriers and social adaptations, he introduces the game-theoretic schema of "chicken game" in order to account for opposing state interests. In this way, fiscal integration demanded by Germany is understood as a quid pro quo for the provision of financial assistance to countries in need. Yet, German bargaining power is shown to be under severe institutional constraints leading Germany to accept a rather opaque fiscal governance framework in return for Eurozone's preservation, namely a path-dependent preference.

Discursive Institutionalism

Crespy and Schmidt (2014), Schmidt (2014) and Warren, Holden and Howell (2017) have advanced discursive institutionalist explanations of the post-crisis reform of the Eurozone's fiscal and macroeconomic governance. Discursive Institutionalism (DI) was introduced by Vivien Schmidt (2006a; 2006b; 2008; 2010) with the aim to encapsulate both ideas *and* discourse in the analysis of institutionalisation (see also Schmidt and Radaelli, 2004). The theory has clear affinities to constructivism. Discourse refers to the "interactive process of conveying ideas" (Schmidt, 2008: 303), while the institutionalist element of the approach is provided by the institutional context within which ideas are communicated. The substantive content of ideas remains important but much more emphasis is placed onto interactive processes. DI's explicit engagement with the latter denotes a greater role for agency in contrast to the other new institutionalist approaches. Indeed, the "foreground discursive abilities" of agents are considered to be key factors for the change (or maintenance) of institutions.

Crespy and Schmidt (2014) and Schmidt (2014) argue that the post-crisis reform of the European Economic Governance is the result of the dominance of the German Chancellor's ordoliberal discourse, which demanded the strengthening of Eurozone's fiscal framework as a necessary counterweight to financial solidarity. The authors examine the substantive content of the EU leaders' ideas about the crisis and observe significant divergence: the German leader adhered to the ordoliberal culture of stability favouring austerity, while the French leaders were inspired by the French tradition of a "dirigiste" state intervening in the economy endorsing Keynesian fiscal stimulus. In view of this divergence, the authors note that ideas alone are unable to account for EEG institutionalisation and, therefore, turn to the discursive interactions

of the EU leaders. Firstly, they focus on the coordinative discourse (discourse among EU policy actors) and find that the leaders hesitated to provide adequate solutions due to their opposing ideas and their national considerations. The EU's heavy reliance on intergovernmental decision-making within the Council restricted coordination even further. Subsequently, they examine the communicative discourse between the EU leaders and the public and trace considerable shifts. Chancellor Merkel's abrupt change of discourse from "anti-Greek, anti-action" to "save the Euro" in May 2010 was very difficult to legitimise. In contrast, President Sarkozy's embracing of austerity developed more gradually and involved the invocation of "gouvernance économique", a notion compatible with the traditional French aspiration of Eurozone convergence. Hence, the strengthening of the Stability and Growth Pact and its sanctioning mechanisms is seen as an effort to enhance the credibility of Merkel's government vis-à-vis the German public in a way compatible with the French public's sensitivities.

Warren, Holden and Howell (2017) are also employing Discursive Institutionalism but their analysis focuses exclusively on the Commission. They argue that the reform is the result of the Commission's strategic action to frame the crisis around fiscal discipline. They link Keynesian ideas with a supranational solution based on centralised fiscal capacity and neoliberal ideas with the enhancement of fiscal discipline in the context of the existing SGP (intergovernmental model). Their examination of the Commission's coordinative and communicative discourses reveals that the Commission framed the crisis as a problem resulting from fiscal profligacy and promoted solutions that were restricted to intergovernmental fiscal discipline on the basis of a limited reform of the SGP. They justify their counterintuitive argument by pointing to the increased political pressures that the Commission faced in that period.

2.3 Discussion

The above explanations of the reform of European Economic Governance have different strengths and weaknesses that are linked to their theoretical foundations. Contributions based on political economy approaches pay particular attention to the issue of power. While they rely on different theoretical foundations and follow varying analytical paths, they explain the legislative developments by referring to power asymmetries among the policy actors after the financial crisis. Apart from the Open Marxist explanation advanced by Radice and the rationalist account of Rommerskirchen, the rest of the political economy contributions highlight the role of Germany in shaping the form of the new policy arrangements. In this

context, “hegemony” is a key concept for many (but not all) scholars. Germany’s leadership is understood either as part of the German government’s role as the regional hegemonic stabiliser (Bulmer and Paterson, 2013; 2019; Bulmer, 2014), or as a hierarchical relationship between economies within the EMU (Lapavitsas, 2019), or even as an expression of an ordoliberal hegemonic project (Ryner, 2015; Bulmer and Joseph, 2016; Oberndorfer, 2014). A number of contributors have explored a distinct dimension of power related to ideas. Explanations employing actor-centred constructivism consider ideas as the source of power imbalances as they perceive ideas as power resources. In contrast, for the neo-Gramscian and Hegemonic Stability explanations ideas are the means to preserve power asymmetries.

Undoubtedly, the contributions based on political economy approaches offer valuable insights on the pressures that power imbalances, hegemonic leadership and ideational domination can put on the policymaking process. Indeed, most of the political economy approaches shift the analytical focus to broader social contexts, such as the system of interstate relations (Hegemonic Stability Theory, Left Intergovernmentalism, Asymmetrical Interdependence) or the regional structure of social power relations (Neo-Gramscianism, Open Marxism and, up to an extent, Left Intergovernmentalism). By situating the political sphere at a higher level than that of the EU politics, a certain degree of economic determinism is inevitable (Cafruny and Ryner, 2009: 237-238; Saurugger, 2014: 180-182). This theoretical orientation, though, has serious repercussions for the explanatory capacity of the respective political economy contributions as it conveys a certain degree of reductionism vis-à-vis the particularities of the institutional setting.¹² For example, they seem to overlook that the European Commission is the sole actor that can initiate legislation within the EU, while the European Parliament has the authority to co-decide on legal acts. By linking the adoption of the EU legislation to other phenomena beyond the sphere of EU politics, such as the development of capitalist accumulation and the material resources of national governments the above contributions downplay the role of the EU institutions in policy change. Related to this is the failure to provide detailed accounts about the phasing of the reform process (three stages instead of one) and the adoption of policy arrangements that resemble the statist interventionist structures of Keynesianism (European Semester, assessment of draft budgetary plans). In contrast, the political economy contributions choose to concentrate on the Fiscal Compact, a policy arrangement that appears to adhere to the German ordoliberal logic and fits better to power-based explanations.

The contributions based on Actor-Centred Constructivism present a different weakness. Their focus on ideational structures is not broad enough as the theory leads them to pay disproportionate attention to *specific* actors and their domestic cultural frames. Indeed, the relevant scholars concentrate on the German ordoliberal ideas and the country's stability culture. While the analysis of the domestic ideational structures of Germany sheds light upon aspects of the country's decision-making regarding the post-crisis EMU reform it cannot adequately explain the adherence of the other governments to the (German) ordoliberal cultural frames. This is a thorny issue given that some of the authors employing actor-centred constructivism acknowledge the existence of powerful alternative narratives in the aftermath of the financial crisis. For instance, Matthias Matthijs notes that “[t]he dominant narrative of the crisis had been driven by the United States (US) government and the IMF, which both emphasised the need to spur demand as a response to the crisis” (2016: 382). A similar point is made by Matthijs and Blyth (2018: 120). Also, these contributions overlook the embeddedness of other governments in rival longstanding cultural frames, such as the interventionist tradition of dirigisme and “embedded liberalism” in France (Howarth, 2007; Howarth and Schild, 2017). Therefore, the actor-centred constructivist explanations end up being equally reductionist vis-à-vis the EMU's institutional environment.

The explanations based on European Integration Theories engage with the analysis of the institutional environment of the EU thereby covering the gap left by the political economy contributions. For instance, the neofunctionalist explanation of Niemann and Ioannou (2015) stresses how the European Parliament and the ECB defended the adoption of certain policy measures and offered guidance to national governments, while Schimmelfennig's (2015a) liberal intergovernmentalist contribution points to the intense bargaining of governments in the context of the Council discussions enabling the linkage of distinct issues and the conclusion of package deals. Also, Puetter's (2016) new intergovernmentalist explanation underlines the existence of particular norms in the EMU's institutional environment that combined with the function of certain bodies, such as the Eurogroup, shaped the legislative outcomes. In parallel, it should be recalled that every integration theory has a political economy dimension: neofunctionalism concentrates on the economic linkages between policy sectors giving rise to functional pressures, liberal intergovernmentalism is interested in the management of the increased economic interdependence urging domestic groups to ask for more European cooperation and new intergovernmentalism considers the political economy of the post-Maastricht era as the reason for the ideational convergence of national elites. As a result, the

contributions employing integration theories attempt to advance sophisticated explanations combining the analysis of the developments in the political economy of the EU with the analysis of the institutional environment.

The explanations employing European Integration Theories present a different limitation from the explanations drawing on political economy approaches. As they rely on the so-called “grand theories”, they attempt to integrate the analysis of the post-crisis reform of the European Economic Governance into the explanation of the general course of the European integration over the years. This means that the contributions follow the Integration Theories in identifying particular drivers, such as functional pressures, economic interdependence or ideational convergence of leading elites, behind the triggering of the legislative reform process. The analyses include the detection of specific phenomena such as the neofunctional spillover, the liberal intergovernmentalist national preference formation or the new intergovernmentalist limited delegation to supranational institutions. While the integration theories offer important insights on the factors and interactions that shape European integration over the long term, they are unable to account for every distinct policy initiative. The reason for this is that certain policy fields present idiosyncratic features that need to be taken into consideration. Also, it is necessary to take on board the particularities of the historical juncture.

The explanations drawing on European Integrations Theories appear to be biased towards the generic integrative paths promoted by the theoretical frameworks, while they overlook the distinctive features of the EMU and the historical occasion. For example, Niemann and Ioannou (2015) build their argument about the triggering of political spillover on the existence of gradual learning processes. However, the period between the eruption of the sovereign debt crisis in early 2010 and the end of March 2010, when the EU leaders decided to promote the strengthening of fiscal coordination, is very short for the development of *gradual* learning (Euro Summit, 2010). The spillover and the shift of loyalties take time to develop. Similarly, Schimmelfennig (2015a) assumes the formation of national preferences reflecting the economic interests of domestic groups (mainly businesses). This assumption underestimates the level of uncertainty over monetary and fiscal policies especially in the aftermath of the financial crisis, when many member states had to deal with skyrocketing fiscal deficits. In this context, it was practically impossible for domestic groups to estimate their preferred policy mix. Also, Schimmelfennig overplays the issue linkage between the provision of financial assistance and the decisions on the EMU’s fiscal framework. Given that the direction of fiscal policy affects every other domestic policy and in many cases determines the political fate of

governments, the countries' stance on the structure of the European Economic Governance cannot be relegated to a byproduct of the primary negotiation on the provision of financial assistance. Another example is Puetter's (2016) insistence on the lack of delegation to supranational institutions that completely ignores developments such as the introduction of Reverse Qualified Majority Voting in the Council and the Commission's new authority to assess and approve national budgetary plans (see Chapter 7). As a result, the above contributions present important limitations as they highlight factors that fit the macroscopic lenses of grand theories.

The explanations employing New Institutional approaches proceed to a thorough examination of the institutional setting of the EMU and, therefore, end up providing detailed accounts of the legislative developments. A basic common underlying assumption of New Institutionalism is that "institutions matter" affecting the behaviour of actors (Bulmer, 1993: 355). At the same time, the various versions of New Institutionalism present significant differences regarding the way through which the institutional environment shapes the decisions of policymakers.

Rational Choice Institutionalism perceives institutions as constraints to rational, self-interested actors. The rationalist explanations of Chang (2013) and Torres (2013) provide important insights on the formal aspects of the institutionalisation process. In particular, they explore the creation of the Van Rompuy Task Force, the emergence of the Treaty on Stability, Coordination and Governance and the strategic activity of the ECB to explain the complexity of the legislative process. While the authors manage to highlight the constraining aspects of the formal institutional structure to the activity of the member states, they adopt the functional reasoning behind the delegation of authority from the national governments to the European institutions in line with the Rational Choice Institutional approach. Indeed, the RCI accepts that actors form their preferences outside the institutional setting (Rosamond, 2000: 116; Hall and Taylor, 1996). Delegation is seen as a rational and deliberate choice by the member states to increase the credibility of their commitments in relation to the EMU. However, it is doubtful that the selected governance structures of the reformed EEG were functionally superior to other policy arrangements. At this point, it should be recalled that other major economies retained Keynesian policy regimes to support their economies. Therefore, the functional logic of delegation constitutes a major weakness of the rationalist explanations.

Historical Institutionalism advances a more sophisticated view of the institutional effects on actors by focusing on the non-deliberate aspect of the institutional constraints. The reviewed historical institutionalist explanations accept that the initial institutional design of the EMU was a rational and intentional decision by the national governments. However, they point to the constraining effects of the original decisions *over time*. Salines, Glöckler and Truchlewski (2012) and Verdun (2015) underline the existence of gaps in the original institutional framework creating negative feedback that instigates incremental reform (see Streeck and Thelen, 2005: 1-19; Pollack, 2009: 128). From their part, Yiangou, O’Keefe and Glöckler (2013) and Schimmelfennig (2014) move one step further focusing on the unintended consequences of the original institutional framework and the sunk costs and policy lock-ins severely constraining the available options to national governments (see, Pierson, 2000; Pollack, 2009: 127). These contributions overcome the problems of the rather simplistic functional logic by pointing to the inconsistencies of the institutional framework that were revealed in the aftermath of the crisis. For example, they note the emergence of macroeconomic imbalances, the failure of market discipline and the weaknesses of peer pressure. The explanation of Yiangou et al. even engages with the policy alternatives (Eurozone breakup, monetary financing) and reveals their incompatibility with the institutional structure of the EMU.

In spite of the valuable insights that they provide on the long-term constraints of the formal institutional environment, the historical institutionalist explanations offer an unconvincing account of institutional change. The contributions promoting an incremental account of policy change (Salines et al., Verdun) overlook the fact that the agreed arrangements differ significantly from the pre-existing framework. For instance, the Macroeconomic Imbalance Procedure is a substantially stricter procedure than the voluntary Broad Economic Policy Guidelines, while the evaluation of national budgetary plans by the Commission signifies an unprecedented intrusion into national-level policymaking in contrast to the national responsibility for fiscal policies. On the other hand, the contributions insisting on more radical change (Yiangou et al., Schimmelfennig) overemphasise the rigidity of the institutional framework and the restriction of the alternatives. The fact that one of the supposedly incompatible options, namely the monetary financing, became institutionalised in 2015 proves that the framework is less rigid than the authors claim (ECB, 2015). Indeed, governments have many ways to apply pressure on European institutions, including through the appointment of personnel and via the application of political pressure in Council meetings.

What is more important, however, is that the above historical institutionalist explanations disregard those aspects related to the interaction of actors *within* the particular social environment.¹³ In other words, actor preferences are treated as given and are not constituted through social action. In turn, this does not allow for the inclusion of non-material sources of actor preferences, such as ideas, beliefs, and identities, into the analysis of institutional change. This is so because these elements are products of the social environment and any analysis of them is essentially an analysis of the social environment. But without taking into consideration such social constructs, too many important factors are left outside the equation (Risse et al., 1999). Thus, it is no matter of chance that the reviewed historical institutionalist contributions of the EEG reform are exclusively interested in formal institutions, such as Treaty provisions, fiscal policy rules, legal regulations and official decisions of EU bodies, and remain unconcerned about the rich social activity within this environment.

Discursive Institutionalism examines the constitution of actors via ideas and discourse. The discursive institutionalist explanations attempt to explore the endogenous dimension of actor preferences thereby overcoming the weaknesses of the historical institutionalist and the rationalist explanations. Crespy and Schmidt (2014), Schmidt (2014) and Warren, Holden and Howell (2017) have revealed the existence of particular frames, such as the ordoliberal frame of stability or the fiscal profligacy frame, which justified the enhancement of fiscal discipline and budgetary austerity through the reform of the structures of European Economic Governance. These contributions offer useful insights on the discursive interactions of significant policy actors, such as the leaders of Germany and France or the European Commission and the ways through which these actors tried to build the legitimacy of their proposed solutions. The authors even engage with the policy alternatives, like the Eurobonds, and explain how their fate was linked to the failure of their underlying frames (Keynesianism). However, the discursive institutionalist explanations provide an incomplete account of the reform of European Economic Governance. While they try to uncover the social construction of actor preferences within the institutional setting and show some engagement with the content of ideas, their primary concern is the actors' discursive interactions. Indeed, the contributions pay particular attention to the communicative discourse of the German Chancellor, the French President and the Commission. Yet, the approach's over-reliance on "sentient actors" and their abilities risks offering an explanation of change that is highly individualistic as it emphasises agency and downplays structure (see Panizza and Miorelli, 2013). The structural dimension, though, is very important because the Eurozone relies on a set of economic policy ideas that

shape its governance structure and the direction of its policies (McNamara, 1998; Dyson, 2000). Ignoring this dimension reveals an important limitation of the discursive institutionalist explanations given the highly complex institutional environment of the Eurozone.¹⁴

The analysis of the above literature shows that a cultural explanation of the reform of the European Economic Governance is missing. Political economy contributions do not offer detailed accounts over the policy arrangements as they tend to focus on broader social contexts and the power dimensions of the reform, thereby, overlooking the institutional aspects. Explanations based on European Integration Theories take into account the institutional dimension but give disproportionate weight to historical integration drivers and, therefore, appear to neglect the idiosyncratic features of the Eurozone. The rationalist and historical institutionalist contributions avoid the macroscopic examination of the legislative developments but are limited to a conception of institutions as constraints due to their preoccupation with actor rationality. The examination of the social construction of actor interests and identities can shed light upon unknown aspects of the legislative reform contributing to a better explanation. Yet, the constructivist contributions employing Discursive Institutionalism and Actor-Centred Constructivism present a major weakness: they are overly attentive to the ideational frames and discursive interactions of individual actors. As a result, they fail to take into consideration the embeddedness of policy actors in the cultural framework of the Eurozone. Indeed, as Kenneth Dyson accurately notes, “the Euro-Zone is also crucial in producing constitutive effects on the way in which power and interest are understood and debated. It is a process of sharing ideas” (Dyson, 2000: 8). According to this view, it is necessary to acknowledge that the Eurozone is a distinct social environment that has developed some shared economic policy ideas shaping the formation of actor identities and their definition of interests. In other words, a turn to structure rather than agency is required to uncover the social constitution of preferences. In this context, an alternative account needs to be based on the theoretical framework of Sociological Institutionalism. Such an account places particular emphasis on the content of the dominant ideas within the Eurozone and takes on board its institutional complexity. Therefore, a sociological institutionalist explanation is needed to illuminate the endogenous dimension of the reform of the European Economic Governance in a more complete way.

¹ A relevant examination of the strategic use of ordoliberal ideas within Germany is provided by Howarth and Rommerskirchen (2013).

² Despite Germany's success in the promotion of ordoliberal reforms, Bulmer and Paterson stress that its hegemony is reluctant and contested as ordoliberal ideas are not universally accepted, while German domestic politics create significant constraints on German policymaking (2013; 2019). Bulmer (2014) proceeded to a deeper exploration of these limitations.

³ Ryner (2015) used the metaphor of an ordoliberal "iron-cage".

⁴ For Oberndorfer (2014) the tightening of the rules of the Stability and Growth Pact with the establishment of more stringent sanctions, the intervention of the European executive in the setting of national wage policies and the questionable legal basis of the legislation are clear manifestations of the authoritarian direction of the reform.

⁵ Lapavistas and colleagues (2010) were the first that raised this issue. A number of diverse scholars followed (Dooley, 2019: 64-65).

⁶ Schimmelfennig notes that due to the diminishing creditworthiness of their sovereign bonds, the indebted states faced harsher "immediate consequences" than the solvent states (2015: 185, emphasis in the original). This fact affected preference intensity for agreement, thereby reducing the bargaining power of deficit countries.

⁷ In previous work Puetter had argued that the EU policy setting offered an attractive resource of political authority to national governing elites seeking to discipline domestic constituencies (Bickerton, Hodson and Puetter, 2015b: 24).

⁸ Writing in 2013, Chang is concerned with the Six-Pack and the TSCG. The Two-pack, which complements Eurozone's fiscal reform, has been adopted later that year.

⁹ For the proponents of RCI, both EU member states and EU institutions constitute rational actors.

¹⁰ Police patrols refer to the active, direct and continuous surveillance of the agent's behaviour by the principal (Pollack, 2003: 42-43).

¹¹ Streeck and Thelen (2005: 19-30) identify five modes of transformative change: displacement, layering, drift, conversion and exhaustion.

¹² Bulmer and Joseph (2016) show awareness for the reductionist implications of neo-Gramscianism and identify multiple contested hegemonic projects. However, by locating the source of contestation at the domestic level they seem to downplay the interaction at the EU level as a source of contesting dynamics. This leads them to overestimate the role of German politics in a complex institutionalisation process comprising a variety of states and EU institutions.

¹³ Some versions of Historical Institutionalism tend to focus on actor intentionality, which brings them close to rational choice theory, while others oppose the exogenous articulation of preferences, which drives them away from the rationalist camp (Aspinwal and Schneider, 2000: 5; Rosamond, 2000: 113-119). The theoretical frameworks of the reviewed contributions, though, belong to the rationalist side of Historical Institutionalism (Pollack, 2009: 127-128).

¹⁴ For example, significant institutional mechanisms, such as the Eurogroup, are sidelined without good reason.

CHAPTER 3

THE SOCIOLOGICAL INSTITUTIONALIST APPROACH

Introduction

The previous chapter revealed a significant lacuna in the literature on European Economic Governance. It indicated the lack of an endogenous meso-level explanation of institutional change. The turn to meso-level analysis is linked to a wave of scholars, who demanded that the institutions should be “brought in” the study of politics (see for example March and Olsen, 1984, 1989; Evans, Rueschemeyer and Skocpol, 1985). The so-called “new institutionalism” constituted a backlash against behaviouralism, which dominated political science in the 1960s and 1970s and placed emphasis on aggregated societal behaviour. New institutionalists argued that institutions had an autonomous role in politics and that they could be treated as political actors. Simon Bulmer (1993) introduced new institutionalism in EU studies by highlighting its usefulness in analysing the governance of the European Union as opposed to explaining integration, which largely employed analytical tools from International Relations. Thus, a new meso analytical level was established in EU studies with new institutionalism at its centre. The different versions of new institutionalism (Hall and Taylor, 1996) seek to explain particular developments within EU policies without linking them to the long-term course of European integration.

This chapter presents the theoretical framework and the analytical approach of the thesis. It will be argued that the sociological version of new institutionalism, namely Sociological Institutionalism, is the appropriate theoretical basis for the explanation of European Economic Governance. In line with the endogenous orientation of Sociological Institutionalism, the research identifies “Sound Money” as EMU’s system of meaning. The analysis of the reform of the legislative framework is then organised in four subsequent steps: the challenge to the system of meaning (due to policy failure), the adaptation of the system of meaning, the shaping of formal negotiations and, finally, the organisational adaptation. The chapter is divided in five parts. In the first part the chapter presents the metatheoretical premises of the theory. The thesis follows Social Constructivism in combining a positivist epistemology with an intersubjective ontology. In the second part the chapter proceeds to the description of Sociological

Institutionalism. This includes the origins of the theory, the definition of Institutions, the effect of institutions on individual action and the process of organisational change with reference to particular mechanisms. Part three summarises previous applications of the theory in EMU and part four delineates the added value of the theory's application to the explanation of European Economic Governance. Here, specific reference is made to the endogenous dimension of the theory. In the final part the chapter presents the application of the theory to the case of EEG by setting and operationalising the analytical model.

3.1 Metatheory: Ontological and Epistemological Premises

Before the delineation of the theoretical approach of the thesis, a reference needs to be made to the ontological and epistemological premises of my project. This is because researchers' philosophical positions on the nature of social reality and the knowledge that somebody can gain about it have determinant effects on their research designs (see Furlong and Marsh, 2010: 184-193; Hay, 2002: 61-65). Indeed, researchers formulate particular research questions, select analytical strategies and employ research methods according to their philosophical positions, even if they do not acknowledge them.

Traditionally the literature of social and political science distinguished between two main camps: positivism and interpretivism. Simplifying considerably, the positivist position is that the world exists independently of the researcher's knowledge of it and that direct observation is possible. The purpose of research is to establish causal relationships between social phenomena. The interpretivist (or post-positivist) position is that reality is socially constructed and that observation of social phenomena is not independent of our interpretations of them. The purpose of research then is to juxtapose an interpretation of social phenomena with (dominant) others. The possibility of combining the positions of these two schools of thought has been met with scepticism (Furlong and Marsh, 2010: 205). More recently, however, some theorists have challenged this approach and explored the interplay between the positions (see, for example, Sil and Katzenstein, 2010). This was facilitated by the emergence of a variety of versions within each camp. Within the subfield of EU studies, the respective concerns about classification give rise to a tendency to present the distinct approaches as ideal types on a continuum with positivism and interpretivism as its extremes (Bache et al., 2015: 63-66; Parker, 2016).

During the 1980s and 1990s International Relations scholars started engaging in a discussion about the emergence of another meta-theoretical camp. The approach of my research to ontology and epistemology is following an important body of literature, which acknowledges the existence of a distinct meta-theoretical framework called social constructivism¹. The latter establishes a “middle ground” (Adler, 1997) or “via media” (Wendt, 1999: 47) between the positivist (or rationalist, in EU studies terminology) and interpretivist (or reflectivist) poles. The new metatheoretical framework was quickly endorsed by some prominent scholars of EU studies (Christiansen, Jørgensen and Wiener, 1999).² In what follows, I present the “modernist” variation of social constructivism, which I endorse, acknowledging that there are more “post-modern” versions oriented closer to interpretivism (see Parsons, 2010: 89-90; Adler, 1997: 334).

Social constructivism combines a positivist epistemology with an intersubjective ontology (Wendt, 1999: 90-91; Christiansen, Jørgensen and Wiener, 1999: 534).³ In particular, social constructivists acknowledge the existence of material reality but underline that this reality is largely shaped by human agents, who do not exist independently from their social environment and the systems of meaning within it (Risse, 2009: 145; Adler, 1997). In other words, they underline a clear difference between natural reality and *social* reality. Social ontologies, then, include norms, rules, intersubjective meanings, institutions, epistemic communities, routinised practices, discourse, deliberative processes, communicative actions (Christiansen, Jørgensen and Wiener, 1999). All these elements of the social environment structure and “socially constitute” the activity of people. They define people’s identities within their respective communities and provide them with direction. As Craig Parsons notes, “the natural world is meaningless and indeterminate for human beings until we begin to socially construct some shared meanings about it” (2010: 87).

Considering epistemology, constructivists share with positivists an epistemological commitment to truth-seeking (Risse and Wiener, 1999). As Emanuel Adler eloquently puts it, “[a] constructivist ‘mediative’ epistemology (...) is interested neither in emancipation per se, nor exclusively in uncovering the power structures that affect the marginalised in history, but in providing better explanations of social reality” (1997: 333-334). Objective knowledge is attainable through carefully designed projects, which reduce interpretive bias and reach acceptable claims. The distance between the observer and the observed social phenomena is retained. In Craig Parsons’ words, “how much the world is socially constructed is something we can document” (2010: 91). However, given their radically different ontological position

(related to the primacy of cultural elements), social constructivists appear to develop research designs, which are different from positivist projects in epistemological terms as well (Moravcsik, 1999). This is not true. As Wendt notes, “[w]e simply can’t study ideas in exactly the same way that we study physical facts because ideas are not the kinds of phenomena that are even indirectly observable” (Wendt, 1998: 107). The confusion is probably due to the use of interpretation.

In social constructivism interpretation becomes “an intrinsic part of a scientific enterprise that seeks to explain the social construction of reality” (Adler, 1997: 328). For social constructivists, the purpose of interpretative analysis is not just to provide an accurate description of social reality in order to improve our understanding, as positivists claim (see King, Keohane and Verba, 1994). Analyses of the social constitution of reality do more than that. As it is stressed by Alexander Wendt, “[c]onstitutive theories provide *explanations*” (1998: 108, emphasis in the original). Even if these explanations are based on constitutive effects rather than causal inference, they retain their explanatory power as they uncover relationships between social actors (Wendt, 1998: 108-115). In these cases, research designs seek to answer “how” or “what” questions about the properties of things (Parsons, 2010: 86). The inclusion of the “*process of social construction* by which people arrive at their ideas, norms or identities” (Parsons, 2010: 87, emphasis in the original) enhances the explanatory capacity of constitutive theories and orients projects to ask “why” questions. In this way, social constructivist designs can compete with positivist projects on the basis of concrete hypotheses (on the significance of competitive alternatives for constructivism, see Parsons, 2015).

As a result, in line with the aforementioned ontological and epistemological premises, my project employs the theory of Sociological Institutionalism, which is the “constructivist-inspired version of institutionalist research” (Risse, 2009: 158; also see Parsons, 2010: 82-83).

3.2 Sociological institutionalism

3.2.1 Origins of Sociological Institutionalism

The origins of the framework can be traced in the works of prominent sociologists (Scott, 2008: 11-16; Peters, 2005: 109-111). Émile Durkheim's (1894 [1982]) preoccupation with symbolic systems and how they become crystallized as 'social facts' (perceived as external and objective by the individuals) marked the beginning of the analysis of social institutions. From a very different (materialist) point of departure, Karl Marx had already acknowledged the importance of social belief systems and ideologies: those superstructures were developed by the dominant capitalist class to prevent the working class from realising its interests (Marx and Engels, 1974). In response to Marxism, Max Weber (1947 [2012]; 1978) focused on how cultural rules define social structures and shape social behaviour highlighting the significance of meaning for social action. Weber was the first that established a direct link between cultural values and formal organisations. Talcott Parsons (1951) further explored the relationship between culture and institutions emphasising normative constraints to action. Viewing institutions as systems of norms, Parsons perceived institutional integration as a process of internalising (cultural) value-orientations (see also Parsons and Smelser, 1956). Parsons' insistence on norms was challenged by one of his students, the ethnomethodologist Harold Garfinkel (1967), who turned to routines, practical reason and processes beneath the level of consciousness to analyse the taken-for-granted element of cognition. Departing from a phenomenological starting point, Peter Berger and Thomas Luckmann (1967) have also challenged the normative approach of Parsons. The two theorists conceptualised institutions as cognitive structures and emphasised the creation of shared knowledge and belief systems through social interaction. Their work on the creation of meaning had profound impact on sociological institutionalists.

The theory of Sociological Institutionalism was advanced by Paul DiMaggio and Walter Powell, who saw value in the insights provided by organisational theory in sociology during the 1970s and 1980s and took over the task to depict the sociological branch of new institutionalism by bringing together related works of various scholars in a seminal edited volume (Powell and DiMaggio, 1991). Some years before John Meyer and Brian Rowan (1977) had explored the myths of the organisational environment as sources of formal structure. Lynne Zucker (1977) followed by elaborating on the issue of institutionalisation. In 1983, Paul DiMaggio and Walter Powell turned to the interaction of organisations incorporating an attention to agency. Richard Scott and John Meyer (1983) provided their own account of the

same issue. According to DiMaggio and Powell, these four texts constitute the initial formulations of Sociological Institutionalism.

The application of the framework has been promoted by the Stanford School and its main proponents, namely Richard Scott and John Meyer (Rowan, 2010; Buhari-Gulmez, 2010). This triggered a wider use of the approach within multiple national, local and international contexts and in diverse policy fields, such as health care (Payne and Leiter, 2013; Miller and Banaszak-Holl, 2005), education (Frank and Meyer, 2007), professional training (Scott and Meyer, 1994) and economics (Dequech, 2003). A constructivist turn of European studies at the end of the 1990s, which followed a similar move in the study of international relations (Christiansen, Jørgensen and Wiener, 1999), brought SI to the attention of the field (see, for example, Checkel, 1999) as sociological institutionalism is closely affiliated with social constructivism (Rosamond, 2000: 119). Scholars of European integration interested in the function and the evolution of the Eurozone, such as Kenneth Dyson (2000), Martin Marcussen (1999) and Kathleen McNamara (1998; 2002) promptly endorsed sociological institutionalism and applied the approach in their analyses. SI has been employed in other areas of EU policy, such as competition (From, 2002) or enlargement (Schimmelfennig, 2001; 2003), but also in the analysis of EU negotiations in general (Lewis, 2010 and, up to an extent, Tallberg, 2010) and the Europeanisation of national policies (Börzel and Risse, 2003; Radaelli, 2000; Zahariadis, 2005).

3.2.2 Definition of Institutions in Sociological Institutionalism

Compared to the advocates of the other versions of new institutionalism, sociological institutionalists develop a distinctive conception of institutions as they identify them with culture. The reason for this is that SI proponents see formal institutional structures to be embedded in particular social environments and affected by them (Meyer and Rowan, 1991; Scott and Meyer, 1991). Peter Hall and Rosemary Taylor accurately note that “sociological institutionalists tend to define institutions much more *broadly* than political scientists do to include, not just formal rules, procedures or norms, but the symbol systems, cognitive scripts, and moral templates that provide the ‘frames of meaning’ guiding human action” (1996: 947, my emphasis). Thus, it is important to stress that SI differentiates between the informal institutional environment and the formal institutions functioning within this environment (Peters, 2005: 116-117). As this differentiation might create confusion over what the term “institution” means in sociological institutionalist accounts it is, therefore, more appropriate to

use the term “organisations” to describe formal institutions within SI. A potentially useful definition would be the one provided by Greenwood and colleagues according to which an institution is a “more-or-less taken-for-granted repetitive social behaviour that is underpinned by normative systems and cognitive understandings that give meaning to social exchange and thus enable self-reproducing social order” (Greenwood et al, 2008: 4-5).

3.2.3 Cognitive and Normative Dimensions

The approach follows the “cognitive turn” in social theory and places great emphasis on the cognitive dimensions of institutions (DiMaggio and Powell, 1991a: 22; Saurugger, 2013). Its theoretical underpinnings can be traced in the work of Peter Berger and Thomas Luckmann (1967) that conceptualised institutions as cognitive structures (Phillips and Malhotra, 2008: 706-707). Cognitive elements refer to “the shared conceptions that constitute the nature of social reality and the frames through which meaning is made” (Scott, 2008: 57) and are considered to be the components of culture (Aspinwall and Schneider, 2000: 8). SI focuses on cognitive scripts, schemas, routines, typifications, classifications, models “that are indispensable for action, not least because without them the world and the behaviour of others cannot be interpreted” (Hall and Taylor, 1996: 948). This turn to cognition reflects the need to take into account the actors’ subjective interpretations of events and conditions when explaining their actions. This kind of analysis concentrates on pre-conscious processes and taken-for-granted understandings (DiMaggio and Powell, 1991; Scott, 2008: 61) moving away from rational-actor models and purposeful action. In Paul DiMaggio’s and Walter Powell’s words, “the neoinstitutionalist rejection of intentionality is founded on an alternative theory of individual action, which stresses the unreflective, routine, taken-for-granted nature of most human behavior” (1991: 14). Thus, by theorising action in a distinct way, SI adherents direct their research to the socially mediated construction of frameworks of meaning.

Earlier work in sociological analysis has indicated that there is also a normative dimension to institutions (Hall and Taylor, 1996: 948). Some scholars classify it as a distinct version of institutionalism, namely normative institutionalism (see, for example Peters, 2005: 25-45), while others integrate the two dimensions in a common framework but consider them separate pillars (see Scott, 2008).⁴ James March and Johan Olsen (1989) are thought to be the main advocates of the normative approach to institutions. The two influential theorists concentrate on *roles* that contain particular norms of behaviour prescribing specific goals and legitimate means to actors. These normative expectations are internalised by the actors as they become

socialized in particular institutional roles. The basis of actor compliance is social obligation. As March and Olsen note, “[a]ction stems from a conception of necessity, rather than preference” (1989: 161). The two theorists introduced the “logic of appropriateness” as a concept that describes the process through which organisations delimit the range of acceptable solutions available to actors: institutional norms determine the nature of the situation, the role of each actor and their relevant obligations. According to this logic, individuals try to conform to the organisation’s norms rather than fulfil egoistic desires.

Comparing the two dimensions, Peter Hall and Rosemary Taylor stress that in the case of the cognitive dimension the impact on actor behaviour is much more profound and elaborate since institutions do not simply determine “what one should do” but are also “specifying what one can imagine oneself doing in a given context” (1996: 948). Richard Scott agrees that the cognitive dimension is the “deepest” as it focuses on preconscious understandings (2008: 61). While some theorists argue that the two dimensions are incompatible and cannot form part of the same analytical framework (Phillips and Malhotra, 2008), this research project sides with the view of B. Guy Peters (2005: 113), who contends that both dimensions are essential for a complete sociological institutionalist explanation of organisational behaviour. However, it should be clear from the above that the normative dimension is subordinate and complementary to the cognitive as SI’s concentration on the latter constitutes the most distinguishing feature of this variant of new institutionalism (Scott, 2008: 16). Indeed, Paul DiMaggio and Walter Powell are very explicit about this: the sociological approach represents a shift “from a normative to a cognitive approach to action” (1991: 19).

3.2.4 Institutions and Individual Action

The cognitive turn in social theory marks some significant developments in the way in which institutions appear to influence individual action. Institutions in SI have a deep, structural and lasting impact on the activity of agents. In DiMaggio and Powell’s inimitable phrase, “[i]nstitutions do not just constrain options: they establish the very criteria by which people discover their preferences” (1991: 11). Similarly, Richard Scott observes – in relation to preferences – that “[f]rom the cultural-cognitive perspective, interests are not assumed to be ‘natural’ or outside the scope of investigation: they are not treated as exogenous to the theoretical framework, they are recognised as varying by institutional context and requiring explanation” (2008: 66). This means that in SI there is a shift from an exogenous to an endogenous account of preference formation. In the words of Ben Rosamond, “[f]or

sociological institutionalists, interests and identities are *endogenous* to (emanate from within) the processes of interaction that institutions represent” (2000: 119, emphasis in the original).

At this point it should be underlined that SI proponents insist that individuals (as much as organisations) are embedded in particular social structures (DiMaggio and Powell, 1991: 10). In this sense, individuals are primarily *social* agents and every reference to their preferences is inextricably linked to the analysis of the social structure in which they are embedded (Risse, 2009: 148). As a result, sociological institutionalists accept that actor preferences are socially constituted. Still, SI proponents do not deny that actors are rational and purposeful. They stress, though, that agents act according to what they perceive to be their rational interest. As Peter Hall and Rosemary Taylor eloquently put it, “what an individual will see as ‘rational action’ is itself socially constituted” (1996: 949). This stance towards rationality is based on Berger and Luckmann’s (1967) view that reality is socially constructed and not objectively given (Rosamond, 2000: 119). By so doing, sociological institutionalists associate preferences with the subjective aspects of social life.

As was mentioned above, SI promotes a cognitive view of institutions. In reality, sociological institutionalists treat institutions as synonymous with culture (Hall and Taylor, 1996: 947-948; Aspinwall and Schneider, 2000: 9). It is then understood that since preferences are socially constructed, institutions give meaning to actors by constituting their basic preferences and even their identity (Rosamond, 2000: 119; Hall and Taylor, 1996: 948; Checkel, 1999: 547; DiMaggio and Powell, 1991: 28). In the words of Ronald Jepperson, “actors and their interests are highly institutional in their origins and operation” (1991: 158). In the same vein, Richard Scott underlines that “[i]nstitutional frameworks define the ends and shape the means by which interests are determined and pursued” (1987: 508). Thus, individuals depend on “systems of meaning”, that is, institutions to understand social reality and identify their preferences (see Peters, 2005: 113). SI then promotes an alternative view of actor compliance to institutions based on shared understandings. Indeed, “[c]ompliance occurs because other types of behaviour are inconceivable” (Phillips and Malhotra, 2008: 710). Actors adjust their behaviour unconsciously based on taken-for-granted meanings. Thus, it is evident that institutions in SI emerge as “major independent variables” (Aspinwall and Schneider, 2000: 9; DiMaggio and Powell, 1991: 8).

3.2.5 Organisational Change in Sociological Institutionalism

Sociological institutionalists perceive the change of organisational form as the process of enhancing an organisation's social legitimacy (Hall and Taylor, 1996: 949). In Kathleen McNamara's words, "the choice of organizational form is linked to *social* processes that legitimate certain types of institutional [organisational] choices as superior to others" (McNamara, 2002: 59, my emphasis). Paul DiMaggio and Walter Powell also recognise the centrality of linking change with legitimation in SI (1991: 27). Richard Scott explains that the cognitive dimension of institutions sees legitimacy emanating "from conforming to a common definition of the situation, frame of reference, or a recognisable role, or structural template" (2008: 61). If the system of meaning does not allow any conceivable appropriate alternatives, then institutional arrangements are reproduced (DiMaggio and Powell, 1991: 10-11). In contrast, when "an existing set of beliefs, norms, and practices comes under attack, undergoes delegitimation, or falls into disuse, to be replaced by new rules, forms, and scripts, we have a study of institutional change" (Scott, 2008: 94). A more normative conceptualisation of legitimacy is related to the pursuit of collectively valued purposes, which conform to their broader cultural environment. Here a specific norm legitimates the means of organisational adaptation. This relates to March and Olsen's "logic of appropriateness" (1989). Still, it should be noted that the logic of appropriateness is sometimes employed as a more generic term encompassing both dimensions (for example, see Hall and Taylor, 1996). As a result, in either case organisational change is dissociated from the advancement of organisational efficiency.

From the previous sections it should be clear that in Sociological Institutionalism there is no *institutional* choice in the sense that is employed in other theoretical frameworks. Within SI institutions and actors that populate them are "mutually constituted" (Aspinwall and Schneider, 2000: 9; Rosamond, 2000: 119). Actors are not able to "choose" institutions, as their own preferences and identities are composed by institutions. At the same time, the fact that individuals constantly interact with institutions⁵ to interpret reality can stimulate institutional change as some institutions face difficulties with the interpretation of real events and become obsolete. So, what is the nature of institutionalisation in Sociological Institutionalism?

The sociological approach to institutionalisation points to a distinct unit of analysis. Indeed, SI contends that institutionalisation takes place at the societal, not the organisational level (DiMaggio and Powell, 1991: 14). Attention is turned to the social environment (which varies) rather than the (formal) organisation itself. Early sociological institutionalists introduced the

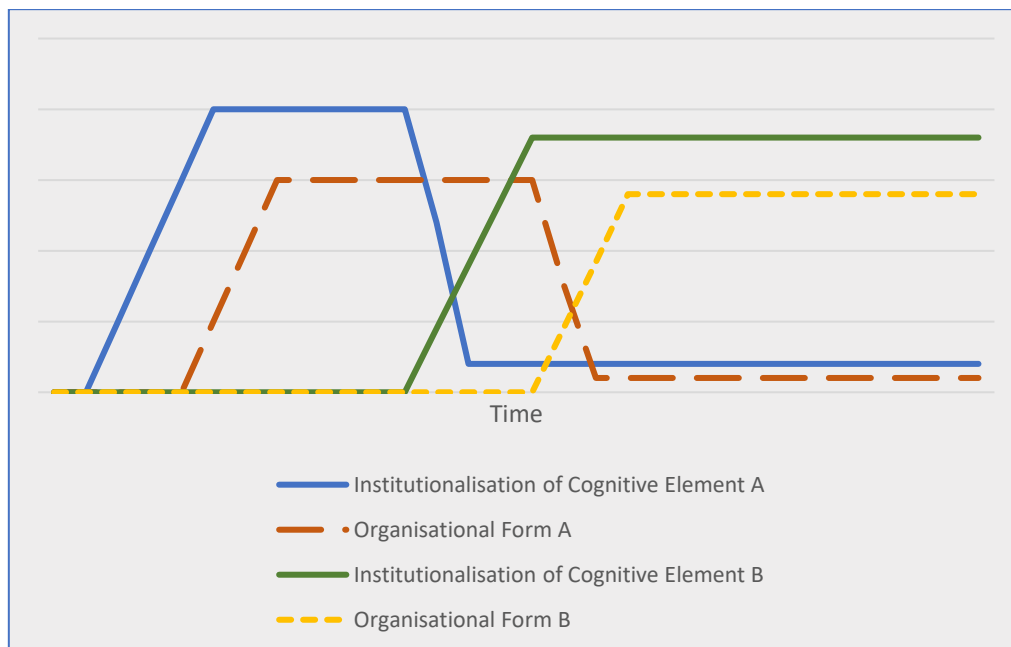
concept of *societal sector*, which was identified with interorganisational systems encompassing various organisations of the same “industry” (Scott and Meyer, 1991: 108-120).⁶ Others employed the term *organisational field* to include all the relevant interconnected actors (DiMaggio and Powell, 1991: 63-65).⁷ This initial analytical preoccupation with the macroanalytical level overshadowed the microlevel approach, which constituted a foundational aspect of SI (Zucker, 1991: 104-105).⁸ Thus, a number of sociological institutionalists signalled an analytical turn to the microfoundations of institutionalisation: the internal institutional processes within organisations (Tolbert and Zucker, 1996; Powell and Colyvas, 2008; Haunschild and Chandler, 2008: 628, Phillips and Malhotra, 2008: 703-705). Here, the social environment refers to groups of individuals within organisations (see also Zucker, 1987).

Institutionalisation in SI is analysed in the light of the cognitive view of institutions. According to Lynne Zucker, “[i]nstitutionalization is fundamentally a cognitive process” (Zucker, cited in DiMaggio and Powell, 1991: 15). Guy Peters summarises it as “the process of creating values and cognitive frames within an organization” (2005: 116). Institutionalisation brings changes to the social legitimacy of any given organisation and, therefore, it is key in revealing the reasons and the process of organisational change. In contrast to other theoretical approaches, institutionalisation in SI is a variable, not an end-state (Zucker, 1991: 83-86). Cognitive elements present different degrees of institutionalisation (Tolbert and Zucker, 1996). Most importantly, though, institutionalisation is perceived to be a continuous process (Zucker, 1991: 104). Schema 3.1 provides an optical illustration of the evolution of institutionalisation and its interaction with the variation of organisational form. Note that changes in the degree of institutionalisation (both in cases of growth or slump) always precede changes in the organisational structure.

Sociological institutionalists recognise the need to continuously reproduce institutions to define social reality (Meyer, 2008: 524). Particular institutionalised frames, scripts and schemas are only provisional elements and their effect on social legitimacy is reversible. Richard Scott accurately describes deinstitutionalisation as “the processes by which institutions weaken and disappear” (2008: 196). In this context, the cognitive approach points to the erosion of cultural beliefs and the questioning of what was once taken for granted. The normative dimension highlights the weakening of social norms and the defiance of obligatory expectations. Increased institutionalisation, however, does not necessarily correspond to extended monitoring and enforcement through the establishment of formal rules on the organisational level. Zucker indicates that “applying sanctions to institutionalised acts may have the effect of

deinstitutionalising them” (1991: 86). Indeed, the absence of sanctions implies a higher degree of institutionalisation. The reason for this is that a highly institutionalised cognitive element is so well embedded in the social reality that individuals would not even think of challenging it. In this case, sanctioning mechanisms are pointless. Surely, formal rules are necessary for the protection of any newly adopted knowledge structures from competing cognitive frameworks (Marcussen, 1999: 401-402). Yet, this indicates a medium or low degree of institutionalisation. Thus, from the above it is evident that for SI proponents, the most critical part of organisational change is the process of institutionalisation and not the stage of organisational adaptation. The analysis of *how* institutionalisation evolves also explains *why* organisational change occurs.

Schema 3.1: Evolution of Organisational Change in Sociological Institutionalism



3.2.6 Mechanisms of Institutionalisation

Sociological institutionalists have identified distinct mechanisms of institutionalisation, which shed light on the processes of creating and sustaining institutions. One such mechanism refers to the generalisation of the meanings of actions. Pamela Tolbert and Lynn Zucker (1996) formulated a three-stage model to describe the workings of this mechanism. At the first stage, called *habitualisation*, patterned behaviours are developed empirically in response to particular organisational problems (stimuli). In this way, innovative responses become formalised in the policies and procedures of organisations. These arrangements, though, are not permanent and are mostly linked with incumbents’ tenures. In reality, this stage constitutes the pre-institutionalisation phase as no formal theorising occurs.

The next stage, called *objectification*, entails the development of shared definitions or meanings for the habitualised behaviours. Through these meanings, habitualised action detaches from the specific context in which it was shaped and can be transferred to other settings. Crucially, in this stage major theorisation occurs.⁹ Some individuals within organisations acknowledge the existence of persistent organisational failure, create a definition of the wider organisational problem and specify the problematic organisational actors. Then they develop theories indicating the sources of failure and promote justifications for organisational arrangements (solutions), which are compatible with these theories. At this point, the use of evidence is employed as a way to convince other individuals for the success of the new organisational arrangement. Thus, a social consensus on the value of the new patterns and the content of the meanings underpinning those patterns emerges. Still, the consensus in this semi-institutionalisation phase is fragile and objectified behaviours can be challenged.

The final stage, called *sedimentation*, refers to the transformation of the objectified behaviours to taken-for-granted meanings. This is achieved through the diffusion of the shared meanings to a wider audience and their perpetuation for a prolonged period of time. This transmission of meanings to others, who are unaware of their origin, imbues them with the quality of ‘exteriority’: meanings are treated as ‘social givens’ possessing ‘a reality of their own’ (see also Berger and Luckmann: 1967). By the end of this phase, meanings become fully institutionalised.¹⁰

Institutionalisation processes are not limited to the creation of original institutions. According to sociological institutionalists, organisations can also borrow cultural elements from other organisational settings. These elements are institutionalised externally and their incorporation in the host organisation shapes its social legitimacy (Meyer and Rowan, 1991: 49-50). Given that organisational form is determined by the content of social legitimacy, it is evident that this sharing of cultural elements among organisations leads them to adopt similar organisational structures. The outcome of this type of institutionalisation process is labelled “isomorphism” and in the early days of Sociological Institutionalism its study preoccupied much of the work of SI proponents.¹¹ Paul DiMaggio and Walter Powell have identified three different mechanisms of institutionalisation via diffusion: mimesis, coercion and normative diffusion (DiMaggio and Powell, 1991b; Saurugger, 2013; Scott, 2014).

Mimesis is related to the imitation of other models in times of great ambiguity and environmental uncertainty. Organisations imitate other organisations, which are perceived as successful and influential.¹² The adoption of symbols, practices, classifications and other institutionalised elements of other organisations can be accomplished indirectly through the migration of professionals from one organisation to the other or more explicitly when organisations resort to consultation. It is expected that modelling will be more extensive in the cases of organisations facing great uncertainty over means and ends as well as organisations, which present ambiguous goals.

Normative diffusion occurs as a result of increasing professionalisation. As officials of different organisations share similar education and professional training, they tend to develop shared professional values regarding their occupation. Professionals, in turn, convey these values to their organisation as they adopt similar practices and favour particular structures. In this context, universities and professional networks are important vehicles for the establishment and promotion of norms. Thus, it is expected that organisations that are more reliant on the academic qualifications of their personnel, will be exposed to increasing normative pressures. In the same vein, organisations presenting high participation of officials in professional networks are expected to incorporate norms from other organisations.

Coercion refers to the dependence of organisations on other organisations and the society. Pressures for diffusion can take the form of regulatory requirements and financial incentives. Since organisations try to avoid sanctions and tend to be resource-dependent, they adopt practices and structures of other organisations or conform to the cultural expectations of the society. Here, political power to impose institutions is important. This interaction of cognitive elements with material interests might appear to be quite distant from the cultural-cognitive dimension of institutions promoted by Sociological Institutionalism (see, for example, Scott, 2008: 50-53). However, it should be understood that this institutionalisation mechanism attempts to integrate the rationalist and cognitive dimensions in a single process, which consists of two phases: in the first phase organisation A establishes certain cognitive institutions and in the second phase organisation B adopts those institutions (which are still cognitive) due to its dependence on organisation A. The rationalist dimension only comes in during the second phase.

3.3 Previous Application of Sociological Institutionalism to EMU

Kathleen McNamara (1998) provided a sociological institutionalist account of the advent of EMU based on “ideas”, which she defined as “shared causal beliefs” (1998: 4).¹³ In this seminal contribution, McNamara followed SI’s endogenous approach to preference formation by focusing on the role of evolving definitions of interest in relation to monetary policy and paid particular attention to the impact of appropriateness on institutional change (1998: 8). She used a template to explain the change of ideas as a three-part process of policy failure – policy paradigm innovation – policy emulation. Her argument was that the perception of failure of Keynesianism in the years after the first oil crisis in 1973 (problem definition), the existence of Monetarism as an alternative policy paradigm legitimising austerity reforms (provision of alternative solution) and Germany’s policy success in the same period based on a strong and stable currency (illustration of policy’s effectiveness) transformed European elites’ preferences over macroeconomic management and created a neoliberal policy consensus. This, in turn, enabled the creation of the EMS and later on the EMU. McNamara discerned two core beliefs lying behind this neoliberal consensus: the primacy of price stability in relation to every other economic policy goal and the incompatibility of high inflation with growth and employment indicating a non-interventionist role for the governments in the economy (1998: 62).

McNamara’s subsequent work on central bank independence (2002), although not confined to the study of the Eurozone, referred repeatedly to the example of the ECB. There McNamara tried to understand the choice of the particular organisational form (independence) based on the sociology of organisations. She argued that the broader social environment within which central banks were situated favoured neoliberal economic policymaking and the primacy of price stability. In that context, the bias of central bank independence against high inflation constituted “a very rational adaptation to a specific cultural environment which rewards certain organisational forms over others” (2002: 60). Functionalist needs and rationalist considerations were largely irrelevant. In contrast, McNamara identified the diffusion of this organisational form as a combination of coercive and normative isomorphic social processes. A clear indication of coercive isomorphism was the existence of the criterion of legal independence of national central banks as a prerequisite for participation in EMU. Normative isomorphic pressures were traced in the conceptual models used by professionalised networks of economists and communities of financiers and in the common training programmes of economic policymakers.

Martin Marcussen (1999) also employed Sociological Institutionalism in his attempt to understand why there was so little controversy in the creation of EMU. To do this, he turned to the study of shared knowledge structures or causal ideas asking why policy elites identified sound macroeconomic management with price stability, central bank independence and numerical benchmarks for the debt and deficit. Following SI, Marcussen paid particular attention to the evolution of elites' *taken-for-granted* understandings and formulated the 'ideational life cycle' as a three-step heuristic model to analyse their development over time.¹⁴ At the first step, institutionalised causal ideas had been destabilised by an external shock and the perception of policy failure. As a result, elites were in an 'ideational vacuum' as they proved unable to provide *legitimate* answers to increasingly difficult questions. At the second step, elites chose a particular set of ideas among various competing combinations as they tried to create *cognitive schemes* that provided coherence and stability to people's understandings of reality. The third step of the ideational life-cycle referred to the consolidation and protection of the newly formed ideational equilibrium through the establishment of formal rules, procedures and organisations.

Marcussen stressed that the first step had to be linked to empirical research and concluded that European elites' perception of threat to their knowledge structures in the 1970s had been well-documented.¹⁵ He noted that the second step was the most decisive and employed institutional isomorphism to explore ideational diffusion. Marcussen argued that a combination of coercive isomorphism (internalisation of the informal rules of the EMS) and, to a limited extent, normative isomorphism (spreading of sound money ideas through the epistemic community of central bankers) and mimetic isomorphism (reproduction of the successful German economic model) could explain the diffusion of sound money ideas. In this context, Marcussen identified the organisational set-up of the EMU as an attempt to safeguard the ideational equilibrium on sound money macroeconomic management by binding the next generation of elites to sound money ideas.

Kenneth Dyson (2000) sought to understand the operation of Eurozone during its first steps through the use of Sociological Institutionalism. In this way, he detected the existence of a particular set of economic policy beliefs with constitutive effects on the formation of interests and identities within the Eurozone, namely the sound money paradigm. According to Dyson, "[t]his paradigm structures, informs and *legitimizes* economic policy discourse in the Euro-Zone. It shapes who has power over policy, on whose terms the discourse about policy is conducted, and what is judged to be *appropriate* conduct in the Euro-Zone policy" (2000: 27,

my emphasis). Dyson paid particular attention to certain elements of the Eurozone's institutional structure: the powerful guarantees of the European Central Bank's independence, the quantitative definition of price stability, the existence of the Stability and Growth Pact to enforce discipline, the constraints on exchange-rate policy and the "implicit" model of policy coordination indicating an asymmetrical design. He convincingly argued that these provisions constituted the institutionalisation of specific economic policy beliefs. A core idea behind EMU's organisational form was the belief in the inherent value of price stability, which justified its prioritisation over other economic policy objectives, such as growth or unemployment. Another belief was the superiority of global financial markets to evaluate good policy and provide credibility on the basis of adequate information from independent central bankers. Fiscal discipline and fiscal consolidation were seen as significant factors that strengthened credibility with markets and investors. This paradigm remained unchanged even after a significant reform of Eurozone's fiscal governance in 2005, as Martin Heipertz and Amy Verdun underlined in a study of EMU's pre-crisis fiscal governance (2010: 172).

3.4 The Added Value of a Sociological Institutional Approach to the Reform of European Economic Governance

This thesis considers Sociological Institutionalism an appropriate framework for the analysis of the reform of European economic governance. Firstly, a sociological institutionalist approach to EEG turns to the underexplored field of culture. Rather than seeking to explain the passage of the new legislation by reference to exogenous preferences, it attempts to explore the organisational environment to trace cultural elements, which rendered the particular reform the only legitimate option for EU policymakers. In other words, SI offers a reading of organisational change based on endogenous preference formation. By incorporating the cognitive dimension, SI is able to explore in great depth the variation in attitudes and shed light upon the underlying causes of institutional developments. Conversely stated, "[n]ot paying attention to the embeddedness of actors in cognitive frames may obfuscate major aspects of policy-making" (Saurugger, 2013: 891). Taken-for-granted understandings and the preconscious level of action are important parts of decision-making as they define which options are conceivable by policymakers. Given that previous research (see previous section) has revealed the existence of strong cognitive elements within the structure of EMU, it is reasonable to explore whether a cognitive variation determined the course of events.

Secondly, a sociological institutionalist account of EEG enables a dynamic analysis of preferences. According to SI preferences are not exogenously given and therefore are not static. By acknowledging the evolutionary nature of preferences, SI provides a more elaborate account of rational action. Sociological institutionalists accept that actors are rational but stress that the perceptions of what constitutes rational action evolve and so do the “rational” preferences of actors. This evolution in the definition of interests takes place as the process of institutionalisation progresses (McNamara, 1998; Lewis, 2000). It is an important aspect of policymaking and needs to be included in the analysis. This evolutionary nature of preference formation is particularly relevant in the case of EEG as the reform was adopted within a period of almost four years in the context of increased interaction among EU decision-makers.

Thirdly, SI can provide an account for the inclusion of crisis in the explanation of organisational change. According to the founders of Sociological Institutionalism, “[f]undamental change occurs under conditions in which the social arrangements that have buttressed institutional regimes suddenly appear problematic” (DiMaggio and Powell, 1991a: 11). Indeed, SI anticipates the occurrence of major policy failure and acknowledges its far reaching implications for organisational structures through its effects on cognitive frameworks. For SI proponents the perception of crisis is a prerequisite for organisational change. Without policy failure cognitive structures remain stable and change does not occur. At this point, it is necessary to recall that SI dissociates organisational change from functional efficiency. Given that organisational structure is determined by social legitimacy rather than efficiency, SI expects the presence of dysfunctional organisational arrangements. In this way, SI is able to explain actors’ (apparently) irrational behaviour and the creation and persistence of very problematic organisational formations. By so doing, SI moves one step further from bounded rationality versions of new institutionalism, which presume a minimum level of rational activity in the past (before the emergence of gaps or agency loss). In the case of the EEG, the gravity of the financial crisis and its impact on major western economies and political systems justifies a deeper exploration of EU decision-making behaviour beyond rationalist assumptions of marginal errors. While sociological institutionalists acknowledge the existence of external events and material reality, what is more important for them is the social constitution of real events. In other words, what matters is the perception of failure within the organisational setting rather than real failure. The existence of deinstitutionalisation processes reveals *when* external events trigger organisational change. Thus, by defining policy failure as a particular crisis of

cognitive elements, they illuminate the underlying effects of policy failure to actor behaviour. The incorporation of the crisis' cultural effects adds further value to the explanation of EEG.

3.5 Application of Sociological Institutionalism to the Post-Crisis Reform of the European Economic Governance

3.5.1 The Analytical Model

The thesis introduces a five-step model to analyse organisational change in EMU drawing on the earlier works of McNamara and Marcussen (see section 3). Steps 1-3 are devoted to the analysis of cognitive change and steps 4-5 explore how cognitive change leads to organisational adaptation. The study of organisational change begins with the identification of the pre-existing cognitive framework (step 1). Empirical research of EMU's initial policy arrangements reveals the existence of highly institutionalised elements. In this way, the pre-existing social legitimacy becomes known. The next step is to detect the delegitimation of the cognitive framework (step 2). To do this, it is necessary to reveal any deinstitutionalisation of cognitive elements by detecting relevant mechanisms. This process is linked to the emergence of problems in the cognitive framework's ability to interpret reality and requires empirical investigation. At this point the level of threat to the pre-existing social legitimacy is uncovered. The following step is to trace the transformation of the cognitive framework (step 3). For this, it is required to identify new cognitive elements, which involves the empirical examination of institutionalisation mechanisms. At this stage, the changes in the social legitimacy become evident. Subsequently, the focus is on the effect of the adjusted social legitimacy on formal legislative negotiations (step 4). Empirical research reveals the existence of newly emerged cognitive elements within the negotiation proposals regarding particular policy arrangements. The final step is the examination of organisational adaptation (step 5). Here it is necessary to test empirically whether organisational developments are in line with the adjusted social legitimacy. This is achieved by analysing the social construction of the adopted organisational arrangements.

3.5.2 Operationalisation

This thesis asks how the Eurozone Member States agreed to strengthen the coordination of economic policies in EMU after the financial crisis of 2007-2009. The application of the

sociological institutionalist theoretical framework to European Economic Governance signifies an analytical turn to the social legitimacy of the EMU. Section 2 has already established the key role of social legitimacy for the explanation of organisational change within Sociological Institutionalism. Thus, the thesis puts forward the hypothesis that an adjustment in EMU's system of meaning legitimised the strengthening of European economic coordination as an organisationally superior form (see Table 3.2). Based on this hypothesis a number of sub-questions emerge: What was EMU's pre-crisis system of meaning? What was the effect of the financial crisis on the EMU's system of meaning? If it was modified, which were the processes, which led to its change? Which were the practical implications for the formal negotiations and the final organisational structure of EMU?

Table 3.2: Central Hypothesis and Sub-hypotheses of the Thesis

<i>Central Hypothesis:</i>	<i>An adjustment in EMU's system of meaning legitimised the strengthening of European economic coordination as an organisationally superior form.</i>
Sub-hypothesis 1:	A pre-existing cognitive framework within the EMU determined its organisational structure before the outbreak of the financial crisis.
Sub-hypothesis 2:	Some elements of the pre-existing cognitive framework (the Sound Money paradigm) became challenged due to the financial crisis.
Sub-hypothesis 3:	Certain cognitive elements (economic policy beliefs) were strengthened as a result of social processes within the EMU.
Sub-hypothesis 4:	The adjusted social legitimacy of the EMU rewarded policy arrangements that were in line with the new economic policy beliefs during the formal legislative negotiations.
Sub-hypothesis 5:	The Six-Pack, the Fiscal Compact and the Two-Pack conform to the adjusted Sound Money paradigm.

EMU's System of Meaning: Sound Money

In line with SI's emphasis on the cognitive dimension of institutions, a sociological institutionalist explanation of EEG focuses on the cognitive and cultural elements of the EMU. The first sub-hypothesis emanating from the theory is that there was a pre-existing cognitive framework within the EMU, which determined its organisational structure before the outbreak of the financial crisis. Revealing EMU's underlying cognitive framework is a major first task for a study of organisational change, which employs Sociological Institutionalism. Previous work on the formation of the Economic and Monetary Union (see section 3) has already detected a first set of economic policy beliefs, which became known as the Sound Money

paradigm. A re-examination is necessary to ascertain that all the cognitive elements of the Eurozone's system of meaning are identified. At this point, it is important to note that these beliefs are not held and promoted consciously by Eurozone's elites. They are taken-for-granted understandings of the reality, which structure and organise the information that decision-makers receive. In this sense, this set of understandings, namely the Sound Money paradigm, constitutes a system of meaning within EMU, which frames the action of individuals and determines the conceivable appropriate alternatives of the Eurozone's decision-makers. Hence, a sociological institutionalist approach to EEG moves away from the examination of purposeful behavior and is directed towards the analysis of pre-conscious action.

Policy Failure as a Challenge to the System of Meaning

A critical part of the sociological institutionalist approach to EEG is the study of EMU's system of meaning after the financial crisis of 2007-2009. Sociological Institutionalism anticipates that major policy failure can cause difficulties in the interpretation of reality according to a system of meaning. The financial crisis of 2007-2009 constitutes a prominent case of large-scale economic policy failure. In this context, a sociological institutionalist approach adopts a reading of the financial crisis as "a crisis of ideas" (Blyth, 2013a: 43) and seeks to understand its effects on Eurozone's system of meaning. Thus, it is reasonable to examine whether Sound Money managed to provide convincing interpretations of the financial crisis. The second sub-hypothesis is that some elements of the Sound Money paradigm became challenged due to the crisis. What matters here is not the actual measurement of economic effects but the identification of perceptions of economic policy failure among Eurozone elites. Given the need to continuously reproduce cognitive frameworks, the content of Sound Money is key in determining EMU's social legitimacy. Any change of Sound Money's constitutive parts signifies a modification of EMU's logic of appropriateness, which in turn requires an adaptation of the organisational framework. As a result, focusing on the deinstitutionalisation of Sound Money's constitutive economic policy beliefs will reveal the existence of any endogenous pressures triggering organisational change. An erosion of economic beliefs would be reflected in a lower level of institutionalisation exposing the de-legitimation of Sound Money. Alternatively, if the institutionalisation of economic policy beliefs proved to be equivalent to the pre-crisis levels, then the sociological institutionalist explanation of EEG reform would be rejected.¹⁶ It should be noted, however, that the de-legitimation of Sound

Money could be partial if only some of the economic policy beliefs became deinstitutionalised, while others maintained the same level of institutionalisation.

Adaptation of the System of Meaning

The next step is to trace any changes in the EMU's system of meaning. According to SI, Sound Money determines the social legitimacy of the EMU and has major effects on decision-making. As the preferences of the Eurozone's decision-makers are socially constituted, these policymakers depend on Sound Money to define the problems that emerged after the financial crisis and conceive possible alternatives. It follows that any change in the Sound Money paradigm would denote an evolution of policy preferences regarding the management of fiscal and macroeconomic policy in EMU. Alternatively, no change of Sound Money beliefs would mean that policy preferences remained stable, discarding a sociological explanation of EEG reform.¹⁷ Thus, the third sub-hypothesis is that certain cognitive elements were strengthened as a result of social processes within the EMU leading to the adaptation of the Sound Money paradigm. At this point it is necessary to identify particular mechanisms, which institutionalised cognitive elements. These mechanisms can only be explored inductively from empirical research. This is so because social structures and social interaction, which are so crucial for sociological institutional analysis, are always unique and case-specific. Certainly, the generalisation of meaning of the ad-hoc activity of a Eurozone decision-making body could have introduced some new elements of Sound Money under the habituation-objectification-sedimentation mechanism. It is also plausible that the Eurozone adopted cognitive elements of fiscal and macroeconomic governance from other settings through mimetic isomorphism. The German model would be an obvious candidate in this case, as EMU has already been modelled on Germany in the field of monetary policy (McNamara, 1998; Marcussen, 1999). Other mechanisms could have been in place, however.

Social Legitimacy Shaping Formal Negotiations

Typically, sociological institutionalist studies move straight from the analysis of institutionalisation to the analysis of the final organisational form without any substantial engagement with the analysis of the formal decision-making processes within the organisations. The reason for this is related to the theory's concentration on cognitive variation, namely the stage preceding formal decision-making procedures. Contrary to other frameworks, sociological institutionalism downgrades the importance of formal negotiations in

organisational change. In the case of the EEG reform, the theory expects that the preferences of Eurozone's decision-makers have already converged at the phase of formal negotiations, given the constitutive effects of Sound Money on preference-formation. In other words, the adjusted Sound Money paradigm should have created an underlying consensus about the basic aspects of EEG *before* the start of the formal legislative process.

This thesis argues that the application of the sociological institutionalist framework is incomplete without a close examination of the formal decision-making process of the studied organisation. This is because the observable behaviour of policy actors during the formal decision-making procedures might create doubts about the existence of an underlying consensus or raise questions about the extent of its effect. Indeed, it is possible that the underlying consensus will not immediately translate into a swift agreement among the policy actors. This is particularly relevant to organisations relying on complex and time-consuming decision-making procedures, such as the EU. Therefore, a sociological institutionalist explanation of the EEG reform should not just assume the impact of the adapted legitimacy on the outcome of negotiations but measure it through the empirical investigation of the different stages of the negotiation process. By so doing, a sociological institutionalist explanation can control for the presence of other factors and establish the independent effect of social legitimacy on the direction of organisational change.

From the early stages of its development, negotiation theory has acknowledged the importance of legitimacy in negotiations. The seminal work of Roger Fisher and William Ury pointed to the impact of using "objective criteria" on the outcome of negotiations.¹⁸ Indeed, objective standards such as "precedent, industry practice or *sound policy considerations*" were seen as sources of negotiating power (Fisher, 1983: 158, my emphasis). In view of the above, the fourth sub-hypothesis promoted by this thesis is that during the formal legislative negotiations the adjusted social legitimacy of the EMU rewarded policy arrangements that were in line with the newly institutionalised beliefs. Negotiation proposals containing cognitive elements are expected to be adopted, while those lacking them are expected to be rejected.

Organisational Change

The final step of the sociological institutionalist approach is to examine whether organisational change corresponds to the adjustment of the system of meaning. According to SI, the change of social legitimacy within an organisation is expected to lead to an analogous adaptation of

the formal organisational structure. Hence, the fifth sub-hypothesis is that the Six-Pack, the Two-Pack and the Fiscal Compact conform to the post-crisis version of Eurozone's Sound Money paradigm. Deviations from the policy direction, which was indicated by the system of meaning, would weaken the sociological institutionalist explanation of EEG. Therefore, it is necessary to trace the cognitive elements of the revised Sound Money paradigm in the legal texts that became finally adopted. This step is necessary to confirm the sociological institutionalist explanation.

3.5.3 The Social Environment

The operationalisation of the analytical model needs to include the delineation of the social environment. As has been established in section 2, SI's analysis of institutionalisation can be based on wider structures, such as societal sectors or organisational fields, or much smaller units, such as groups of individuals within organisations. McNamara's (1998) and Marcussen's (1999) previous works on EMU were clearly focused on a particular organisational field, namely the EMS, which comprised the governments of the member states participating in monetary coordination. McNamara's (2002) subsequent work on central bank independence concentrated on the societal sector of central banking to analyse institutionalisation. In contrast, Dyson (2000) was much more attentive to social environments of a smaller scale, such as the ECB executive board, the ECB governing council, the ECOFIN and its preparatory body, namely the Economic and Financial Committee (EFC).

This thesis adopts a microinstitutional approach to the analysis of institutionalisation. It acknowledges the need to provide a deep and detailed account of the institutionalisation process by opening up the "black box" of the organisational level (see Zucker, 1991: 105-106). A focus on the interorganisational level, while plausible under the SI framework, is not appropriate for the purposes of the present research. The examination of a social environment, which consists of several organisations, tends to be more descriptive than analytical due to the lack of adequate resources. It is more suitable for mapping the spread of cognitive elements and tracing general trends, rather than illuminating the exact process, through which cognitive elements are created and diffused. Providing a robust explanation of organisational change requires thorough exploration of the institutionalisation process within organisations. A narrower focus enables the uncovering of richer evidence about how the institutionalisation evolves and can lead to the establishment of a more solid linkage to the development of organisational change. Thus, following a relevant sociological institutionalist branch of EU studies (see, for example, Lewis,

2010; 2000), this thesis identifies the social environment with groups of individuals within the formal structures of the European Union.

Revealing EMU's particular social environment entails a careful examination of Eurozone's organisational design and function. According to the Treaty, the competence to coordinate member states' economic policies rests primarily with the Council (Article 121, TFEU), while the European Commission provides the necessary recommendations. The Council, though, is a multilayered entity, which includes three decision-making levels: the level of national officials participating in the various working parties, the level of diplomats forming the Committee of Permanent Representatives (COREPER) and the political level of ministers (Bache et al., 2015: 257-267; Wallace, 2010: 75-81; Häge, 2008). In general, Commission proposals are first discussed on the level of national officials, who attempt to achieve a consensus on the dossiers. Any unresolved issues are discussed in the COREPER with the aim to minimise the items for consideration by the ministers, who come to choose among pre-defined alternatives.

The structure of EU decision-making is even more complex in the field of economic policy. Here, the work of preparing the Economic and Financial Affairs Council configuration (ECOFIN) is shared by the Economic and Financial Committee (EFC) and the COREPER. The EFC is an advisory body established by the Treaty (Article, 134, TFEU), which distinguishes it from the great majority of committees, groups and parties established by Council acts or COREPER decisions. Indeed, EFC's predecessor, namely the Monetary Committee, which was established in 1958, constituted (together with the committee, which would later become COREPER) the oldest committee of the European Economic Community (Lewis, 2000). In the course of time the EFC has managed to outflank COREPER as the primary preparatory body of the ECOFIN (Grosche and Puetter, 2008). In the case of EMU-related issues, the situation does not differentiate, even though the ministers of Eurozone member states form "a council within the council" by meeting informally as the "Eurogroup" and predetermining their stance in the official formation. As Uwe Puetter notes, "[t]he EFC is the EU's expert committee for EMU affairs" (2006: 73). This is highlighted by the fact that it is the EFC's working party, namely the Eurogroup Working Group (EWG), which is preparing informal Eurogroup meetings.

This thesis promotes the view that the group of individuals participating in the EFC constitutes a distinctive social environment within the EMU. The group is composed by one senior finance

ministry official per member state (usually state secretary or director-general of budgetary policy or director general of European affairs, or vice-minister), the vice-president of each national central bank, plus two high-ranking European Commission officials (the director-general and deputy director-general of DG ECFIN), plus the vice-president of the ECB and another member of the ECB's executive board (Puetter, 2006: 68-70; Grosche and Puetter, 2008). To improve efficiency, the EFC seldom meets in its full configuration. Usually the vice-presidents of national central banks do not participate in its meetings to keep the number of attendants low. Alternate EFC members can replace EFC participants, if necessary. The group's composition reveals the dual role of its members: they are experts on economic issues but also the most senior civil servants in the field of economic policy. Given that economic policymaking has also a strong political dimension, EFC members are able to engage with the technical *and* the political aspects of policy (Grosche and Puetter, 2008: 531). This joint role of EFC members is highlighted by the fact that they delegate the more technical questions of policy to the subcommittee of alternates (Grosche and Puetter, 2008: 534). This quality distinguishes the EFC participants from the technical experts of the working groups, the policy generalists of the COREPER and the politicians of the Council. Thus, it can be argued that EFC members form a particular kind of community.

Certain working arrangements increase the cohesion of the community of EFC participants. The group shares a common responsibility for the success and smooth functioning of the ECOFIN (Lewis, 2000: 278-279). In this context, the EFC members discuss until they reach a consensus on a given issue, without recourse to voting. The EFC elects its President and Vice-President for a two-year period not following the rotation system of the presidency in the Council/COREPER. This enhances the institutional memory and stability of the Committee (*ibid*). During the meetings, there is a conscious effort to project the members' personal capacity, as opposed to their institutional or national affiliation (Grosche and Puetter, 2008). It is indicative that the voting rule (even if voting does not take place in practice) is that each member has one vote (Council Decision 2012/245/EU), while no country or EU institution signs appear on the table inside the meeting room. Most importantly, though, the group is notoriously secretive. Discussions and exchanges of notes and working documents remain strictly confidential. There are no public statements or press releases. Considering that the EFC is a formal body established by the Treaty, this level of secrecy is unprecedented. This insulated environment enables the building of trust among the members of the group and fosters deliberation among them. Günter Grosche and Uwe Puetter accurately note that confidentiality

is “making it easier for members to question their own positions during the collective debates” (2008: 534). The frequency of the meetings (at least once a month) cements this trust among the EFC members.

The function of the group of EFC participants is central for the operation of EMU. EFC’s “pivotal position in the operation of the Euro-Zone” (Dyson, 2000: 75) is linked to the fact that the Committee constitutes the “prime institutional venue” (ibid), where all the different interests are represented. Indeed, the EFC brings together officials from national finance ministries, national central banks, the European Commission and the European Central Bank, namely all the major players within EMU. Due to the function of the EFC as an EMU-forum, the Commission can test ideas by presenting them to the EFC informally and receiving reliable feedback before making formal proposals (Grosche and Puetter, 2008). Another aspect of EFC’s central position in EMU is related to its role as independent advisor of the ECOFIN and the Commission. This is manifested by the ability of the Committee to act on its own initiative (that is, without the invitation of another EU institution) and issue opinions to the Commission and the Council. The fact that the Committee is represented in all the formal and informal meetings of the ECOFIN (including the Eurogroup) provides extra evidence for this function. The EFC’s President, a highly respected figure among Eurozone officials (Puetter, 2006: 70), has the opportunity to intervene directly in the political discussions and influence their direction. This signifies the independent role of the EFC within EMU.

The most important function of the EFC is the introduction of issues in ECOFIN’s (or Eurogroup’s) agenda in the form of “shared problems” (Puetter, 2006: 143). As Kenneth Dyson notes, “[p]erhaps the most important contribution of the Economic and Financial Committee to the operation of the Euro-Zone is its influence in constructing how problems are defined and tackled” (2000: 76). The definition of problems entails the identification of root causes and the delineation of possible alternatives. The EFC structures discussions in the ECOFIN/Eurogroup by providing focus on specific challenges and by pointing to specific policy options. To do so, the EFC presents issues in technical terms to orient discussion towards what is technically necessary and functional for the sustainable management of the Eurozone as a whole. During this process, issues are being stripped of their politically contested character and become shared problems. In practice, the EFC uses briefing notes to ministers, working papers, oral presentations by its President and the provision of statistical and analytical data to push for the convergence of views. Thus, the level of the EFC’s influence on the agenda of the ECOFIN/Eurogroup reveals the centrality of the Committee for the operation of EMU. As a

result, a microinstitutional analysis of institutionalisation within the coherent and influential EFC community fits well with the analytical model of this thesis.

Conclusion

This chapter presented the theoretical basis of the thesis. It advanced the argument that Sociological Institutionalism constitutes an appropriate framework for the analysis of European Economic Governance. The theory identifies institutions with culture placing particular emphasis on the cognitive dimension of organisational settings. Routines, typifications, schemas and taken-for-granted understandings create systems of meaning within organisations that have determinant effects on decision-making. As a result, organisational change is not related to the advancement of functional efficiency but is linked to the promotion of social legitimacy. The institutionalisation process, which takes place before organisational change, defines social legitimacy through the creation and enhancement of cognitive elements. An explanation of EEG reform based on SI concentrates on endogenous processes of preference formation unveiling the important role of cognitive elements. Actor preferences are not considered static as it is assumed that they evolve in parallel with the evolution of institutionalisation. Also, the theory integrates crisis in the analysis of organisational change as it anticipates the existence of major policy failure as a prerequisite for organisational change. This kind of explanation avoids any reference to macro-patterns and is limited to the specific policy field of European economic policy. Thus, the designed explanation covers the gap of an endogenous and meso-level approach to the analysis of the fiscal and macroeconomic reform.

A sociological institutionalist-inspired explanation of EEG reform points to a five-step model, which brings EMU's system of meaning to the centre of the analysis. The thesis identifies EMU's Sound Money paradigm (step 1) and seeks to trace how it was challenged due to manifest policy failure (step 2). Adaptations of Sound Money caused by the institutionalisation of cognitive elements (step 3) are linked to legislative proposals emerging during the formal negotiations (step 4) and particular organisational changes appearing in the final texts (step 5). Unveiling mechanisms of institutionalisation is a key part of the above model and requires empirical research. Thus, in the next chapter the thesis is going to introduce the design of this project's empirical research including the methods of data collection and processing.

¹ Adler (1997: 323), Christiansen, Jørgensen and Wiener (1999: 530), Risse and Wiener (1999: 778) argue that (social) constructivism is not a theory but a meta-theoretical framework.

² It is useful to remember that EU studies initially emerged as a subfield of International Relations. As a result, the field of EU studies follows closely the theoretical developments in International Relations.

³ It should be noted that Kratochwil and Ruggie (1986: 766) were the first that contemplated the option of this particular combination but rejected it.

⁴ Others have considered the pillar structure problematic (see Phillips and Malhotra, 2008).

⁵ Wendt makes a similar argument: agency and structure are mutually constituted. He points to the fact that structures evolve because of agents' "practices" (Wendt, 1999: 184-185).

⁶ According to Richard Scott and John Meyer, "[a] societal sector is defined as (1) a collection of organizations operating in the same domain, as identified by the similarity of their services, products or functions, (2) together with those organizations that critically influence the performance of the focal organizations: for example, major suppliers and customers, owners and regulators, funding sources and competitors" (1991: 117).

⁷ Paul DiMaggio and Walter Power define organisational field as "those organizations that, in aggregate, constitute a recognised area of institutional life: key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products" (1991: 64-65).

⁸ Referring to DiMaggio and Powell's (1991) seminal work on Sociological Institutionalism, Walter Powell and Jeannette Colyvas note that "DiMaggio and Powell's initial outline of a theory of practical action was brief, but it clearly attempted to build on microfoundations" (2008: 279).

⁹ David Strang and John Meyer define theorisation as "the self-conscious development and specification of abstract categories and the formulation of patterned relationships such as chains of cause and effect" (Strang and Meyer, 1993: 492).

¹⁰ During this phase theorisation remains low as meanings are treated as social givens.

¹¹ Eva Boxenbaum and Stefan Jonsson note that initially isomorphism had been conceptualised as the outcome of diffusion but later on the literature tended to view isomorphism as the cause of diffusion (2008: 79).

¹² Typically, this type of analysis is undertaken at the inter-organisational level encompassing various organisations. For this, DiMaggio and Powell introduced the notion of "organisational field" (1991a: 64-65) to include all the relevant organisations.

¹³ In this book McNamara makes an explicit reference to the (meta-theoretical) social constructivist school (1998: 57) but her theoretical grounding on the sociological view of institutions only appears in a footnote.

¹⁴ By so doing Marcussen answers both *why* and *how* ideas on macroeconomic management develop over time. As it is already mentioned in a previous section of this chapter, these questions are inextricably linked for sociological institutionalists.

¹⁵ Marcussen noted that since the ideational vacuum constitutes a cognitive phenomenon, it is hard to designate specific generalisable criteria determining when the shock is big enough to undermine existing knowledge structures.

¹⁶ If the institutionalisation of Sound Money's economic policy beliefs remained identical after the crisis, then only a marginal organisational adaptation would have been justifiable under the sociological institutionalist framework. To explain a large-scale reform, a change of cognitive elements is a requirement.

¹⁷ Again, only a marginal policy reform would have been compliant with the preservation of the Sound Money beliefs.

¹⁸ In later editions Bruce Patton was added as co-author (see Fisher, Ury and Patton, 2011). While Fisher and Ury introduced the game-theoretic concept of BATNA (Best Alternative to a Negotiated Agreement) to measure bargaining power that has profoundly affected the field (including the work of Andrew Moravcsik on interstate bargaining), they clearly insisted on the primacy of principled negotiation based on objective standards (see Sebenius, 2013; Moravcsik, 1993: 497-507). Curiously, this part of their work does not appear in Moravcsik's approach to negotiations.

CHAPTER 4 METHODOLOGY

Introduction

The previous chapter explored the theoretical framework and the analytical approach of the thesis. This chapter presents the research strategy of the thesis and the methods that the project uses to collect and analyse the empirical material.

My central argument in this chapter is that this thesis research on the post-crisis reform of European Economic Governance should be based on a qualitative research design. I show that the ontological and epistemological premises of Sociological Institutionalism that were analysed in the previous Chapter fit well with a qualitative approach to inquiry. Due to the type of the research question that this thesis seeks to answer a case study design is the appropriate way forward. Given that the purpose of this thesis is to examine an inherently interesting and atypical event, namely the reform of European Economic Governance after the financial crisis, the research proceeds as an intrinsic case study. Data collection proceeds through documentary investigation and elite interviewing. The latter is an essential step for the collection of information on the cultural and cognitive beliefs within the social environment. 21 semi-structured interviews have been conducted in 8 EU member states. Considering the selection of the methods of empirical analysis, the thesis employs a combination of Process Tracing and Discourse Analysis. The Process Tracing method enables the examination of organisational change as a sequence of intermediate steps facilitating the description of events and the testing of theoretical predictions. Discourse Analysis is necessary for the interpretation of empirical material and the identification of cognitive elements.

The first part of the chapter explores the research strategy of the thesis linking the choice of the type of research design to the purposes of the inquiry. The second part examines the process of data collection. The third part presents the analytical methods and explains how they fit in with the research design of this project. The fourth part summarises the application of the methods to the analysis of the empirical material.

4.1 Research Strategy: An Intrinsic Case Study

This thesis's approach to inquiry is qualitative. According to John Creswell, “[q]ualitative research begins with assumptions and the use of interpretive/theoretical frameworks that inform the study of research problems addressing the meaning individuals or groups ascribe to a social or human problem” (2013: 44). Certainly, the social constructivist metatheoretical framework and the theory of Sociological Institutionalism (both introduced in the previous chapter) determine the procedures that this project applies to acquire knowledge about the research problem. The philosophical and theoretical emphasis on the centrality of cultural and cognitive elements in combination with a commitment to truth-seeking requires the employment of appropriate instruments that can trace and measure these elusive objects. Considering the particular type of the research design, the thesis advances as a single case study. At this point, it should be underlined that the case study approach is the appropriate way to answer this thesis' basic research question: how can change in Eurozone's socially constructed norms and economic policy beliefs explain the form of the post-crisis European Economic Governance? As Robert Yin notes ““how” and “why” questions are more explanatory and likely to lead to the use of case studies, histories, and experiments as the preferred research strategies. This is because such questions deal with operational links needing to be traced over time, rather than mere frequencies or incidence’ (Yin, 2003: 6, emphasis in the original).

A case study can be defined as an “in-depth inquiry into a specific and complex phenomenon (the ‘case’), set within its real-world context” (Yin, 2013: 321). It should be clear then that the case study constitutes an empirical inquiry (Yin, 2003: 13). Still, not everything can be considered a case (Stake, 2000: 436). While there is a variety of objects that can be classified as cases (depending on the field of study), the distinguishing feature of a case is that it constitutes a “bounded system” (Creswell, 2013: 97). As Robert Stake notes, “[f]unctional or dysfunctional, rational or irrational, the case is a system” (2008: 120). This thesis argues that the post-crisis reform of European Economic Governance is a particular case of public policymaking within the EMU. This is because the legislation of the Six-Pack, the Two-Pack and the Fiscal Compact can be considered as a system bounded by time and place. Indeed, the reform is part of a specific EU policy field, that is fiscal and macroeconomic coordination, while it has particular time references: the period between the financial crisis of 2007-2009 and mid-2013, when the last piece of legislation was formally adopted.

There are different versions of case studies. The literature distinguishes three types based on the purpose of the conducted research: intrinsic, instrumental and collective (Stake, 2008: 121-125; Creswell, 2013: 99-100). An intrinsic case study is undertaken because researchers aspire to gain a better understanding of this particular case. The case is not explored because it is illustrative of a wider phenomenon but because it is deemed inherently interesting. In contrast, an instrumental case study is chosen as a way of exploring a wider issue. The focus is on the latter and the case is used as an illustrative instrument. A collective case study has a similar purpose to an instrumental case study but uses several cases to illustrate an issue instead of one. The distinct research purposes are linked to the important issue of generalisation (Goertz and Mahoney, 2009: 307-308). Case study experts insist that generalisation is possible even on the basis of single cases (Flyvbjerg, 2004: 420-434). They point, for example, to a sub-category of instrumental cases, the critical cases. Here, the selected case has such strategic importance in relation to the general issue that the case will either confirm the theory or reject it (Yin, 2003: 40). The logic is that “if this is (not) valid for this case, then it applies to all (no) cases” (Flyvbjerg, 2004: 426). Intrinsic case studies have been traditionally viewed as inappropriate ways for theory building as they are focusing on the particular (Stake, 2000: 437). However, later on the literature acknowledged that the traditional view should be qualified as “even intrinsic case study can be seen as a small step toward grand generalization” (Stake, 2008: 125). This is because intrinsic cases are atypical or unique cases and their study can reveal more information than the average case (Flyvbjerg, 2004: 425).

This thesis follows the intrinsic case study design. The primary research purpose of this research project is not to explore the evolution of European integration in generic terms or test the explanatory capacity of the employed theory in the field of European public policy. In contrast, this thesis argues that the latest reform of Economic Governance is an inherently interesting atypical case of European integration and, as such, it deserves to be studied thoroughly in the context of a doctoral research project. Still, it can provide some useful insights to interested scholars regarding the application of Sociological Institutionalism to the analysis of European Integration.

As was explained in the Introduction, the object of this thesis’ research is uniquely interesting. The 2010-2013 reform of European Economic Governance is part of the long history of European economic coordination. Previous policy developments in the fields of economic and monetary policies marked the change in the pace and the degree of European integration. The creation and the function of the European Monetary System and the Economic and Monetary

Union have deeply affected the nature and the direction of the integration project in its entirety. Any major policy development in these fields deserves to be studied thoroughly. The reemergence of the principle of parallelism within the EMU after its abandonment in the 1970s and the concurrent strengthening of economic coordination to match the centralisation of monetary policies are crucial events requiring an in-depth examination. Later formal policy proposals, such as the (highly symbolic) creation of a European Minister of Economy and Finance (European Commission, 2017c) or the establishment of a macroeconomic stabilisation instrument (European Commission, 2017b) build on the 2010-2013 reform, making the latter an important object of investigation. The global historical context of the financial crisis highlights the significance of the European policy developments in the area of economic governance during the period between 2010 and 2013. As the Eurozone is one of the world's most important economic areas, its policy response demands special attention. Also, the fact that the Eurozone experienced a regional debt crisis during this period that amplified diplomatic conflicts among member states and led to political upheavals at the national level makes the investigation of the post-crisis reform of European economic governance even more interesting. Finally, the reform of 2010-2013 is unique because it has established a fiscal and macroeconomic governance framework that interferes in the everyday politics of member states in an unprecedented way. The rejection of the Italian budgetary plans of 2019 by the Commission vividly illustrates the constraints on national democratic politics that the new reform has brought. It is, therefore, appropriate to advance the analysis of the reform as an intrinsic case study.

4.2 Data Collection Techniques

4.2.1 Documentary and Archival investigation

The collection of empirical material evolved in two steps. The first step of data collection was dedicated to extensive documentary and archival investigation. Primary documentary sources included texts composed in the organisational setting, namely EU primary law (EU Treaties) and intergovernmental Treaties as well as texts produced by the European Institutions. These included European Regulations and Directives, European Commission legislative proposals and draft proposals, European Commission Meeting Minutes, European Commission Communications and Reports, Council Conclusions and Council Reports, ECB Working Papers and Monthly Bulletins, European Parliament Committee Reports. Most of the above

documents were retrieved from the *EUR-Lex* and the *europa.eu* websites. 569 documents were collected. Additionally, primary sources included public addresses, interviews and newspaper articles of Eurozone officials. The above texts were used to trace events and explore the construction of meaning over economic policy in the course of time. Most of the documents had been issued between 2008 and 2013. Some older documents were included to add background information and for reasons of comparison to indicate the evolution of beliefs. The project's focus on primary material was attentive to the need to base the analysis on authentic and credible documents (see Vromen, 2010: 261-265). This did not mean that the research did not incorporate secondary sources. Yet, this material was employed to complement the primary data and provide the necessary contextual information. Secondary sources comprised commentary and review articles from the press, scholarly articles, academic books, and publications from influential EU think tanks. This material was used to shed light on the wider discourse in the context of discourse analysis and as an additional way of tracing events, such as informal meetings of EU decision-makers.

4.2.2 Elite Interviewing

The second step of data collection proceeded through elite interviewing. This technique was employed to uncover events that were not recorded in the official documents contributing to a more detailed description of the process of organisational change. Most importantly, though, elite interviewing was essential for the in-depth analysis of meaning within EMU. By approaching directly the participants in the organisational setting, this research project generated a considerable amount of original texts that contained typifications and meaning constructions. The discursive analysis of these texts helped revealing the origins and development of economic policy beliefs over time (on the link between the elite interviewing technique and the analytical methods, see below). At this point it is important to underline that elite interviewing was particularly relevant in the case of European Economic Governance reform as the organisational setting of economic policymaking within the EU was based on elusive decision-making bodies, such as the Eurogroup, the Economic and Financial Committee and the Eurogroup Working Group that rarely publicise any documents (on the use of elite interviewing in sensitive policy environments, see Davies, 2001). Thus, elite interviewing was an essential technique to gather the necessary data and have input from important actors. Before proceeding to the implementation of the technique I applied and received approval on ethics grounds by the University of Sheffield.

Identification of Participants

The application of elite interviewing started with the delineation of the target group. As was explained in a previous section, the analysis of the EU's organisational setting in the light of the sociological institutionalist framework leads this research to focus on the Economic and Financial Committee. A major issue was the identification of potential participants, as the list of the Committee's members is not publicised. Contacting the Committee's Secretariat was not effective as the Secretariat refused to disclose the names of the Committee members on the grounds of personal data protection. Subsequently, I embarked on extensive internet research using Google search. I used key words such as "Economic and Financial Committee", "Eurogroup" in combination with the names of the Presidents and Vice-Presidents of the Committee that appear in the list of Council participants or the names of the Presidents and Vice-Presidents of the Eurogroup working group (also members of the EFC) that are disclosed in the group's webpage. Moreover, as most of the EFC members are national finance ministry officials, I tried to identify them by searching the webpages of national finance ministries. In many cases the texts were not available in English so I used the "Google translate" tool to translate parts of the webpages and assess whether they contained any relevant information. The names of the confirmed participants were used as key words in further searches. Afterwards I sought to collect information about the background of the EFC members and their current affiliation.¹ As I was interested in identifying individuals that participated in the EFC in a specific period (2009-2013), many of those members had already left their organisations and were working in the private sector or assumed other public sector roles. This increased the complexity of the identification process.

Gaining Access

Gaining access to elites was an anticipated challenge of the method (Burnham et al., 2008: 235; Moyser, 2006: 87-88; Lancaster, 2017). The secretive nature of the EFC posed a further hurdle. EFC participants could not afford to lose their credibility in the eyes of their colleagues or the trust of their governments (for Commission and ECB representatives the trust of their respective organisation) as this might have an impact on their career development. Therefore, the potential interviewees were provided with full anonymity and confidentiality. The anonymity condition included the non-disclosure of their organisational affiliation. To approach the EFC members, I opted to send them a formal letter providing all the necessary information about the aims and the context of the research as well as the reasons for inviting

them to participate. I followed the University of Sheffield's Ethics procedure regarding the recruitment of participants, the acquisition of informed consent and the safeguarding of confidentiality. Apart from sending the letters by regular mail, I sent emails to ensure that the recipients would read the invitation. Also, to increase my chances of gaining access I tried to increase my credibility by referring to my work experience at the Secretariat-General of the European Commission in 2012. In many cases I had to follow up the letters and emails with phone calls to the recipients' offices. Occasionally, I liaised with former colleagues at the Secretariat-General, who helped me establish a first contact with certain interviewees (on the importance of making connections to conduct interviews see Goldstein, 2002).

Selection of Interviewees

The selection of the EFC members to be approached was based on purposive sampling following certain criteria (Tansey, 2007). Firstly, it took into consideration their personal experience in the post. A balanced mix of individuals with many years' presence in the EFC meetings and individuals that joined the group for only a few years was achieved. Secondly, the selection was attentive to the organisational affiliation of the EFC members with a view to include individuals representing different constituencies such as Northern and Southern countries, big and small member states, Eurozone and non-eurozone countries, national finance ministries and EU institutions. Also, the choice of individuals was based on practical considerations regarding the complexity of travel arrangements (see below). In this sense, an element of convenience sampling was introduced in the selection process (Tansey, 2007). Finally, to increase the validity of my research I opted to follow a strategy of triangulation in order to gather data from different sources (Creswell, 2009: 190-191; Davies, 2001). Thus, I approached non-EFC participants that were in close cooperation with members of the EFC. So, I turned to the ECOFIN participants (political/ministerial level), the COREPER II participants (level of diplomats) and the national and European Union officials assisting with the preparations of the EFC meetings (without participating in them).

Arranging & Conducting the Interviews

Arranging interviews entailed considerable logistical preparation. The organisation of the fieldwork required the planning of several trips in different European cities and countries. The

financial aspect of interviewing proved a significant challenge. I had to combine interviews in a way that would minimise the cost of travelling and accommodation. While this project has greatly benefited from the generous financial support of the University of Sheffield's Faculty of Social Sciences, it was necessary to pursue extra sources of funding to cover the increased costs of the aforementioned empirical research design. Thus, in October 2016 I applied for a joint UACES/ James Madison Charitable Trust Scholarship to cover fieldwork expenses. Being awarded the scholarship enabled me to undertake extensive travelling. At this point, it is important to stress that *in-situ* interviews (Cassell, 2009) were considered more appropriate than interviews via telephone call or teleconference because in this way the researcher can be more responsive to the interviewee's answers and incorporate the non-verbal communication in the notes.² Given the special attention of this project to the interpretative part of the analysis of empirical research, it is evident that in-situ interviewing was essential. Also, due to the secretive function of the EFC, meeting the interviewees in person was an important step in the process of gaining their trust and getting high quality data (on this see also, Burnham et al., 2008: 234; Harvey, 2011: 433).

The fieldwork was conducted in three phases: a) November-December 2016, b) June-October 2017, c) October 2018. In total, I have approached 36 potential participants and conducted 21 interviews in 8 EU Member States. 12 interviewees were members of the EFC or EFC alternate members,³ 4 interviewees were officials that assisted with the preparation of the EFC meetings, 2 interviewees belonged to the political (ministerial) level, 2 interviewees participated in the meetings of diplomats, 1 interviewee was a Member of the European Parliament. One interview took place via *Skype* and another via *Webex*. In the former case, the interviewee had to reschedule the interview and there was no other date available. In the latter case, substantial logistical impediments forced me to arrange a teleconference. Typically, the interviews lasted more than 60 minutes. While my letter indicated 20-30 minutes interviews taking into account the busy schedules of the interviewees, in most cases the interviews lasted much longer as the subjects showed increased interest in the discussion. In one case the interviewee even postponed a scheduled meeting for 20 minutes. The conduct of the interviews was in line with the University of Sheffield's Ethics procedure regarding the obtainment of consent and the avoidance of harm during the interview process (the template of the Participant Consent Form can be found in Annex I).

Structure of the Interviews

The interviews followed the semi-structured format allowing interviewees to add new topics and perspectives that could be included in subsequent interviews (Burnham et al., 2008: 238-245). This format enabled me to combine hypothesis testing with the collection of detailed data (Leech, 2002). The interview protocol consisted of open-ended questions allowing subjects to indicate important and relevant information. Also, open-ended questions gave me the opportunity to probe in order to gather more depth about the issues and to explore unanticipated paths offered by some interviewees (Berry, 2002; Burnham et al., 2008: 243). To improve the reliability of the data collection method, I structured the interview questionnaire around four phases: the EFC discussions just after the financial crisis (2008-2009), the introduction of European economic governance reform in EFC discussions (2009-2010), the early discussions on the direction of the economic governance reform (2010), the formal negotiations on the legislative proposals (2010 - 2013). In this way, I promoted the consistency of the results of the questionnaire across interviews (Berry, 2002). In parallel, the four phases oriented my interview guide to incorporate “theoretically driven questions” enabling “the collection of data that is highly relevant and specific to the research objectives being pursued” (Tansey, 2007: 771). Indeed, following the framework of Sociological Institutionalism the first three phases were devoted to the processes of deinstitutionalisation – institutionalisation taking place *before* the triggering of the official negotiations. Thus, I attempted to enhance the validity of my interviewing results by devising relevant questions fitting the employed theoretical approach.

The questions were distinguished in “primary”, “secondary” and “optional” (see, for example, Burnham et al., 2008: 240-241). Primary questions had to be asked because they were essential for the project. Secondary questions were important for the project but could be skipped if the interviewee’s answers revealed more interesting avenues. Optional questions were asked if time permitted. It should be noted that the questionnaire was revised in the context of the preparation before each interview and was adapted according to the background of each interviewee (for an indicative list, see Annex II). That was a necessary step because of the differences in the organisational affiliation and the period in office among interviewees. Additionally, as I conducted more interviews, I gathered sufficient data on some issues and, thus, I sought to explore some unanticipated perspectives (Burnham et al., 2008: 244). The sequence of the questions was changed sometimes to allow for a smooth development of the interviews taking into consideration the interviewees’ profiles.

Transcription & Data Storage

The transcription of the interviews was conducted by taking notes during the interviews and completing the notes immediately after the end of them. Undoubtedly, without the use of a voice recorder the transcription process was expected to incur a loss of data. However, it was anticipated that by avoiding the presence of a voice recording device the interviewees could be more frank and forthcoming during the discussions. Given that secrecy was a crucial working method of the particular community of decision-makers, the issue of trust between the interviewee and the interviewer appeared as a greater challenge for the collection of reliable data than the recording technique. Finally, I used the notes to write interview reports structured on the four phases. The anonymisation of the transcriptions and the management of the confidential data followed the University of Sheffield's Ethics procedure.

4.3 Analytical Methods

4.3.1 Process Tracing

The primary research method that this project employs is process tracing (PT). The method can be defined as “the examination of intermediate steps in a process to make inferences about hypotheses on how that process took place and whether and how it generated the outcome of interest” (Bennett and Checkel, 2015: 6). Process tracing clearly focuses on the identification of causal mechanisms and causal chains between independent and dependent variables (Beach and Pedersen, 2013: 1; Trampusch and Palier, 2016: 440-442). Derek Beach and Rasmus Pedersen explain that the “analysis is structured as focused empirical tests of each part of a mechanism” (2013: 34).

Descriptive inference is certainly an important part of process tracing. As David Collier eloquently puts it, “the descriptive component of process tracing begins not with observing change or sequence, but rather with taking good snapshots at a series of specific moments. To characterize a process, we must be able to characterize key steps in the process, which in turn permits good analysis of change and sequence” (2011: 824). However, intermediate steps need to be “theoretically predicted” (Checkel, 2006: 363; Moumoutzis and Zartaloudis, 2016: 338) as process tracing is not just a narrative presentation of events but an analysis guided by theory. In other words, the method requires the creation of hypotheses about the underlying causal mechanisms (Bennett and Checkel, 2015: 9). The next step of the testing involves the

formulation of specific predictions about expected observable evidence (in each intermediate step) followed by their comparison with observable evidence (Beach and Pedersen, 2013: 95; Hall, 2006: 27-28). The outcome of the tests updates the researcher's level of confidence in the hypothesis (Beach and Pedersen, 2013: 95; Bennett, 2015: 229). As a result, by analyzing within-case evidence the method is particularly strong in enhancing the internal validity of causal inferences⁴ (Schimmelfennig, 2015b: 102; Beach and Pedersen, 2013: 2).

Considering the research purposes of process tracing, three variants can be distinguished: theory-testing, theory-building and explaining-outcome process tracing (Beach and Pedersen, 2013: 11-22). The first two versions are theory-oriented as they concentrate on generalisable theorised mechanisms, while the third one aims to formulate a minimally sufficient explanation of a specific outcome. In the latter case, the theorised causal mechanisms are considered to be heuristic instruments for the identification of the best possible explanation of the outcome and are usually complemented by case-specific mechanisms. At this point it should be noted that all the versions of process tracing involve a dialogue between theory and evidence and as a result the method's application presents both deductive and inductive sides (Bennett and Checkel, 2015: 17-18; Mahoney, 2016: 496; Beach and Pedersen, 2013: 19).

Process tracing is an appropriate method for the analysis of this study's empirical material. The method is compatible with the modernist variation of social constructivism that was outlined in the previous chapter. It should be recalled that modernist social constructivists aspire to provide explanations of reality and are committed to truth-seeking. Indeed, as Andrew Bennett and Jeffrey Checkel note, "[n]ot surprisingly, process tracing figures prominently in the work of many conventional constructivists" (2015:15). Additionally, the method fits well with the design of this thesis as a single case study on European Economic Governance being able to increase the internal validity of causal inferences. According to Adrian Kay and Phillip Baker the method makes the most of within-case analysis (2015: 1-2), and thus, it is highly compatible with a single case study. Also, process tracing fits well with the framework of Sociological Institutionalism (Parsons, 2002: 49) enabling the analysis of the constitution of preferences (Hay, 2016). In this way, the method proves to be a particularly useful instrument for the assessment of the endogenous dimension of preference formation. Given that this thesis turns to the evolution of economic policy beliefs to explain organisational change within EMU, process tracing's sequential analysis of events can capture the origins and transmission routes of actors' beliefs (Jacobs, 2015). The method's combination of deduction and induction (Mayntz, 2016: 487)⁵ is particularly relevant for my project, which seeks to test deductively

the hypothesis of sound money paradigm's adaptation and identify inductively specific mechanisms of cognitive and cultural change.

4.3.2 Discourse Analysis

As was explained above, Process Tracing is a very strong qualitative method. In the context of the particular project, however, it is not enough for the in-depth analysis of the empirical material. This is due to the theory's ontological basis. Cognitive elements and other intersubjective meanings cannot be defined a priori as the theoretical framework indicates that these elements emerge within social environments and, therefore, cannot be established according to generalisable criteria (see, for example, Hay, 2011: 173; Marcussen, 1999: 404). In the previous chapter it became clear that the application of Sociological Institutionalism entails the analysis of the system of meaning. The identification of cognitive elements and cognitive processes that form the system of meaning requires an analytical turn to the microfoundations of institutionalisation (Meyer, 2008: 532; Powell and Colyvas, 2008). This analytical direction has some important methodological implications as well. It involves the use of interpretation as a way of detecting institutionalisation processes.⁶ According to Bob Hinings and Pamela Tolbert “[t]he essential point about an interpretative approach is that it takes the actor, subjectivity, meanings, and reflexivity seriously. In so doing it opens up the black box of institutionalization both in stability and change” (2008: 485). Given that cognitive elements are very hard to observe (Wendt, 1998: 107), close description of events should be combined with a more elaborate method for the interpretation of the empirical data.

This thesis employs the method of Discourse Analysis to complement process tracing and unveil the creation of meaning at the microlevel. Discourse Analysis can be defined as “the systematic study of texts –including their production, dissemination, and consumption – in order to explore the relationship between discourse and reality” (Phillips et al., 2004: 636).⁷ It should be noted that the method does not refer to the analysis of random collections of individual texts but the examination of bodies of texts. While discourse analysis is often associated with the poststructuralist theoretical framework it is important to underline that it also constitutes a practical methodological approach (Phillips and Oswick, 2012: 445). Indeed, organisational discourse analysis became a commonly applied method in the field of organisation studies. Here, the focus is on the use of language in an organisational setting (Phillips and Oswick, 2012: 442-443).

Discourse Analysis is highly compatible with the theoretical framework of sociological institutionalism. As a method, discourse analysis provides a way of exploring institutionalisation through the empirical examination of microlevel processes of institutional production (Phillips and Malhotra, 2008: 704). Walter Powell and Jeannette Colyvas accept that “[l]anguage and vocabulary are a first step” for the study of the creation of meaning (2008: 292). In reality language constitutes the most important “ ‘reservoir’ of typifications” and the primary instrument for the transmission of meaning (Meyer, 2008: 531). While it is fair to acknowledge that institutionalisation does not necessarily involve the production of texts, it is equally true that the production of texts is a common way of conveying meaning. This is particularly the case within organisational settings. Phillips and colleagues (2004) underline that some texts leave meaningful traces. Thus, it is reasonable to examine the appearance of influential texts to find key concepts and understandings and trace how meaning is constructed and reshaped over time (Phillips and Malhotra, 2008: 715). Here it is important to note that different versions of Discourse Analysis present varying degrees of engagement with particular texts. Indeed, Nelson Phillips and Cynthia Hardy conceptualise a continuum between text-based Discourse Analysis and context-based Discourse Analysis (2002: 19-29). The authors delineate the Social Linguistic perspective of Discourse Analysis as the version that is more text-based and constructivist.⁸ The focus of this type of Discourse Analysis is primarily on the particular text rather than the text’s links with the general discourse. The method engages in the close reading of the text in order to reveal its organisation and construction and uncover the ways through which this text constructs other phenomena. In contrast, the Interpretive Structuralist variant of Discourse Analysis turns to the broader discursive activity to produce interpretations. This version is more context-oriented but remains constructivist. Subsequently, the process of interpretation is similar to other interpretative methods. Coding is used to create categories of information (Creswell, 2013: 184-187). A tentative short list of codes is formed with the purpose of creating a shorter list of broader themes, which are the constitutive units of the interpretative analysis (Strauss and Corbin, 1998: 113-120; Neuman, 2014: 480-487).

4.4 Analysis of the Empirical Material

4.4.1. Applying Process Tracing

The first stage of the application of Process Tracing in the analysis of the empirical material entails the identification of theoretically predicted intermediate steps in line with the

Sociological Institutional approach to the reform of European Economic Governance. This means that the central hypothesis of this thesis that an adjustment in EMU's system of meaning legitimated the strengthening of European economic coordination as an organisationally superior form needs to break down into intermediate steps. For each intermediate step, the Process Tracing method requires the formulation of particular predictions emerging from the application of the theory. Five intermediate steps can be identified. In Step 1, the existence of a system of underlying economic policy beliefs existing in the pre-crisis EMU must be confirmed. In Step 2, the weakening of some or all the pre-existing economic policy beliefs is anticipated. In Sociological Institutional terms this process refers to the deinstitutionalisation of cognitive elements. In Step 3, a strengthening of alternative economic policy beliefs is expected. This is the institutionalisation process in SI terminology. In Step 4, organisational arrangements that are in line with the adapted system of meaning are expected to be rewarded during formal legislative negotiations. In Step 5, the newly established organisational structure of European Economic Governance should comply with the institutionalised elements of Stage 3. In reality, these intermediate steps constitute mini empirical cases that can be examined in turn.

The second stage of the application of Process Tracing requires the examination of the empirical material to detect relevant evidence. The method identifies four types of evidence: sequence, trace, account and pattern (Beach and Pedersen, 2013: 99-100). Sequence evidence refers to expected temporal sequences of events. Trace evidence can be understood as indirect proof that an event has taken place. For example, the existence of meeting minutes proves that a meeting has actually taken place. Account evidence refers to the content of discussions or oral accounts of meetings. Pattern evidence has to do with tendencies. At this point, it should be stressed that tracing evidence differs from the random selection of raw empirical data. Evidence carries inferential weight as it substantially updates the researcher's confidence about the validity of the theoretically based predictions (Beach and Pedersen, 2013: 120-132). Hence, evidence refers to *relevant* observations. As I am going to explain in a moment both expected and surprising evidence are important for the assessment of predictions. My analysis of the predictions in each intermediate step is based on sequence, account and trace evidence. Being attentive to the issue of the reliability of the empirical observations I opted to triangulate the data. Therefore, I collect observations from multiple sources (independent interviewees with different institutional affiliations) and combine the types of sources (documents and interviews)

to corroborate my findings. In this way, elite interviewing fits well with process tracing (Tansey, 2007).

The third stage of Process Tracing involves the testing of each part of the causal mechanism on the basis of the empirical evidence. I employ two types of tests: hoop tests and smoking gun tests. Hoop tests rely on the criterion of necessity to evaluate the validity of an explanation. Failure to find the necessary evidence in each step of the theorised process eliminates the particular part of the causal chain disconfirming the central hypothesis. For example, a failure to trace evidence of deinstitutionalisation or institutionalisation mechanisms would preclude any cognitive variation in EMU's underlying beliefs thereby falsifying the hypothesis that an adjustment in EMU's system of meaning legitimated the strengthening of European economic coordination. In contrast, passage of the hoop test is not enough to confirm the hypothesis: finding evidence of institutionalisation processes within the social environment of the EMU cannot (solely) prove the effect of newly established beliefs on the adoption of new policy arrangements. Every part of the sociological institutionalist-inspired causal mechanism needs to be present. For this, I use hoop tests for the predictions of every intermediate step.

The second type of test is the so-called smoking gun test. The latter relies on the detection of rare, unique evidence that provides strong support to the hypothesis. One such case is the successful promotion of the proposal of the government of Luxembourg for the establishment of the European Semester (see Chapter 7). The unexpected rewarding of the far-reaching proposal of a small member state during the legislative negotiations strongly supports the hypothesis of the reform of the Economic Governance in line with the evolution of EMU's underlying economic policy beliefs.

The fourth stage of the Process Tracing method refers to the evaluation of the sufficiency of the explanation. Minimal sufficiency is achieved when an explanation accounts for every significant part of the outcome under examination (Beach and Pedersen, 2013: 63-64; 2013: 91-93). When the theory is unable to provide a sufficient explanation of crucial developments (something common in the explaining-outcome version of Process Tracing), a second iteration of empirical analysis is required to trace the non-systematic (non-theory based and case specific) parts of the causal mechanism. In the case of my research, the explanation should be able to account for the establishment of the Six-Pack, the Fiscal Compact and the Two-Pack. As the emergence of the Fiscal Compact in the agenda of the formal negotiations cannot be

explained by the theorised causal mechanism of the Sociological Institutional approach, I am complementing the explanation with case-specific parts (see Chapter 7).

4.4.2 Applying Discourse Analysis

Discourse Analysis evolves in parallel to the Process Tracing method detailed above. This means that the analysis of discourse fits into the five intermediate steps. In Step 1, I employ the Interpretive Structuralist variant of Discourse Analysis to identify the constitutive economic policy beliefs of the Eurozone's original Sound Money paradigm. To do so, I examine the organisational discourse of the Eurozone during its formative years and search for typifications and taken-for-granted understandings. I use coding to organise the data and define some initial categories. Subsequently, I move beyond the particular organisational texts and focus on the broader economic ideas that have informed the decision-makers. The reading of the economic literature (academic articles and books) enables me to define the evolution of the economic ideas and their logical interconnections. Then I turn back to the organisational texts and use contextual knowledge to limit the initial categories into eight and define their hierarchical relationships. This set of eight economic policy beliefs constitutes the Sound Money paradigm, which is identified as the Eurozone's original system of meaning.

In Step 2, I apply the Social Linguistic variant of Discourse Analysis to detect mechanisms of deinstitutionalisation of cognitive elements. Initially, I use the economic policy beliefs that I traced in Step 1 as a heuristic device. Close reading of the post-crisis official documents in combination with the transcripts of the interviews unveils the level of the institutionalisation of the constitutive elements of the Sound Money paradigm. Subsequently, I focus on the deinstitutionalised elements. By tracing the changes in the language of the official documents over time I unlock the sequence of events leading to the weakening of certain beliefs and present the relevant ad-hoc deinstitutionalisation mechanism.

In Step 3, I examine the institutionalisation mechanism. Drawing on the insights of Sociological Institutionalism's generalisation of meaning mechanism I focus on the routinised behaviour of Eurozone policymakers and their theorisation of policy solutions within the EFC. Here, I employ Social Linguistic Discourse Analysis as my purpose is to analyse the microdiscourse within the EFC. The analysis of the language of the official documents and the interview transcripts reveals the emergence of three cognitive scripts ("codes") pointing towards the adjustment of Sound Money paradigm. Then I analyse the documents produced by

other EU bodies in combination with some interview transcripts to detect the transmission of the theorised elements outside the EFC.

In Step 4, I investigate the impact of the adapted social legitimacy on different negotiation proposals. I use Social Linguistic Discourse Analysis to uncover the existence of cognitive elements within the available negotiation documents and the interview transcripts. Then I look at the sequence, trace and account evidence unveiled in the context of the process tracing analysis to evaluate the effect of the adapted system of meaning on the content of negotiations. In Step 5, I trace the existence of cognitive elements in the adopted legal texts. Here, the Social Linguistic Discourse Analysis is employed to confirm the alignment of the new policy arrangements with the adjusted Sound Money paradigm.

Conclusion

This chapter presented the methodological approach of the thesis. To answer the research question, this study develops a qualitative empirical research design. I argued that European Economic Governance can be conceptualised as an intrinsic case study. Being part of the historical integrative process of the EMU, the reform emerged in the aftermath of the most important financial crisis since the 1930s establishing unprecedented constraints on national democratic policymaking. Marking a significant change of course in the field of European fiscal and macroeconomic coordination, the EEG is an inherently interesting collection of events deserving thorough investigation.

Data collection advanced through documentary investigation and elite interviewing. The employment of the time-consuming technique of elite interviewing was deemed necessary due to the elusive nature of some central economic policymaking bodies of the EU, such as the Eurogroup and the Economic and Financial Committee. Given that textual data from these bodies is scarce, tracing cognitive elements and typifications required contacting participants directly. The fieldwork produced 21 semi-structured interviews.

Considering the selection of the analytical methods, the thesis employs Process Tracing and Discourse Analysis. Process Tracing will be used to detect the origin and progress of beliefs on the basis of empirical evidence. Its application entails the separation of this thesis' hypothesis in intermediate steps and the formulation of theoretically based predictions for each step. By testing each prediction against the empirical evidence, the method will help evaluate

whether the hypothesized causal chain is in place and to whether it produces a sufficient explanation for every significant policy arrangement. Discourse Analysis will be used to detect the constitutive cognitive elements of the Eurozone's system of meaning and uncover the microlevel processes of institutionalisation and deinstitutionalisation by focusing on the creation of meaning through language. Both methods are compatible with the sociological institutionalist framework and the social constructivist foundations of the project.

In the next chapter the thesis proceeds to the analysis of the empirical material by presenting the Eurozone's Sound Money economic policy paradigm and detecting the immediate effects of the financial crisis on the prevailing economic policy beliefs.

¹ Finding contact information required considerable research involving many hours of web search and telephone calls to their offices in some cases.

² This is related to the format of semi-structured interviews (see below).

³ EFC alternate members attend EFC meetings and replace EFC members if necessary. They also convene in an 'EFC alternates' format to discuss technical aspects of dossiers at the request of the EFC.

⁴ By gathering evidence from one particular case it is inferred that all the components of the hypothesised causal mechanism are present in this case.

⁵ Renate Mayntz accurately notes that "[I]nductive process tracing and deductive process tracing are closely interdependent exercises" (2016: 487).

⁶ Thomas Christiansen and colleagues put it even more bluntly, for them the analysis of social construction "cannot be done within a research context that is closed towards interpretative tools" (1999: 529).

⁷ Ian Parker (Parker, cited in Phillips et al., 2004) defines discourse as structured collections of meaningful texts as well as the relevant practices for their production, transmission and reception.

⁸ Phillips and Hardy categorise the different versions along two axes: a vertical text-context axis and a horizontal constructivist-critical axis. Social Linguistic Analysis is located towards the text-based and constructivist ends.

CHAPTER 5
THE SOUND MONEY PARADIGM
& THE KEYNESIAN CHALLENGE

Introduction

The previous chapters presented the theoretical approach and the methodological parameters of the thesis. This chapter begins the analysis of the empirical material. Tracing adaptations in the Eurozone's system of meaning is not possible without the previous identification of its constitutive cognitive elements. Therefore, this chapter seeks to answer what was the EMU's system of meaning at the time of its launch and how it evolved throughout the years before the financial crisis. Given that the theory anticipates that policy failure can have significant effects on the social legitimacy of organisations, I attempt to evaluate the impact of the financial crisis on Eurozone's system of meaning.

The chapter advances the argument that the Eurozone's system of meaning is the Sound Money economic policy paradigm. I present Sound Money's eight constitutive economic policy beliefs and trace their intellectual roots. I show how these economic policy beliefs determined EMU's organisational structure. Subsequently, I turn to Sound Money paradigm's evolution. I argue that before the financial crisis the paradigm remained relatively stable but became seriously challenged in the aftermath of the collapse of Lehman Brothers. The resurgence of Keynesian ideas undermined basic aspects of the Sound Money paradigm opening the way for its adaptation. The erosion of economic beliefs was reflected in deinstitutionalisation processes exposing the changes in Eurozone's social legitimacy. The first part of the chapter proceeds to the analysis of the Sound Money paradigm in the beginning of EMU. The second part turns to the evolution of Sound Money before the outbreak of the financial crisis focusing on one particular element: rules-based discipline. The final part presents the effects of the financial crisis on the Sound Money paradigm and identifies significant deinstitutionalisation processes linked to the Keynesian shift in economic thinking.

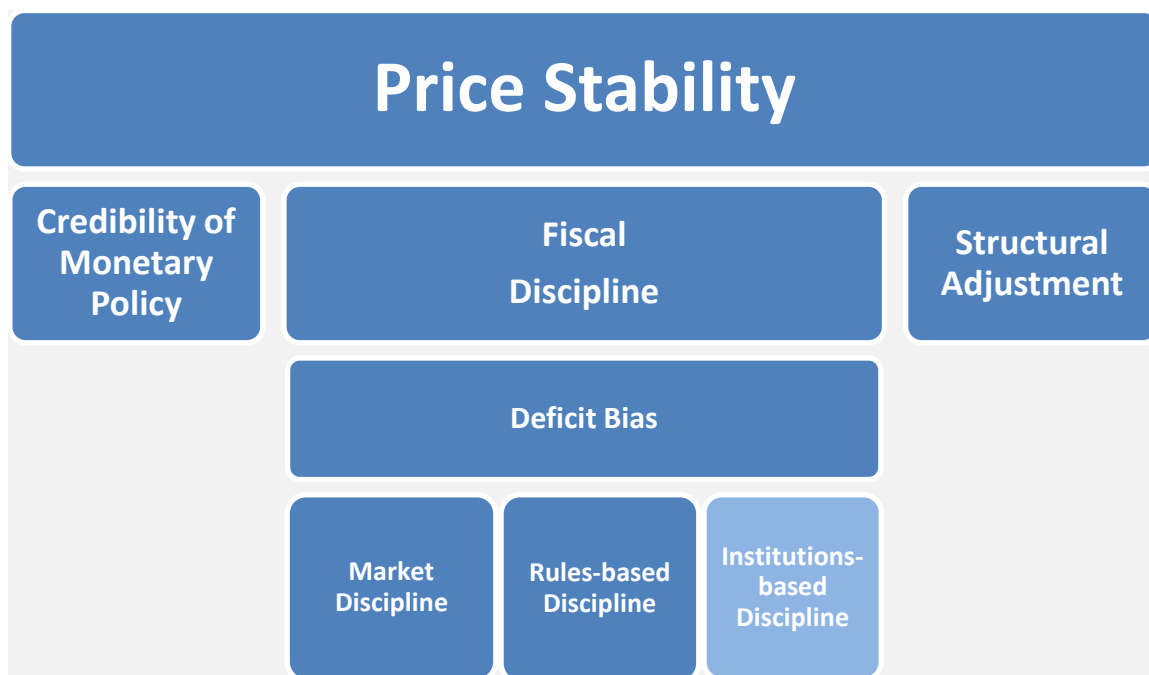
5.1 The Sound Money Economic Policy Paradigm

The Eurozone's system of meaning is the "Sound Money" economic policy paradigm. This paradigm refers to a particular set of economic policy beliefs with constitutive effects on the formation of interests and identities within the Eurozone. Kenneth Dyson was the first that proceeded to the identification of the underlying economic policy beliefs of the EMU. Writing in the aftermath of the signing of the Maastricht Treaty, he focused on the Sound Money ideas that the EMU shared with the EMS: price stability, borrowing credibility, central bank independence and hostility towards devaluation (Dyson, 1994: 231-239). Naturally, at that stage his examination of the Sound Money beliefs was limited to the monetary dimension. As the Eurozone started to take shape and the member states prepared to launch the common currency Dyson re-examined the Sound Money paradigm identifying fiscal and structural dimensions. Apart from price stability and monetary policy credibility, the paradigm included three additional beliefs: fiscal consolidation, labour-market flexibility, and market discipline (Dyson, 2000: 27-31). Dyson concluded that the ECB-centric nature of the EMU and its asymmetrical policy design were the by-products of the Sound Money beliefs (Dyson, 2000: 31-44).

My argument here is that the above view of the pre-crisis Sound Money paradigm is incomplete. While Dyson accurately detected the existence of a hierarchical relationship between the monetary and the fiscal dimension of the Sound Money beliefs leading to the prominent role of the ECB within the EMU, he did not elaborate on the necessity of fiscal consolidation or the underlying logic of market discipline. For this reason, the links between the individual elements of the Sound Money paradigm were not fully grasped. For example, why was fiscal consolidation considered to be a prerequisite for price stability? Or, why were financial markets seen as the enforcers of discipline? By proceeding to a more in-depth exploration of the fiscal discipline belief, I reveal the existence of further hierarchical relationships within the Sound Money paradigm and uncover three undetected cognitive elements: deficit bias, rules-based discipline and institutions-based discipline (see Schema 5.1). Additionally, I find the interconnections between market discipline and the other cognitive elements. To do so, I use Interpretive Structuralist Discourse Analysis. I examine official documents of the organisational environment searching for typifications. Then, I turn to the economic literature to detect the construction of taken-for-granted understandings. Eight economic policy beliefs are identified and analysed: price stability, the credibility of monetary

policy, fiscal discipline, governmental deficit bias, market discipline, rules-based discipline, institutions-based discipline and structural adjustment as a means of stabilisation. Subsequently, I show how the different parts of the Eurozone’s organisational structure reflect the eight underlying cognitive elements. The hoop test confirms the existence of an underlying system of meaning in the EMU.

Schema 5.1: The pre-crisis Sound Money Paradigm



5.1.1. Price Stability

The core idea behind EMU’s organisational form was the belief in the inherent value of price stability. The importance of this economic policy belief was that it justified the prioritisation of the fight against inflation over other economic policy objectives, such as growth or full employment. Good economic results were considered to be just the by-products of low inflation. ECB’s Chief Economist Otmar Issing explained that “...confidence in lasting price stability removes the inflation risk premium on interest rates, thereby ensuring low real interest rates which, in turn, will foster investment, growth and employment” (2002: 351-352). This rationale gained prominence with the rise of monetarism during the 1970s and 1980s but was not always dominant (McNamara, 1998: 144-151). During the period of “embedded liberalism” the pursuit of Keynesian full-employment interventionist policies at home was the basis of the

international monetary regime (Ruggie, 1982) and, as such, it was prioritised by western European states. The primary economic policy belief at the time was that there was a trade-off between high inflation and low unemployment. The prioritisation of full employment justified higher inflation. Monetary policy was preoccupied with keeping interest rates low to assist government intervention in the economy to create more jobs and in some cases was employed to stimulate demand directly (McNamara, 1998: 85-87). In general, the monetary policy doctrine was that of “cheap money” (Friedman, 1968).

The endorsement of monetarist thinking during the 1970s and 1980s meant the rejection of the Keynesian view of the world (Commission, 1990: 90). According to monetarists, the root cause of inflation was identified with the growth in the money supply (De Grauwe and Polan, 2005). By accepting that “inflation is always and everywhere a monetary phenomenon” (Friedman, 1963) monetarists assigned to money the prominent role in monetary policymaking (Friedman, 1968).¹ Preserving the value of money became an end in itself. Taming inflation required the setting of targets for a stable annual increase in the aggregate money supply. In reality, monetarists advocated tight monetary policies. The implication of this approach was that monetary policy could no longer be used to assist in the fine-tuning of the economy. To avoid the overexpansion of money supply, governments had to abandon demand management through countercyclical fiscal and monetary manipulations (McNamara, 1998: 144-145). The level of employment could no longer be a criterion for monetary policy. Inflation had to remain low at all times even if the government had to tolerate a certain level of unemployment, which constituted the market’s “natural rate of unemployment” (Friedman, 1968).

The primacy of price stability was reflected in EMU’s organisational structure (Dyson, 2000: 27-31). The Treaty,² clearly acknowledged the importance of price stability.³ The chapter on the monetary policy began by recognising that “[t]he primary objective of the European System of Central Banks (hereinafter referred to as ‘the ESCB’) shall be to maintain price stability” (TFEU, Article 127).⁴ From the early days of its establishment the Governing Council of the ECB underlined the monetarist underpinning of the ECB’s monetary policy. The first Monthly Bulletin of the ECB explained that “[t]he stability-oriented monetary policy strategy of the Eurosystem assigns a *prominent role to money*, founded on the essentially *monetary nature of inflation* in a medium and long-run perspective” (European Central Bank, 1999: 19, my emphasis). While the Treaty made reference to additional monetary policy objectives noting that “[w]ithout prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives

of the Union” (TFEU, Article 127),⁵ the Governing Council quickly downplayed those goals by stressing that the ECB would focus *strictly* on price stability (Galí, 2002: 42; European Central Bank, 1998). The quantitative definition of price stability, namely the year-on-year increase of prices below but close to 2% (European Central Bank, 2003), which is at the centre of ECB’s monetary strategy (European Central Bank, 2000) was not a Treaty requirement. The Governing Council proceeded to an interpretation of the Treaty provision based on the monetarist idea that inflation should remain low at all times. The use of a numerical inflation target as a nominal anchor proved popular in the 1990s for various central banks⁶ (Svensson, 2000). The issue was not in any way trivial as inflation targeting leads to lower inflation in the long run (Mishkin and Schmidt-Hebbel, 2007). ECB President Trichet admitted that “[a] different definition of price stability would have immediately led to higher inflationary expectations” (2005: 25).

The monetarist belief about the monetary origins of inflation appears to have an additional imprint on the organisational framework of EMU. To achieve the objective of price stability the ECB announced that its stability-oriented strategy would be based on two pillars. The first pillar consisted of the announcement of a reference value for the growth of a broad monetary aggregate (European Central Bank, 1999). While the indication of a 4.5% reference value of M3 growth did not have particular practical implications for ECB’s monetary policymaking (Galí, 2002: 51-59), as the ECB employed the monitoring of the development of M3 purely as an analytical instrument (European Central Bank, 2000), it provided the bank with a good opportunity to underline the monetary origins of inflation and the necessity to assign money an important role in monetary policymaking (Gaspar, Masuch and Pill, 2002: 83-84). By focusing on monetary growth, the ECB asserted its conformity to monetarism underlining that “money must have a stable relationship with the euro area price level” (European Central Bank, 1999: 47).

5.1.2 Credibility of Monetary Policy

A second economic policy belief closely related to the aforementioned primacy of price stability was the belief that monetary policy had to be credible. For the prevalent economic literature, securing the primacy of price stability entailed dealing with the distinct issue of enforcement. The logic behind the importance of credibility in monetary policymaking was the economists’ concentration on the so-called time-inconsistency problem (Papadia and Ruggiero,

1999). According to Robert Barro and David Gordon, “[w]hen monetary rules are in place, the policymaker has the temptation each period to ‘cheat’ in order to secure the benefits from inflation shocks” (1983: 102). The temptation exists because, when people expect that the rule will be followed, cheating from the part of the policymaker or, to put it in more formal terms, behaving in a time-inconsistent way produces better results. In a seminal paper Kydland and Prescott (1977) had already established the suboptimality of the consistent policy in a given current situation. Still, given that people tend to adjust their inflationary expectations, the optimal inconsistent monetary policy comes at a cost. People cannot be systematically deceived to maintain low inflationary expectations. In Barro and Gordon’s words, “the cost of cheating today involves the increase in inflationary expectations for the future” (Barro and Gordon, 1983: 108). Therefore, consistent monetary policy is considered preferable over time. Consistency is perceived as an investment in credibility.

Acknowledging the importance of the time-inconsistency problem for monetary policy led economic thinkers to propose significant organisational changes. To address the inherent inflationary bias of monetary policy and increase credibility, economists endorsed the delegation of monetary policymaking to independent central banks (Grilli et al., 1991; Cukierman, 1994). This literature built on Kenneth Rogoff’s (1985) argument that the enhancement of the central bank’s commitment to fighting inflation leads to substantially lower average inflation even if this might come at the cost of unstable employment and inferior economic performance (loss of output stabilisation). Alesina and Summers (1993) rejected this trade-off concluding that inflation-averse independent central banks have no apparent real costs. Alesina and Gatti (1995) identified the elimination of electoral uncertainty as the reason behind the reduction in output variability. The literature moved on to determine the content of central bank independence (De Haan, 1997; see also, Papadia and Ruggiero, 1999; Grilli et al. 1991). A central bank had to enjoy personnel independence so that the government had marginal involvement in the bank’s appointment procedures. Functional independence meant that the government could not use the central bank to finance its expenditure or manage its debt. Policy independence was identified as the freedom of the central bank to set the final goals of monetary policy as well as the freedom to select the instruments through which it would attempt to achieve its goals.

The economic belief about monetary policy’s credibility had a significant impact on the organisational form of the EMU. According to the Treaty, monetary policymaking is delegated to the European Central Bank and the national central banks of Eurozone members (TFEU,

Article 282).⁷ The ECB is established as a legally independent EU Institution having its own legal personality. Additionally, the legal rank of its Statute is elevated to constitutional level (Papadia and Ruggiero, 1999). The ECB possesses functional independence as the Treaty explicitly prohibits the bank from providing credit to governments or other public bodies and forbids the purchase of their debts (TFEU, Article 123).⁸ Personnel independence is secured through the appointment of high ranking ECB officials for long tenures and by ensuring that their removal is difficult (Gros and Thygesen, 1998: 492). Policy independence is achieved because although the Treaty determines price stability as the goal of monetary policy, the ECB has enough discretion to define its content (De Haan, 1997; McNamara, 2002). In parallel, the ECB is free to select its policy instruments (Papadia and Ruggiero, 1999; De Haan, 1997). Most importantly, the treaty forbids the ECB or even national central banks from taking instructions from any other EU or national body (TFEU, Article 130).⁹ Thus, it is safe to conclude that the ECB appears to be the world's most independent central bank (McNamara, 2002; Papadia and Ruggiero, 1999). This level of independence is the result of the prevalence of credibility as the key requirement of monetary policymaking. The ECB's Governing Council stressed from the first Monthly Bulletin the centrality of credibility for monetary policy (European Central Bank, 1999).¹⁰ ECB President Trichet was even more explicit in drawing the link between the bank's independence and the underlying logic of monetary policy credibility noting that "[e]conomic research has shown that a central bank's independence from other institutions and pressure groups is crucial in ensuring its *credibility*, and therefore in creating the conditions for *inflation expectations* firmly anchored upon the announced definition of price stability" (2005: 25, my emphasis).

The underlying economic belief of credible monetary policy fostered the adoption of a particular organisational principle in EMU. As Daniel Gros and Niels Thygesen accurately note, one of the fundamental EMU principles existing since the Maastricht Treaty is the *sharp division of responsibilities* between the monetary and budgetary spheres (1998: 549). ECB's economists related this organisational principle to the belief of monetary credibility explaining that "[t]he Maastricht Treaty (...) provides for a clear division of responsibilities among policy making institutions which – by providing the proper *incentives* – enhances the *credibility* of all policies" (Gaspar, Masuch and Pill, 2002: 78, my emphasis). As was shown above, the issue of monetary policymakers' incentives became a major concern for economists due to the time-inconsistency problem. In this line, the clear division of responsibilities, together with the allocation of distinct objectives and policy instruments was expected to help the monetary

authorities to have every incentive to preserve price stability. In turn, the adoption of this organisational principle had an important effect on EMU's organisational form. The assignment of clear responsibilities to fiscal and monetary authorities limited the scope for macroeconomic policy coordination within EMU (Issing, 2002). Explicit "ex ante" coordination of fiscal and monetary policies had to be avoided because it risked blurring responsibilities and distorting incentives and in this way reduced the accountability of the decision-makers inducing uncertainties about the policy framework (Dyson, 2000: 30; Issing, 2002: 350; Brunila and Martinez-Mongay, 2002: 154). For similar reasons, no ex ante coordination between monetary and structural policies could take place (Gaspar, Masuch and Pill, 2002: 79). In this context, the EMU design promoted an implicit "ex post" model of policy coordination according to which national governments and social partners had to align their expectations taking into consideration the monetary policy's credible commitment to price stability (see also Alesina et al., 2001).¹¹ Consequently, the asymmetric framework of the EMU can be seen as the product of the Sound Money belief on monetary credibility (Dyson, 2000: 31-32).

5.1.3 Fiscal Discipline

A third economic policy belief was that the credibility of monetary policy was dependent on fiscal discipline. The belief derived from the economists' recognition of the interaction between monetary and fiscal policies. While the monetarist thinking established the precedence of monetary policy over fiscal policy, it was acknowledged that a mismanaged fiscal policy could have adverse effects on monetary policy. The economic conceptualisation of these effects came to be known as the "Fiscal Theory of the Price Level" (Woodford, 1995; Christiano and Fitzgerald, 2000). The concept diverged from the more traditional monetary thinking as it placed particular emphasis on fiscal policy to preserve price stability. In other words, central bank independence was not enough to safeguard the credibility of monetary policy and had to be accompanied with fiscal discipline (Artis and Winkler, 1997; Papadia and Ruggiero, 1999). According to economists, the impact of fiscal policy on the monetary sphere would be twofold (see Gros and Thygesen, 1998: 320-329). Firstly, it was argued that an expansionary fiscal policy could increase the inflationary pressure on prices forcing the central bank to intervene more aggressively. In this way, there was "a risk of overburdening monetary policy in countering inflation" (Brunila and Martinez-Mongay, 2002: 152). In the context of a monetary

union, a spillover effect could not be excluded: lax fiscal policy in one member state could increase demand in other member states putting (upward) pressure on the level of prices.

Secondly, there was the fear that a member state's overly expansionary fiscal policy could create a liquidity or funding crisis for this state thereby increasing the pressure on the ECB to loosen its monetary policy. Although the ECB would not be in any way legally obliged to assist the member state to finance its debt by lowering interest rates and enabling higher inflation, it was imagined that the central bank would try to avoid the triggering of a banking crisis with systemic effects following a run on the country's debt (Beetsma, 2001: 28-29).¹² To avoid a financial meltdown, the ECB could even be forced to take a more radical step and monetise governmental debt by buying the bonds of the member state in distress (Eichengreen and Wyplosz, 1998). The above would signify a reversal of the primacy of monetary policy over fiscal policy and the end of ECB's independence. Also, it was conceivable that in some cases even a small tightening of credit conditions by the ECB would push an indebted member state into a liquidity crisis (Gros and Thygesen, 1998: 330). At that point the ECB could be very reluctant to implement its favoured monetary policy mix. Therefore, it was believed that the credibility of the monetary policy could be severely compromised in the case of expansionary fiscal policies as these situations (even in their modest versions) could create adverse incentives for the ECB. Fiscal discipline then was deemed as a prerequisite for the protection of the ECB's independence and the credibility of monetary policy.

The organisational structure of the EMU was profoundly influenced by the fiscal discipline belief. The Treaty established that the economic policies of the member states had to comply with the "sound public finances" guiding principle (TFEU, Article 119).¹³ Also, according to the Court of Justice of the European Union, Article 125 of the Treaty directly links sound budgetary policy to "maintaining the financial stability of the monetary union" (Court of Justice of the European Union, 2012, paragraph 135). The aforementioned economic rationale behind the endorsement of fiscal discipline was echoed in the Commission's "One Market One Money" report that advocated the transition to EMU. The Commission explained in this report that "[b]udgetary sustainability is always a concern for monetary policy because monetary and budgetary policy are interdependent in the long run: protracted deficits leading to unsustainable budget positions end up either in debt monetisation or government default" (1990: 106). The ECB shared this logic as it has argued that a price stability-oriented monetary policy needs to be accompanied with fiscal discipline in order to maintain low inflation (European Central Bank, 2004: 42).

Achieving fiscal discipline was not a simple issue. The Sound Money paradigm included four distinct economic policy beliefs that guided the implementation of fiscal discipline having profound effects on the organisational structure of EMU.

5.1.4 Deficit Bias

A crucial cognitive element was the great mistrust towards politicians, who were seen to be prone to adopt inappropriate (unsound) expansionary policies. In other words, it was believed that governments were subject to a deficit bias (Wyplosz, 2006). The rationale behind the deficit bias was inspired by Public Choice Theory's view of fiscal policy (Gros and Thygesen, 1998: 324; see also Buchanan and Wagner, 1977). According to this view, special interest groups shape the direction of fiscal policy with the aim to maximise their benefits without internalising the overall budget constraint. Fiscal authorities were seen as unable to ensure that the outcome of the interest groups' interaction would be compatible with the interest of the overall economy. That was the so-called "common pool problem" (Ayuso-i-Casals, et al., 2009: 5-6). A different problem was the short-term horizon of policymakers. Economists acknowledged that politicians were rational utility maximizers. Incumbent governments had an incentive to distort fiscal policy before elections and increase government spending to secure re-election, while voters made inferences about the competence of incumbents but were disadvantaged due to information asymmetries. Overestimating the (short-term) benefits of lower taxes and higher governmental spending but unaware of the possible long-term costs, voters suffered from "fiscal illusion".¹⁴ Thus, a "political budget cycle" emerged as a result of the structure of the democratic political process (Rogoff, 1990). As some prominent economists put it "[e]ven the best-intentioned finance ministers are subject to extensive political constraints – electoral concerns, the necessity to strike deals with opposition parties, or to favour certain constituencies such as public sector unions" (Alesina et al, 2001: 9). In this context, the democratic process was perceived as a burden to virtuous policymaking.

The mistrust towards politicians became embedded in the organisational structure of the EMU. The European Commission endorsed the underlying logic of the deficit bias, namely the concern about political short-termism and the adverse effects of electoral cycles. In the One Market, One Money Report the Commission noted that "[g]overnments typically have electoral cycles which may at times make it attractive to exploit short-term gains against long-term costs" (1990: 22). Similarly, the ECB acknowledged that "[n]ational policymakers tend to act

within short time frames that are influenced by the electoral timetable” (European Central Bank, 2007: 67). The Bank directly linked the danger of a deficit bias with the Maastricht Treaty’s provision for an “Excessive Deficit Procedure” and the signing of the Stability and Growth Pact (European Central Bank, 2008b: 53). In reality, the deficit bias belief did not underpin any particular organisational arrangement within EMU. The significance of the belief was that it precluded an unqualified reliance on democratic policymaking for the management of national fiscal policies. Thus, the endorsement of deficit bias opened up the discussion about the imposition of constraints on policymakers’ discretionary judgement about the course of fiscal policy (Ayuso-i-Casals, et al., 2009: 7).

5.1.5 Market Discipline

A distinct belief was the superiority of global financial markets to evaluate good fiscal policy and imbue credibility to governmental decisions. Financial markets were seen by some economists as external “enforcers” that would discipline public sectors (Gros and Thygesen, 1998: 329-330). The economic thinking behind the market-based fiscal discipline mechanism concentrated on the fact that sovereign states relied upon financial markets to finance their sovereign debt. In turn, financial markets determined the borrowing cost and the availability of credit to sovereigns. The underlying logic was that an unsound policy of persistent fiscal deficits would lead to a rising default premium on the debt of the state running excessive deficits (Bayoumi, Goldstein and Woglom, 1995). Eventually the state would be denied access to additional credit, facing insolvency. Thus, the increasing borrowing cost and the threat of reduced availability of credit would incentivise the state to correct its irresponsible fiscal policy. To be effective, market discipline rested on certain conditions. Financial markets needed to be free, namely without capital controls, lenders needed to have adequate information about states’ outstanding debts and market participants had to be confident that borrowing states would not be bailed out in case of default (Lane, 1993).¹⁵ The first two conditions were already met before the advent of the EMU. The third one was crucial because its absence created a moral hazard problem: lenders had reduced incentives to monitor the borrowing state’s behavior and states had weaker incentives to maintain solvency. Bailouts could take various forms. Two prominent examples were the monetary bailout, which corresponded to debt monetisation (the central bank purchasing the government’s debt), and the fiscal bailout, which referred to the purchasing of the irresponsible state’s debt by other fiscal authorities.¹⁶

For a number of economists, a credible commitment to avoid any bailout was thought to enable the enforcement of market discipline (Buiter, Corsetti and Roubini, 1993).

The economic belief of market discipline had a noticeable impact on the organisational structure of the EMU. The Treaty explicitly prohibited both the monetary bailout (TFEU, Article 123)¹⁷ and the fiscal bailout (TFEU, Article 125).¹⁸ The purpose of the no bailout clauses was to “make it absolutely clear and credible that national debt is, and remains, the exclusive obligation and responsibility of its own national government”, supporting in this way the proper function of the financial markets (Buiter, Corsetti and Roubini, 1993: 79). The idea of relying on financial markets to promote fiscal discipline can be traced in the early plans of the EMU (Delors, 1989: 20; Commission, 1990: 100-113). While the EMU blueprints signalled some caution noting that market discipline could not be taken for granted, it seems that by the time that the Eurozone became operational “the whole EMU construction was based on the belief of market efficiency” (Anonymous Interviewee 08). As Marco Buti and Nicolas Carnot from European Commission’s DG ECFIN eloquently put it, “it could be expected that efficient financial markets would price in default risk premiums in the event of unsound policies. Market discipline, in other words, would contribute to the maintenance of stability-oriented monetary and fiscal policies” (2012: 901).

An implicit effect of the presence of the market discipline belief was that it undermined the strengthening of alternative fiscal discipline mechanisms. Conceptualising the function of the financial markets as a genuine disciplinary mechanism for the Eurozone Member States did not resonate with the establishment of a strong supranational fiscal framework (Buiter, Corsetti and Roubini, 1993: 82).

5.1.6 Rules-based Discipline

While the financial markets were expected to function as a disciplinary mechanism to governments in the long run (see above), it was also acknowledged that for high deficit and debt countries the abolition of national currencies would remove the disciplining effect of international currency markets (Artis and Winkler, 1997: 90). Those countries would be relieved from the burden of interest rate premia for devaluation and the risk of inflation gaining easier and cheaper access to financing, at least in the short run. The limitations of the market discipline mechanism were known to the members of the Delors Committee that drew up the blueprint for EMU. In their report, they noted that “[r]ather than leading to a gradual adaptation

of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of access to market financing. The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive” (Delors, 1989: 20). In this sense, the case for using the fiscal framework to guarantee fiscal discipline is stronger in a monetary union than in a national setting (Papademos, 2006: 32).

An important Sound Money belief was that fiscal policy could be managed through a set of binding rules. Again, this idea was linked to the mistrust towards politicians and the deficit bias belief.¹⁹ In their seminal article, Kydland and Prescott (1977) argued that the introduction of fiscal policy rules could improve economic performance by limiting the discretion of policymakers. Milton Friedman (1948) had been an early advocate of a balanced budget rule. Similarly, the prominent monetarist Robert Lucas promoted an annual budget balance requirement as a way of enforcing time-consistent fiscal policies to governments (1986). Public Choice theorists were passionate proponents of constitutional budget rules (Buchanan and Wagner, 1977: 175-182). The rationale of rules-based discipline was to prevent discretion by binding fiscal policy in the short-run (Wyplosz, 2005). The application of strict limits to short-term fiscal policy was expected to lead to long-term fiscal discipline. The limits took the form of numerical targets for the budget resembling a contract between the government and the legislature (von Hagen and Harden, 1995; Hallerberg, Strauch and von Hagen, 2007).

The effectiveness of fiscal rules was challenged by many economists. The main argument against them was that they made fiscal policies pro-cyclical by exacerbating the swings of business cycles (Artis and Winkler, 1997; Wyplosz, 2005). In the case of recessions states were forced to cut spending and impede the working of automatic stabilisers when the counter-cyclical tools were most needed. In parallel, some economists noted that during upturns numerical thresholds did not do enough to guide fiscal policies (von Hagen and Mundschenk, 2002: 192). When the states respected the numerical limits no further action against emerging fiscal problems was undertaken. Additionally, it was argued that numerical targets increased the volatility of tax rates and enhanced the incentives for creative non-transparent accounting (Alesina and Perotti, 1996). Finally, some economists stressed that in the context of a monetary union numerical targets might hinder the coordination of national fiscal policies as they limit the flexibility of national fiscal authorities (Eichengreen and Wyplosz, 1998; Eichengreen and von Hagen, 1996).

The scepticism towards fiscal rules was not shared by the German Ordoliberal tradition that shaped the Sound Money paradigm. The origins of ordoliberalism can be traced in the so-called “Freiburg School” of the 1930s founded by the economist Walter Eucken and the law scholar Franz Böhm. Ordoliberalism’s primary concern is the establishment of a viable price system based on unrestricted competition (Eucken, 1952 [1982]: 116). The latter constitutes *the* fundamental principle of the envisaged economic order. In contrast to other liberal thinkers, ordoliberals acknowledged that a well-functioning market economy cannot simply emerge as a result of the free interaction of market forces. As Werner Bonefeld accurately notes, “[t]he ordoliberal notion of complete competition is distinct (...) [i]n this account, competition is perfect on the condition that no participant has the power to determine prices” (2017: 81). The proponents of the approach perceived the market system as inherently unstable and stressed the threat that private economic power poses to the competitive market order (Vanberg, 2014).²⁰ For this, a strong state had to assume the role of the “guardian of the competitive order” to protect the fundamental principle from the monopolistic tendencies of the market forces. In parallel, ordoliberals were conscious of the deficiencies of the state’s involvement in the economy: an excessively strong state is in reality a weak state because it becomes the prey of different interest groups that rip it apart, obtain various privileges and exploit it for their own purposes. Therefore, for ordoliberals the strong state is the self-limited state that “stands above individual groups and above interested parties” securing a “free market and fair competition with the same rules applied to all” (Rüstow, 1932 [2017]: 148).

The Freiburg School developed the concept of *Ordnungspolitik* to describe an economic policy that shapes the market through a rules-based (constitutional) framework but does not dictate economic decisions to market participants (Eucken, 1952 [2017]: 99; Feld, Köhler and Nientiedt, 2015). The framework, which Ordoliberals call “economic constitution”, includes the various formal-legal rules and informal traditions that govern a country’s economy leading to the establishment of a particular economic order (Vanberg, 2014). *Ordnungspolitik* prohibits discretionary intervention in the economy. Walter Eucken praised the importance of consistency in economic policy stressing that “if economic policy is not marked by sufficient permanence, the competitive system cannot function, either” (1952 [1982]: 129). Thus, consistent economic policymaking became one of the constitutive principles of the (German) economic constitution. Eucken was adamant that temporal emergencies could not justify exceptional measures infringing the economic constitution. Discretionary countercyclical policies were seen as major impediments to the prevalence of the constitution’s fundamental

principle, namely the establishment of a working price mechanism (1952 [1982]: 115-116). Discretionary policies were considered to be susceptible to pressures from powerful economic interests and mass democratic demands (Bonefeld, 2017: 71-73). As a result, ordoliberals insisted that governments and legislators could not be allowed to have discretion over policy and that economic interventionism had to flow from the economic constitution. In this context, German Ordnungspolitik presents clear affinities with Kydland and Prescott's rules-based fiscal discipline (Vanberg, 2014: 13-14). While the Freiburg School did not formulate the request for the introduction of specific fiscal rules, the latter seemed to epitomise the ordoliberal emphasis on the constraining role of the economic constitution.²¹ Given the importance of the German economic policy paradigm for the creation of the EMU, Ordnungspolitik became an inextricable part of the monetary union (McNamara, 1998: 69-70; Gros and Thygesen, 1998: 549). The prevalence of the rules-based discipline belief can be clearly traced in the influence of the ordoliberal tradition on German and European economic policymaking.

The economic belief of rules-based discipline was reflected in the organisational structure of the EMU. The Treaty included a couple of criteria to evaluate member states' compliance with fiscal discipline: the ratio of government deficit to gross domestic product and the ratio of government debt to gross domestic product (TFEU, Article 126).²² The specification of a 3% reference value for the deficit criterion and a 60% reference value for the debt criterion set particular numerical targets to national budgets (TFEU, Protocol No 12).²³ To safeguard national authorities' compliance with the above rules, the Treaty established a particular procedure to identify and sanction deviant fiscal behaviour, the so-called Excessive Deficit Procedure (EDP).²⁴ These provisions constituted an effort to use the legal framework to limit the discretion of national fiscal policymakers in accordance with the rules-based approach to fiscal discipline and the ordoliberal tradition.

Despite the aforementioned Treaty provisions, during the first years of the transition to the EMU the consolidation of public finances did not proceed in a satisfactory pace. It seemed that the rules-based character of the Treaty framework was not far-reaching enough. In turn, this created concerns about the sustainability and duration of fiscal discipline after the launch of the final stage of the EMU. In this context, the Stability and Growth Pact was an attempt to eliminate those aspects of the criteria and the EDP that did not fully comply with the rules-based belief. Behind the German initiative to propose a Stability Pact in the autumn of 1995 was the concern of German finance ministry officials about the wording of certain Treaty provisions, which could undermine the rules-based character of the fiscal framework (see

Stark, 2001). The Treaty provided the Commission and the Council with significant discretionary latitude to interpret what constituted a breach of the reference values and to decide about every step of the EDP process. Enhancing the rules-based nature of fiscal governance pointed to a stricter definition of reference values and an increase in the automaticity of the EDP. Indeed, the 1997 SGP introduced a medium-term objective of “close to balance or in surplus”²⁵ for each country’s budgetary position, which practically transformed the 3% reference value for the deficit into an upper ceiling, and created a quasi-automatic sanctioning mechanism²⁶ by significantly narrowing the margin for interpretation by the EU Institutions (Costello, 2001: 131; Stark, 2001: 104).²⁷

The belief of rules-based discipline promoted a particular organisational principle within the context of the EMU: the national responsibility for fiscal policymaking. The existence of multiple fiscal authorities meant that any setting of aggregate fiscal targets for the whole euro area would create adverse incentives to *individual* governments. A member state adopting an overly expansionary fiscal policy would force the rest to tighten their budgetary policies even if they were within the limits (“free-rider” problem). Therefore, a Commission proposal to introduce a budgetary target for the Council during SGP negotiations was rejected by member states. As DG ECFIN’s Declan Costello notes, ‘[m]ember states argued that a surplus in one member state provides no justification for a deficit elsewhere, and that member states could not be expected to adjust their budgetary position so as to “contribute” their share to an aggregate target for the euro area’ (2001: 117). Euro area targets were thought to cause a loss of clarity about the rules, a blurring of individual governmental responsibility and, as a result, a loss of discipline (Stark, 2001: 93). More importantly, an enhanced coordination of national fiscal policies could increase the *collective* discretion of fiscal authorities in direct opposition to the rules-based belief. In turn, this could undermine the sharp division of responsibilities within the EMU and the policy assignment of the Treaty (Winkler, 1999). Anything that resembled a centralisation of fiscal policies had been associated with the Keynesian economic paradigm and was rejected as it could lead to a more active fiscal policy (Korkman, 2001; Pisani-Ferry, 2006). Alesina and colleagues expressed it eloquently: “[i]f fiscal authorities coordinate on the wrong policies, then, acting together they may increase the pressure on the ECB to deviate from inflation targeting” (2001: 12). According to this thinking fiscal authorities had to “keep their houses in order” preserving in this way the national responsibility for fiscal policymaking.²⁸

The organisational principle of national responsibility that was underpinned by the rules-based belief severely restricted the coordination of national fiscal policies within EMU. Member states could only coordinate their fiscal policies *ex post*: national governments were responsible for the design and implementation of budgetary policies, while the Council assessed afterwards whether those policies complied with the supranational rules. In reality, no real coordination was envisaged because a series of economic parameters were not taken into consideration during the “coordination” process. Indeed, the SGP was “not designed to produce an E(M)U wide fiscal stance that ‘adds up’ and makes sense given the monetary policy stance of the ECB and the other EU area central banks and given economic developments (including monetary and fiscal policies) in the rest of the world” (Buitter, 2006: 698). Consequently, the weak framework of fiscal coordination was in line with the Sound Money paradigm and occurred not by chance but by design. The fiscal framework was about the imposition of strict restrictions on national budgets but beyond that it effectively prevented the active cooperation among governments for the design of an EU-wide fiscal policy stance.

5.1.7 Institutions-based Discipline

A competing idea to rules-based discipline was institutions-based discipline.²⁹ The seminal work of Jürgen von Hagen and Ian Harden (1995) promoted an alternative approach to deal with the deficit bias and the fiscal illusion based on the reform of the budget *procedures*. In reality, the approach concentrated on the centralisation of the budgetary process through the introduction of hierarchical procedures (von Hagen, 2002). Firstly, the proponents of the approach focused on the initial stage of the budgetary process (planning stage) noting the importance of delegating strategic powers to the finance minister, who could issue guidelines to other ministers acting like a “fiscal entrepreneur”. Then, they turned to the subsequent stage of the budgetary process (legislative approval stage) underlining the significance of limiting parliamentary amendments as a way of protecting the finance minister’s proposed budget. The centralisation of the budgetary process was expected to affect the balance of power between the democratic decision-making bodies of the state deliberately limiting the influence of those bodies that were considered to be more prone to unsound fiscal policies, such as spending ministries or parliaments. Important economists have quickly acknowledged the advantages of introducing hierarchical procedures as a way of enhancing fiscal discipline (Alesina and Perotti, 1996).

Amending the structure of the budgetary process and changing the power balance among democratically elected bodies in relation to fiscal decision-making was not enough, however. Drawing on the example of monetary policy the proponents of the institutions-based discipline moved further than the original work of von Hagen and Harden advocating the delegation of parts of fiscal policymaking to new *independent institutions* (Wren-Lewis, 2000; Calmfors, 2003; Wyplosz, 2006: 229-230).³⁰ Those new institutions could take the form of debt boards and fiscal policy committees operating at the national level (Eichengreen and von Hagen, 1996; Wyplosz, 2005). Also, it would be possible to create new institutions at the supranational level assessing and sanctioning the behaviour of national governments (Buti and Giudice, 2002). As in the case of monetary policy, independent experts would be employed to guarantee the credibility of the policy constraint (here, the fiscal constraint). The main drawback of the institutions-based discipline is that by purposefully reshaping the relations between legislatures and executives at the national level it exacerbates the pattern of executive dominance (Chrysochoou, 1995). In turn, this shift in the balance of power from parliaments to executives can lead to the de-democratisation of the national state as it limits the responsiveness of the government to popular demands and the accountability of fiscal policy officials (Beetham and Lord, 1998: 74). Additionally, the reform of national budgetary procedures in the case of member states participating in the EMU could be perceived as an intrusion of supranational decision-makers into national affairs (Beetsma, 2001: 47).

The institutions-based belief gradually became stronger within the EMU as economists realised the value of discretionary fiscal policy for output stabilisation in certain contexts. In particular, the economic literature of the early 2000s started to contemplate the issue of stabilisation when monetary policy is unable to play its stabilising role, as in the case of a currency union suffering a so-called asymmetric shock (Wren-Lewis, 2000; Calmfors, 2003; Wyplosz, 2002). Indeed, within the EMU monetary policy cannot function as a *national* stabilisation tool thereby increasing the difficulty of stabilising the *domestic* economy when an individual country faces adverse cyclical developments. In view of this, the rigidity of the fiscal rules appeared as a much more important issue in cases of country-specific recessions. Given the loss of the exchange rate instrument, discretionary fiscal policy seemed to be a useful tool to provide stabilisation in certain times. However, the deficit bias belief remained deeply entrenched in the minds of the economists. The economic rationale behind the institutions-based belief was the combination of short-run flexibility with long-term discipline (Wyplosz, 2005). National fiscal authorities would be required to protect debt sustainability (long-term discipline) but

would be able to use fiscal policy to contribute to output stabilisation over the business cycle. This intermediate position between the full discretion of Keynesian countercyclical fiscal policy and the rigidity of fiscal rules could be described as a model of “constrained discretion”. According to Jean Pisani-Ferry this is “a framework for decisions which prevents arbitrariness and pure political choice through reliance on principles and indicators, while leaving room for case-by-case decisions” (2006: 840). In reality, the concept of “constrained discretion” antagonised the absolute nature of the fiscal discipline belief and, by so doing, opened the way for the challenging of rules-based discipline. Discretionary judgement *is allowed* but this is not in the hands of elected politicians.

Apart from the developments in the economic literature of the early 2000s, the institutions-based discipline had clearly benefitted from the existence of the French economic tradition of *dirigisme*. Even though the French post-1980s model of economic policymaking could not be characterised as statist, it certainly retained some *dirigiste* features (Levy, 2017). This tradition pointed to the retention of a margin of manoeuvre in fiscal policymaking by the national government (Howarth, 2007). Without challenging the belief of fiscal discipline, the French tradition emphasised the importance of injecting some flexibility in the fiscal framework thereby providing the political level with some discretion. In parallel, the French tradition valued the guidance of the French Treasury technocrats to the political level. In line with these interventionist features, the French finance ministry officials actively promoted economic policy coordination between member states via the establishment of a “*gouvernement économique*” during the negotiations for the creation of the EMU (Dyson and Featherstone, 1999: 202-255; Dyson, 2000: 13). Certainly, the French approach displayed “intellectual weaknesses” at the time and, therefore, appeared weaker than German ordoliberalism (Pisani-Ferry, 2006: 841). As a result, the interplay between rules-based and institutions-based discipline became critically affected by the German ordoliberal tradition, which tipped the balance in favour of the former.

Institutions-based discipline was not entirely absent from the organisational framework of the pre-crisis EMU. The Treaty provided that the member states “shall regard their economic policies as a matter of common concern and shall coordinate them within the Council” (TFEU, Article 121).³¹ The instruments of this coordination were the Broad Economic Policy Guidelines (BEPGs) and the multilateral surveillance of national economic policies. The BEPGs were adopted by the Council on a recommendation by the Commission and the multilateral surveillance was conducted by the Council on the basis of reports drafted by the

Commission. The SGP reinforced multilateral surveillance of national budgetary policies by introducing the submission of Stability and Convergence Programmes by EMU participating member states and non-participating member states respectively.³² Those programmes were the basis of an early-warning system focusing on the prevention of fiscal deficits (Costello, 2001). In this way EU Institutions and bodies, such as the Commission, the Council and the Economic and Financial Committee, participated in the assessment of national budgetary policies. Additionally, the creation of the Eurogroup was clearly inspired by the institutions-based belief and the French tradition (Verdun, 2003). The issue of combining political discretion with a system of automatic imposition of fiscal discipline was at the core of the negotiations that led to the establishment of the Eurogroup (Puetter, 2006: 59). The practice of informal Eurogroup discussions led its members to reinterpret the SGP by placing less emphasis on nominal fiscal targets and taking structural indicators into account (Puetter, 2006: 119-122). This evolution of the working consensus was in line with the logic of constrained discretion. Undoubtedly, the legal provisions in line with the institutions-based discipline were considerably weaker than those in accordance with the rules-based approach but their presence indicated the influence of a distinct economic policy belief (Pisani-Ferry, 2006).

5.1.8 Structural Adjustment

A final cognitive element was that macroeconomic stabilisation could be achieved through structural adjustment. At first glance, the root of this belief could be traced in the internal logic of the monetary union (Feld, Köhler and Nientiedt, 2015: 12). Given that Eurozone member states followed a single monetary policy (devaluation was not possible) and that their national fiscal policies were constrained by the European fiscal framework (expansionary policy was precluded), the only available way of stabilising the economy was to gain external competitiveness through wage and price adjustments (Deroose and Langedijk, 2002: 211-212). Thus, microeconomic policies could replace macroeconomic stabilisation (Mabbett and Schelkle, 2007). The Commission in the One Market, One Money report that put forward the economic argument for the transition to EMU was quite clear: “labour market flexibility, and more in particular wage flexibility, is the single most important adjustment instrument in the absence of the nominal exchange rate instrument” (1990: 152). However, it is important to stress that the belief of structural adjustment was also linked to the demise of the Keynesian economic policy paradigm. Without the replacement of full employment by price stability as the top priority of economic policy, the use of wages and prices to promote adjustment would

be impossible. Under Keynesianism, employment relations were strongly protected and wage flexibility was not an option. In contrast, with the ascendance of monetarist beliefs the “structural rigidities in the labour markets” and the “misguided incentives provided by the national social security and welfare systems” came to be identified as the “major causes of the unacceptably high level of unemployment in Europe” (Issing, 2002: 354).

The economic rationale of stabilisation via structural adjustment was that incentives for reform increased due to the elimination of the time-inconsistency problem (Calmfors, 2001; Alesina, Ardagna and Galasso, 2008). Once labour market participants (mainly trade unions) realised that countercyclical monetary policy was not available anymore due to the function of the independent central bank and that government spending was subject to the constraints of the fiscal framework, they were expected to acknowledge that rising labour costs had immediate effects on employment. Therefore, they were expected to alter their views and support labour market reforms. According to this economic belief both the governments and the labour market participants would be found with the “back against the wall” as they would be forced to promote structural reforms³³ or risk suffering from higher unemployment due to the economy’s loss of competitiveness (Mabbett and Schelkle, 2007). An attempt by the trade unions to achieve the equalisation of nominal wages across the EMU was considered to be unrealistic because trade unions remained organised at the national level and did not have the power to create a sizeable pan-European “cartel” (Gros and Thygesen, 1998: 551-552).

The economic belief of structural adjustment left a clear imprint on the organisational structure of the EMU. The Treaty did not provide a strong framework of coordination between member states but acknowledged the need to promote “a skilled, trained and *adaptable* workforce and labour markets *responsive* to economic change” (TFEU, Article 145, my emphasis).³⁴ A new way of coordination was developed, the so-called “Open Method of Coordination”, which relied on mutual learning, best practices, benchmarking and peer pressure avoiding binding decisions (Hodson and Maher, 2001). This “soft-law” approach became the primary instrument for the implementation of EMU’s ten-year programme to enhance competitiveness, namely the Lisbon Strategy. Still, the effective exclusion of supranational institutions and the abandonment of hard-coordination instruments were in compliance with the “back against the wall” hypothesis. EU legislation was unnecessary because the framework of the EMU created enough incentives for the governments to pursue structural reforms, while the one-size-fits-all approach would be inappropriate given the need of the member states to use employment and market regulation as instruments of adjustment. The latter meant that the regulatory framework

needed to be easily adaptable at the national level. A comparison of the Lisbon Strategy with the previous multi-year liberalisation programme of the EU, namely the Single European Market, reveals stark differences in the implementation approach of the Union (see Bulmer, 2012). The decentralisation of the liberalisation process can be attributed to the Sound Money belief of stabilisation via structural adjustment.

5.2 The State of the Sound Money Paradigm before the Outbreak of the Financial Crisis

The problematic aspects of the rules-based approach were revealed shortly after the establishment of the Stability and Growth Pact in 1997. In February 2002, just three years after the beginning of the final stage of EMU and only days after the circulation of the euro, the Commission avoided an attempt to issue early warnings to Germany and Portugal under SGP's system of multilateral surveillance (the so-called preventive part of the SGP).³⁵ In November 2003 the Commission attempted to launch the EDP process against Germany and France but failed to achieve the necessary qualified majority in the Council. In contrast, the Council adopted political pledges in the form of conclusions and placed the EDP in abeyance. In January 2004 the Commission decided to take legal action against the Council exposing EMU's constitutional crisis. In July 2004 the European Court of Justice confirmed the Council's responsibility for enforcing fiscal discipline but nullified the Council's conclusions that attempted to replace the Commission's recommendation. In reality, the Court accepted that the Council could *de facto* suspend the EDP but confirmed the Commission's role in the procedure. The constitutional crisis proved that the SGP was unworkable.

The emergence of the problem of the enforceability of rules during the application of the SGP opened the way for the Pact's reform in 2005 (De Haan, Berger and Hansen, 2004; Beetsma and Debrun, 2007). By October 2002, the Commission was questioning the rationale of the rules-based approach, as President Prodi described the Pact as 'stupid' in an interview creating a huge row (Economist, 2002). In line with the criticism of a number of economists regarding the pro-cyclicality of rules (see above), the President of the Commission stressed that the rules-based SGP was overly inflexible at a time of economic slowdown. Shortly after the ruling of the Court on the suspension of the EDP, the Commission issued a Communication on the strengthening of economic governance that called for the reinforcement of the economic rationale of the SGP (Commission, 2004). The Communication promoted the combination of short-term stabilisation with fiscal discipline in line with the institutions-based policy belief

(see, Buti and Pench, 2004). DG ECFIN's Deroose and Langedijk confirmed that the Commission's approach was based on the model of "constrained discretion" (2005: 12) In parallel, the Communication delineated a shift from short-term towards long-term discipline. The emphasis of the proposals was on the ex ante prevention of deficits in contrast to the previous attention on ex post disciplinary action (Begg and Schelkle, 2004: 1052).³⁶

The Commission's proposals about the organisational changes in the SGP reflected the turn to the institutions-based approach. The SGP surveillance would have to concentrate on medium-term debt sustainability enabling the countries with lower debt projections to run larger deficits for a period of time.³⁷ While the numerical targets were maintained, the Commission proposed the differential treatment of countries. This differential treatment would be extended to the medium-term objective (MTO). The Commission proposed the replacement of the "close to balance or in surplus" MTO that in practice indicated a requirement for a balanced budget position every year throughout the cycle with a country-specific MTO based on debt levels and longer-term growth. The Commission explained that "uniform objectives for all countries do not appear appropriate and lack economic rationale" (2004: 4). A number of factors, such as structural reforms or potential economic growth, would be used to define the appropriate MTO. Also, in the corrective part of the SGP, namely the EDP, the Communication proposed the introduction of an "exceptional circumstances clause" to allow for the special treatment of countries that suffered a protracted period of sluggish growth.

The proposed amendments would not just increase the flexibility of the framework but, in reality, enhance the Commission's discretion in the application of the SGP: the Commission would be responsible for making judgements about the special treatment of countries. This signalled a clear deviation from the rules-based approach of the SGP. As Barry Eichengreen puts it, "[a]llowing the decision of how strictly to enforce the SGP to hinge on the Commission's evaluation of the sustainability of a government's debt is thus a formula for abandoning the rule-based approach almost entirely and vesting very considerable discretion with the EU's technocrats" (2005: 434).

A more explicit indication of the Commission's endorsement of institutions-based discipline was the attempt to influence the domestic budget *procedures*. The Communication highlighted the advantages of reinforcing the link between the Broad Economic Policy Guidelines, the SGP and the national budgetary processes calling for a revision of the economic policy calendar. According to the Commission, "a proper EU semester for economic policy, by increasing the

interaction between European and national levels before a draft budget for the following year is prepared is likely to increase the Member States' ownership of EU policy coordination, making it easier to factor common orientations into domestic policymaking" (Commission, 2004: 7). Deroose and Langedijk confirm the Commission's vision of Stability and Convergence Programmes being "transformed into real ex ante coordination processes with a medium-term orientation, *interacting* with the national budgetary processes rather than merely reflecting it" (2005: 20, my emphasis). Thus, the Commission's Communication clearly promoted the rationale of the institutions-based discipline.

In contrast to the Commission's stance, the discussions in the Council did not indicate a decisive shift towards the institutions-based belief. A report on the reform of the SGP issued by the ECOFIN confirmed the centrality of the rules-based discipline belief (Council of the European Union, 2005a). The Council reiterated that the rules had to remain simple and transparent. Also, the report made clear that the organisational principle of national responsibility for fiscal policymaking remained intact.³⁸ However, the report included some elements of the institutions-based approach linked to the idea of constrained discretion. The Council accepted the need for a "higher degree of economic judgement and policy discretion in the surveillance and co-ordination of budgetary policies" acknowledging that the increased flexibility could improve the effectiveness of rules (2005a: 3). In this context, the Council endorsed the differential treatment of countries that had been proposed by the Commission. More significantly, the Council approved the combination of short-run flexibility with long-term discipline by promoting the creation of room for manoeuvre: fiscal consolidation efforts would be cyclically-adjusted. The Council noted that "adjustment effort should be higher in good times; it could be more limited in bad times" (2005a: 11). This step towards the direction of the institutions-based rationale was limited as the Council was reluctant to delegate enforcement powers to the Commission. The report underlined that the responsibility for the application of discretion would have to reside with the Council. The report avoided any reference to the reform of budgetary procedures stressing instead "the prerogatives of national Governments in determining their structural and budgetary policies" according to the principle of subsidiarity (2005a: 4).

The limited adoption of some elements of the institutions-based rationale by the Council was met with concern by the ECB (European Central Bank, 2005a). In one of its Monthly Bulletins issued a few months after the ECOFIN report, the bank explained that the differential treatment of countries and the cyclically-adjusted fiscal consolidation, namely the two institutions-based

elements adopted by the Council, reduced the clarity and simplicity of rules (European Central Bank, 2005b: 59). The bank noted that “[c]ompliance with the rules must be relatively easy to monitor if they are to serve as an effective disciplining device” (2005b: 66).³⁹ The ECB argued that the institutions-based rationale, which the bank described as “the more sophisticated approach”, presented serious problems of definition and measurement (2005b: 67). The assessment of compliance would become very difficult in practice due to the uncertainty that was embedded in economic indicators. The ECB resisted the shift towards institutions-based discipline.

The organisational change that took place in June 2005 incorporated some important elements of the institutions-based approach. Firstly, the medium-term objective of “close to balance or in surplus” in Stability and Convergence Programmes was replaced with a country-specific MTO that introduced the differential treatment of member states.⁴⁰ Secondly, the reformed SGP established the definition of the adjustment path as a mechanism of monitoring the consolidation effort towards the MTO. Through the evaluation of the adjustment path, the Council was able to assess not only the medium-term budgetary target but also the *way* of achieving it.⁴¹ Member states had to create “room for budgetary manoeuvre” in good times to avoid pro-cyclical policies.⁴² In other words, the fiscal effort had to be cyclically adjusted. Thirdly, a temporary deviation was included in the preventive surveillance process. Member states undertaking major structural reforms were allowed to temporarily deviate from the adjustment path to their MTO or even from the specified MTO itself.

Deviations were introduced in the corrective part of the Pact, as well. The definition of the “severe economic downturn” escape clause that was included in the original pact to cover countries suffering a real loss of GDP was broadened considerably. The revised definition allowed countries to escape the EDP just because their growth had been slightly negative or even below their potential growth.⁴³ Also, the reform operationalised a previously inactive exemption clause in the first step of the EDP. The specification of (previously unidentified) “other relevant factors” in the Commission’s report triggering the EDP linked the assessment of the existence of excessive deficits with the developments in the medium-term budgetary position.⁴⁴ This comprehensive assessment “in qualitative terms” of a state’s public finances could lead to the freezing of the EDP for member states that showed strong consolidation efforts in good times, maintained sustainable debts or implemented Lisbon Agenda policies.⁴⁵ These deviations reflected the need to enhance the economic rationale of the Pact in line with the institutions-based approach.

Despite the incorporation of significant institutions-based elements in the organisational framework, the 2005 reform of the SGP was in accordance with the Council's reluctant approach and did not follow the Commission's complete embracing of institutions-based discipline. The revised SGP established more flexible procedures enabling greater discretionary judgement to fiscal authorities (European Central Bank, 2005b: 69). While the reform followed the economic rationale of constrained discretion by attempting to combine short-term discretion and long-term discipline, the overall SGP framework was not based on the institutions-based approach. As Benoît Coeuré and Jean Pisani-Ferry accurately note, "the Eurozone has moved away from its initial emphasis on governance by fixed rules and has reintroduced discretion. However, it has neither put in place intellectual foundations for a renewed system of governance nor addressed the issue of enforcement" (2005: 609). A key missing element was the empowerment of independent institutions. Contrary to the Commission's Communication, the Council hesitated to create structures that would interfere with domestic budgetary procedures and avoided delegating to the Commission the discretion to interpret the framework. The economic policy belief of institutions-based discipline was not endorsed by Eurozone policymakers. The rules-based belief remained dominant and continued to underpin the constitutional arrangement of the EMU after the 2005 revision. The organisational principles of the Eurozone remained intact as fiscal policymaking remained a national responsibility and the centralisation of surveillance procedures did not take place (European Central Bank, 2005b: 65). Rules became more flexible leading to a weaker organisational framework but there was no real shift to institutions-based discipline.

5.3 Sound Money Challenged: The Keynesian Response to the Financial Crisis

After the analysis of EMU's system of meaning the thesis turns to the deinstitutionalisation of cognitive elements. At this point it should be recalled that according to the cognitive dimension of Sociological Institutionalism, deinstitutionalisation is the erosion of cultural beliefs and the questioning of what was once taken for granted. The hypothesis here is that the Financial Crisis of 2007-2009 was a major external shock with destabilising effects on EMU's Sound Money economic policy beliefs. To test the hypothesis, the thesis will examine the EMU's response to the Financial Crisis in the aftermath of the collapse of Lehman Brothers in September 2008. The thesis expects to find evidence of beliefs that contradicted the above-analysed Sound Money elements within the organisational discourse. The eight economic policy beliefs of the

pre-crisis Sound Money paradigm are used as a heuristic device (see section 5.1). Through the close reading of official documents that were produced in the aftermath of the financial crisis in combination with the analysis of interview transcripts, I detect changes in the institutionalisation of the Sound Money beliefs. The aforementioned Social Linguistic Discourse Analysis is complemented by an examination of the relevant economic literature of the period to provide the necessary contextual background.

5.3.1 Price Stability not Sufficient

The financial crisis undermined the core Sound Money economic policy belief, namely the primacy of price stability. In the words of Paul de Grauwe and Daniel Gros, “[t]he financial crisis of 2007-08 has called into question the mainstream view that price stability should be not merely the primary, but effectively the only objective of a central bank” (2009: 2). The monetarist preoccupation with the stabilisation of the price level had been discouraging any attempt to stabilise the economy with the use of the monetary policy. Financial stability was expected to be a by-product of price stability. Differently put, “financial instability could not occur in a world where the central bank keeps inflation low” (De Grauwe, 2013: 157). The monetarist approach of limited state intervention (via the control of the money supply) indicated that efficient financial markets were able to price assets accurately avoiding bubbles (Krugman, 2009). From the early days of monetarism, Robert Lucas had stressed the ability of market participants to form rational expectations arguing that “all prices are market clearing, all agents behave optimally in light of their objectives and expectations, and expectations are formed optimally” (1972: 103). Central banks had no information advantage over market participants making them more able to detect bubbles (Issing, 2003; Mishkin, 2011: 18). The eruption of a financial crisis after a long period of controlled inflation did not make sense according to monetarist economic thinking. Monetarists found it difficult to explain how problems in the financial sector caused a sharp recession (Woodford, 2010: 23).⁴⁶ Former ECB Executive Board Member Otmar Issing was even asking whether monetarism was dead (2010).

The problems of monetarism in explaining reality led to a resurgence of Keynesian ideas. One month after the collapse of Lehman Brothers John Maynard Keynes was the “man in the news” (Crooks, 2008). The Keynesian view that financial markets were inherently unstable regained popularity. The crisis was understood as an outcome of market sentiments: spontaneous waves of optimism and pessimism in the market (‘animal spirits’) had created a cycle of boom and

bust (Shiller, 2009). The rational expectations assumptions proved to be unfounded.⁴⁷ As a result, monetary policy could no longer concentrate exclusively on inflation. The central bank had to intervene to guarantee financial stability (De Grauwe, 2008).

The Keynesian turn can be clearly traced in the evolution of the ECB's approach to monetary policymaking. In the Monthly Bulletin of October 2008, the ECB formulated the conventional monetarist concept of financial stability as a by-product of price stability.⁴⁸ However, a few months later in the Monthly Bulletin of May 2009 the ECB acknowledged that "[t]he depth of the current financial crisis (...) calls into question the wisdom of ignoring asset price imbalances in the conduct of monetary policy" (European Central Bank, 2009a: 88). In line with the Keynesian view, the ECB started to recognise the role of "unreasonable expectations" of segments of the financial market in asset prices and economic conditions. According to the revised approach, "excessive optimism" in the market could lead to the accumulation of capital and the appreciation of market prices. Once expectations for higher returns would prove to be unrealistic, a sharp decline in investment and the devaluation of market asset prices could lead to the reassessment of economic prospects. The acceptance of unreasonable market expectations signified the ECB's shift from the monetarist notion of market rationality. The evolution in the thinking of the ECB had an important impact on the organisational structure of monetary policymaking. The quantitative definition of price stability and the concomitant avoidance of excessive activism by the central bank proved inadequate tools in the context of unreasonable market expectations. The ECB concluded that the financial crisis required "a reinforcement of strategic mechanisms *beyond* a quantitative price stability objective" (2009a: 90, my emphasis).

The monetary policy measures taken in the aftermath of the bankruptcy of Lehman Brothers revealed a process of deinstitutionalisation regarding the primacy of price stability. In October 2008 the ECB adopted a number of non-standard monetary measures under a scheme called "enhanced credit support" with the aim to prevent a systemic liquidity crisis in the financial system of the Eurozone (2010a: 67-68). The bank highlighted that dysfunctional money markets disrupted the transmission of monetary policy decisions (interest rate decisions) to the economy (see also, Trichet, 2010). In this way the ECB linked the adoption of non-standard measures with the primary objective of maintaining price stability: if the normal channels of transmission were impaired by the financial crisis, the bank was justified to adopt non-standard measures to achieve the same objective.⁴⁹ However, the provision of liquidity to banks through non-standard measures was not a mere technicality. Ensuring liquidity conditions for financial

institutions through the monetary policy decisions of the ECB was an integral part of Eurozone's attempt to preserve the financial system (Council of the European Union, 2008b). The ECB made a conscious choice to deal with banks as counterparties in an attempt to reactivate the market and did not try to bypass banks by supporting the functioning of private credit markets (as happened with the Federal Reserve) or by providing credit directly to the non-financial sector (Lenza, Pill and Reichlin, 2010). The real problem of transmission disruptions was employed as a pretext to conceal the ECB's decision to pursue a distinct objective: the stabilisation of the financial system. The Bank acknowledged that underestimating the financial stability functions of monetary policy had a very high cost (Praet, 2011). As monetary policy and financial stability policy were intrinsically linked, preserving financial stability emerged as a separate (secondary, if not comparable) objective of monetary policy (Smets, 2014). This meant that the ECB would face necessary trade-offs. Financial stability became rapidly institutionalised and was established as the new economic policy belief of the Sound Money paradigm. Consequently, the financial crisis seriously challenged the monetarist belief in the unqualified primacy of price stability.

5.3.2 Turn to Discretionary Fiscal Policy

As the Sound Money paradigm was built around the core belief of price stability, the latter's weakening had serious effects on other elements of the Eurozone's system of meaning. The turn to Keynesianism undermined the monetarist-inspired precedence of monetary policy over fiscal policy. If controlling inflation was no longer the single most important economic objective, then the strict limitations to the use of fiscal policy that were established by the Fiscal Theory of the Price Level (see above) could be lifted. In other words, it became conceivable to use fiscal policy to achieve different economic objectives. In parallel, the deepening recession revealed monetary policy's limitations to stabilise the economy in the context of a severe downturn confirming another aspect of the Keynesian approach: the zero lower bound constraint. As Laurence Seidman explained, "in a severe recession a pessimistic private sector is unwilling to borrow and spend, even if banks offer very low interest rates" (2012: 276). Keynes noted that central banks were unable to reduce interest rates below zero as agents could opt to hold money instead of interest-bearing assets (Gerlach and Lewis, 2014: 866-867). Thus, Keynes promoted fiscal stimulus as a way to address the unwillingness of the private sector to spend more and the inability of the monetary policy to offer sufficient incentives to market agents (Krugman, 2009). In the autumn of 2008 the ECB followed other central banks and

rapidly reduced interest rates without managing to stabilise the economy. The problems in the transmission of the monetary policy in the real economy highlighted fiscal policy as “the most potent policy instrument” (Münchau, 2008). Economists revisited the role of fiscal policy in economic policymaking (Fatás and Mihov, 2009; Feldstein, 2009; International Monetary Fund, 2008b). As a result, fiscal discipline was not a priority any more.

The fiscal discipline economic policy belief underwent a process of rapid deinstitutionalisation in the autumn of 2008. On 7 October 2008, a few days after the collapse of Lehman Brothers, the ECOFIN adopted conclusions “on a coordinated EU response to the economic slowdown” (Council of the European Union, 2008a). The document was in line with the fiscal discipline belief: fiscal prudence was “necessary to support confidence”. Together with the implementation of structural reforms, these policies could curb inflation “restoring an environment supportive to monetary policy”. In a similar vein, the Commission issued a communication at the end of October 2008 describing a European framework for action (Commission, 2008b). The communication noted that fiscal policy together with monetary policy could contribute to supporting demand but reckoned that policy instruments (for stimulating demand) remained in the hands of member states. The Commission expected that the recapitalisation of banks that had been announced by individual member states after the collapse of Lehman Brothers in September would deteriorate public finances but anticipated that the deficit of the Euroarea would remain below 3% of GDP so some fiscal space would be available. Thus, at that stage the Commission resorted to the familiar calls for the implementation of structural reforms in the context of the Lisbon Strategy.

At the end of November 2008 the state of the real economy was significantly worse. In this context, the Commission issued a Communication on a European Economic Recovery Plan (Commission, 2008c). The Plan depicted falling economic activity and rising unemployment as the main economic problems of the time. The direction proposed by the Commission was markedly different from the one in the previous communication: member states had to use fiscal policy to “[s]wiftly *stimulate demand* and boost consumer confidence” (2008c: 5, my emphasis). The Plan sought to address the crisis by coordinating national fiscal efforts and complement them with EU policies and funds. National budgetary expansion would amount to 170 billion euros (1.2% of EU GDP) accompanied by 30 billion of EU funding (0.3% of EU GDP). The Commission explained that “[o]nly through a significant stimulus package can Europe counter the expected downward trend in demand, with its negative knock-on effects on investments and employment” (2008c: 7). By proposing a counter-cyclical macroeconomic

response to the crisis, the Commission endorsed Keynesian demand management. In addition, the Commission shared the Keynesian view about the limitations of monetary policy within a deep crisis. During the discussion of the College of Commissioners for the adoption of the Plan, Commissioner for Economic and Financial Affairs Joaquín Almunia stressed that “[u]ntil the measures to support the financial system yielded results, budgetary policy instruments would have to be used to rekindle demand in the short term” (Commission, 2008d: 15). In reality the Commission questioned the value of the monetarist rationale in the context of the crisis. Keeping inflation low was not enough to attract investment and produce good economic results. Active state intervention, in line with the Keynesian school of thought, would be required to stabilise the economy and avoid a protracted recession. Fiscal discipline was in retreat.

The ECOFIN quickly endorsed the Commission’s Plan accepting its economic rationale (Council of the European Union, 2008c). Discussions within the EFC revealed the changing priorities of Eurozone elites. Indeed, the main concern of the majority of the EFC members was the falling demand. As one interviewee noted:

The thinking was that we would take some expansionary measures and then the crisis would be over. That was the thinking at the time. Central Banks were taking coordinated action. There was dampening of domestic demand

(Anonymous Interviewee 01)

Another member of the EFC made clear that the fall in the economic activity justified the turn to Keynesianism:

With the financial crisis of 2007 – 2008, trade dropped off a cliff, there was no confidence in the system, economic activity dropped. In response to this, the countries expanded, economic policies became “almost Keynesian”, we had the rebirth of Keynesianism in a way

(Anonymous Interviewee 15)

Representatives from northern European countries, like Sweden, Denmark, Finland and the Netherlands had dissenting views but were the minority. A member of the EFC that followed the monetarist approach explained how the Plan’s rationale clashed with the established economic thinking:

...my country was critical; we criticised the fiscal expansionary plan. I thought that it was not a good idea because public finances were in a bad shape. The plan did not seem to recognise the challenges. From an intellectual point of view, the expansion defies logic: you can't expand, then the ECB would (need to) respond by increasing interest rates and as a result the economic result would be neutralised. So it was *intellectually challenging*

(Anonymous Interviewee 09, my emphasis)

The ECB recognised that the re-emergence of Keynesian demand management constituted a threat to the monetarist foundations of the EMU. While ECB President Trichet initially supported fiscal expansion (Anonymous Interviewee 01), other Executive Board members of the ECB, such as Jürgen Stark, had serious objections (Anonymous Interviewee 09). In its Monthly Bulletin of December 2008 the ECB carefully criticised the Commission's plan noting that "[e]xperience has shown that policy activism has only led to the accumulation of fiscal imbalances and has not helped to solve the underlying economic and structural problems" (European Central Bank, 2008a: 76). Three months later, in March 2009 the ECB became more vocal about the risks of fiscal stimulus stressing that "[n]ot all measures are clearly linked to the root of the current economic problems or can be implemented quickly. Some measures may reflect political compromises rather than economic considerations. Government intervention also carries the risk of distorting the behaviour of economic agents and undermining an efficient allocation of resources" (European Central Bank, 2009b: 77). The bank concluded that the fiscal stimulus had to be abandoned as soon as possible. The turn to fiscal expansionism raised serious questions about the necessity of fiscal discipline.

5.3.3 Consolidation of Constrained Discretion

The financial crisis and the subsequent turn to Keynesian economic beliefs challenged some important cognitive elements of the Sound Money paradigm but did not topple it. The weakening of the monetarist approach to fiscal discipline strengthened the economic rationale of constrained discretion. The combination of Keynesian countercyclical fiscal stimulus with budgetary limitations emerged as an appropriate solution in the context of shaking cognitive structures. One interviewee explained the interplay between discipline and stimulus:

There *can* be Keynesian situations, but the *normal* structure cannot be Keynesian, there are supply-side problems. Keynesianism can create a problem, so it depends on the situation as the economy is complex. But the state cannot apply anticyclical policy in general

(Anonymous Interviewee 16, my emphasis)

Constrained discretion legitimised the pursuit of countercyclical stabilisation through fiscal expansion without overthrowing budgetary sustainability. Timing was crucial for the attainment of incompatible Keynesian and monetarist fiscal policy objectives: different fiscal policies would be pursued at different phases. Short-term countercyclical fiscal expansion would be used for a limited period of time to boost demand before being replaced by fiscal consolidation to achieve long-term fiscal sustainability. Constrained discretion would provide enough flexibility to national fiscal policies to achieve the stabilisation of the economies in the short-term. Once that stabilisation was achieved, a more rigid application of fiscal discipline would make sure that the public finances of member states remained within the confines of the fiscal framework. Constrained discretion guaranteed the preservation of the Sound Money economic policy paradigm at a difficult time.

The European Economic Recovery Plan (EERP) was in line with the economic rationale of constrained discretion. While the plan sought to stimulate demand through the implementation of fiscal stimulus, the turn to Keynesian demand management was not unconditional. The Commission highlighted that “[t]his budgetary stimulus should be *temporary*. Member States should commit to *reverse* the budgetary deterioration and return to the aims set out in the medium term objectives” (Commission, 2008c: 7, my emphasis). The reversibility of countercyclical fiscal expansion was an important element indicating the presence of constrained discretion. Keynesianism would not be reinstated: long-term fiscal sustainability continued to be a major concern of the Eurozone. A short-term judicious application of Keynesian demand management could stabilise the economies of member states and halt a catastrophic recession undermining the legitimacy of national governments and European institutions. Therefore, fiscal expansionism had to be *timely*. This condition ensured that fiscal laxity would be tolerated only in the context of the particular economic circumstances and that member states would not use the additional fiscal discretion at a different stage of the economic cycle. Fiscal policy had to remain countercyclical. Moreover, the EERP provided that the fiscal stimulus would be differentiated: member states that undertook extra efforts during the good

times achieving healthier public finances would have more room for manoeuvre for fiscal stimulus during the recession. The differential treatment of countries followed the logic of the differential adjustment path and the differential MTO that were introduced in the 2005 reform of the SGP. As was explained in the previous section, the differential treatment of countries was in accordance with the doctrine of constrained discretion.

The endorsement of constrained discretion did not signal a shift towards the institutions-based discipline belief. While Eurozone decision-makers welcomed the combination of short-term flexibility with long-term discipline, they were reluctant to amend budget procedures and enhance the role of European institutions. In contrast to the reform process of the SGP in 2005, the Commission did not propose any further delegation of fiscal powers to the EU-level. The reformed SGP was considered to be a suitable framework enabling the implementation of the more flexible approach. The Commission noted that “[t]he 2005 revision of the Pact allows better account to be taken of cyclical conditions while strengthening medium and long-term fiscal discipline. The resulting framework is more demanding in good times, it affords more flexibility in bad times” (2008c: 9). The Commission anticipated that some member states could breach the 3% numerical target for the deficit but insisted that such an event could be dealt with by the SGP procedures “which guarantee that the excessive deficit will be corrected in due time, ensuring long-term sustainability of the budgetary positions” (2008c: 9). By avoiding to make any reference to the reform of procedures, the Commission promoted the idea that the model of constrained discretion was compatible with the governance structures established in accordance with the rules-based economic policy belief. While the Commission noted that the budgetary stimulus had to be coordinated in order to exploit synergies and avoid negative spillovers, the connotation was that the existing framework would be adequate to enable the coordination of subsequent fiscal consolidation efforts.

The ECOFIN did not question the Commission’s approach accepting that “[t]he long-term sustainability of public finances should be ensured in accordance with the Stability and Growth Pact” (Council of the European Union, 2008c: 4). The Council recognised the need for “a coordinated budget consolidation” to replace the coordinated fiscal stimulus but considered the SGP as the appropriate framework to organise the coordinated fiscal tightening (Council of the European Union, 2009a).

Conclusion

This chapter proceeded to the analysis of the Eurozone's cognitive framework. It put forward the argument that an underlying system of meaning, namely the Sound Money economic policy paradigm, determined EMU's organisational structure. The chapter identified eight economic policy beliefs (price stability, credibility of monetary policy, fiscal discipline, deficit bias, market discipline, rules-based discipline, institutions-based discipline, structural adjustment) and uncovered their interlinkages through an in-depth exploration of the economic logic behind them. Subsequently, the chapter presented the evolution of the Sound Money paradigm after the launch of the EMU. The problem of the enforceability of rules in the early years of the EMU raised questions about rules-based discipline but the institutionalisation of the particular belief did not decrease.

The chapter explored the effect of the financial crisis of 2007-2008 on the Sound Money paradigm. The crisis was perceived as a case of major policy failure by Eurozone decision-makers forcing them to revise some of their taken-for-granted understandings. Low inflation and reliance on rational expectations of market participants could not guarantee a sufficient level of economic activity. The chapter argued that the post-crisis Keynesian turn of Eurozone's monetary and fiscal policies led to the deinstitutionalisation of the price stability and fiscal discipline beliefs. In parallel, the Keynesian response enhanced the economic logic behind the institutions-based discipline. Constrained discretion would merge the monetarist objective of long-term fiscal sustainability with the short-term necessity of using discretionary fiscal expansion to boost demand. The full-scale institutionalisation of institutions-based discipline did not proceed, however, as Eurozone decision-makers considered the predominantly rules-based organisational structures of the SGP as an adequate framework for the implementation of coordinated consolidation.

The next chapter will focus on the adjustment of the Sound Money paradigm in the period 2009-2010. The analysis will concentrate on two beliefs: rules-based discipline and institutions-based discipline. It will be shown that the problems that EFC and Commission officials faced with the implementation of coordinated consolidation urged them to create new meaning out of their practices leading to a revision of their approach to fiscal discipline.

¹ As Milton Friedman noted ‘Money did not matter. Its only role was the minor one of keeping interest rates low, in order to hold down interest payments in the government budget, contribute to the "euthanasia of the rentier," and maybe, stimulate investment a bit to assist government spending in maintaining a high level of aggregate demand’ (1968: 2).

² To avoid confusion and increase consistency, citations of EU primary law provisions are made with reference to the Treaty on the Functioning of the European Union as amended by Lisbon Treaty. It should be clear that many organisational elements were introduced with other Treaties (under different numbering of articles). These cases are identified in the following notes.

³ Commenting on the Treaty provision for price stability the ECB Governing Council noted that the logic of the Treaty was “rooted in the *belief* (...) that a monetary policy that maintains price stability in a credible and lasting way will make the best overall contribution to improving economic prospects and raising living standards” (European Central Bank, 1999: 39-40, my emphasis).

⁴ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 105).

⁵ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 105).

⁶ The Fed proceeded only in implicit inflation targeting for this period. The principal objection against explicit inflation targeting was that it would focus the Fed too narrowly on inflation and lead the Federal Bank to overlook its other goals: output and employment (Goodfriend, 2003).

⁷ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 105).

⁸ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 104).

⁹ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 107).

¹⁰ The Governing Council noted that “[m]onetary policy is most effective when it is credible – that is, when the public is completely confident that monetary policy is fully committed to the objective of price stability and is being implemented in a manner that will effectively achieve this goal. Therefore, the monetary policy strategy must not only signal the overriding objective of monetary policy, but must also convince the public that this objective will be achieved” (ECB, 1999: 43).

¹¹ ECB’s Otmar Issing noted that “if national governments and social partners take the single monetary policy’s credible commitment to maintain price stability as given, when deciding on their own actions, this will lead to *implicitly* co-ordinated policy outcomes *ex post*, while at the same time limiting policy conflicts and overall economic uncertainty” (Issing, 2002: 346, emphasis in the original).

¹² As Gros and Thygesen note, “[t]he higher inflation is, the lower is the real *ex post* debt service burden for the economy, at given nominal interest rates” (1998: 328, emphasis in the original).

¹³ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 3a).

¹⁴ Alesina and Tabellini (1990) have doubts about the fiscal illusion of voters. They point to the disagreement between current and future policymakers to account for what they perceive as a strategic choice by the incumbents to influence the policies of their successors. In other words, deficit bias is linked to political conflict, while public debt is seen as a political tool.

¹⁵ Gros and Thygesen have serious doubts about the effectiveness of market discipline because borrowers always possess better information than lenders about their own financial position.

¹⁶ As Michael Artis and Marco Buti eloquently put it, “[i]n the context of EMU an individual country can no longer implicitly promise to pay off its own debt in its own money” (2000: 583). This fact was expected to have a restrictive effect on fiscal policy.

¹⁷ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 104).

¹⁸ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 104b).

¹⁹ As former ECB Vice-President Lucas Papademos noted, “[t]he case for fiscal rules relates to the notion that fiscal policy is prone to suffer from a deficit bias. There is no shortage of evidence that fiscal policy is influenced by the electoral cycle” (Papademos, 2006: 31).

²⁰ According to Böhm, “[o]n the one hand private economic power is nurtured and fed by a free, entrepreneurial economy. On the other hand, *its very existence simultaneously destroys and explodes the ordering of this economic system*” (1947 [2017]: 124, emphasis in the original).

²¹ The preference of the ordoliberal tradition for the establishment of constraining rules in fiscal policymaking and the endorsement of an institutions-based approach to monetary policymaking (creation of an independent ECB emulating the German Bundesbank) might appear contradictory. However, as Lars Feld and colleagues note, “the distinguishing feature of the Bundesbank’s institutional design – its high degree of independence (...) is not essential to the monetary concepts of Ordoliberalism” (2015: 7). It seems that the institutional design of the Bundesbank was not in line with the ordoliberal proposals and that the concept of central bank independence is incorrectly attributed to ordoliberals.

²² The provision was originally introduced in the Treaty of Maastricht (TEC, Article 104c).

²³ The protocol was attached in the Treaty of Maastricht (TEU, Protocol No5).

²⁴ At this point it should be noted that during the transition to the EMU, the fiscal targets were included in the convergence criteria (TEC, Article 109j) and the evaluation of member states' budgetary position did not follow the EDP (TEU, Protocol No6) but became integrated in the overall assessment of their convergence. However, it is clear that the numerical targets were established from the very beginning.

²⁵ Council Regulation (EC) No 1466/97.

²⁶ Council Regulation (EC) No 1467/97.

²⁷ As Jean Pisani-Ferry accurately notes, “[i]t was in fact the Commission, not the Council, that lost discretion in the implementation of the EDP, since the Pact spells out in great detail when the Commission (which retains the monopoly of initiative) can abstain from proposing activating the procedure against a country whose budget deficit exceeds 3 per cent of GDP” (2006: 828).

²⁸ It is worth noting that the concept of self-responsibility presents affinities to another ordoliberal principle apart from the consistency of the economic policy: liability. According to Walter Eucken, “[t]hose who benefit from something must also be prepared to bear the loss if need be” (1952 [1982]: 126). Feld and colleagues explain that joint liability without proper transfer of formal responsibility for fiscal policy to the European level creates moral hazard and it is, therefore, unacceptable (Feld, et al., 2015). The ordoliberal liability concept is another pillar of self-responsibility.

²⁹ In this section I follow the relevant economic literature and use the term “institutions” to identify the alternative approach to rules-based discipline. However, it is important to clarify that the use of the word “institutions” here has the meaning of formal institutions, namely organisational elements. For the distinction between formal and informal institutions, see Chapter 3.

³⁰ Making a parallelism with monetary policy Charles Wyplosz noted that “[a]nother approach is to follow the lead from monetary policy, where the need for both discretion and discipline is similar. Over the last decades, monetary policy-making has moved from discretion to rules and then on to institutions. The last step involved granting independence to central banks and entrusting decision-making to committees of independent experts” (2006: 229).

³¹ The provision was originally introduced in the Treaty of Maastricht (TEC, Article 103).

³² Council Regulation (EC) No 1466/97.

³³ Alesina, Ardagna and Galasso define structural reforms as “deregulation in the product markets liberalization and deregulation in the labor markets” (2008: 1).

³⁴ The provision was originally introduced in the Treaty of Amsterdam (Article 109n) that amended the TEC.

³⁵ Heipertz and Verdun (2010: 113-162) provide a detailed account of the relevant events preceding the reform of the SGP.

³⁶ As it was explained in the previous section, the preventive arm of the original SGP drew heavily on the institutions-based approach of fiscal discipline. The Commission's choice to strengthen the preventive elements of the framework indicated the endorsement of the institutions-based belief.

³⁷ The adjustment path to the numerical target would be different for countries with lower debt. The Commission explained that “[o]ne-size-fits-all deadlines for the correction of excessive deficits have basic limitations because they do not permit distinguishing between countries with different cyclical developments and with different debt levels” (Commission, 2004: 5).

³⁸ The ECOFIN clarified that “the Council confirms that enhanced coordination of fiscal policies must adhere to the Treaty principle of subsidiarity, respecting the prerogatives of national Governments in determining their structural and budgetary policies” (Council of the European Union, 2005a: 4).

³⁹ On this issue the ECB drew on the seminal work of Kopits and Symansky considering the necessary features of fiscal rules. The two authors argued that “[i]deally, a fiscal rule should be well defined, transparent, adequate, consistent, simple, flexible, enforceable, and efficient” (1998: 18).

⁴⁰ Article 2a of Council Regulation (EC) No 1466/97, as it was amended by Council Regulation (EC) No 1055/2005.

⁴¹ Article 5 of Council Regulation (EC) No 1466/97, as it was amended by Council Regulation (EC) No 1055/2005. According to the revised text, the Council would assess “whether the adjustment path towards the medium-term budgetary objective is appropriate and whether the measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the medium-term objective over the cycle”.

⁴² Council Regulation (EC) No 1055/2005, Recital 6.

⁴³ Article 2 of Council Regulation (EC) No 1467/97, as it was amended by Council Regulation (EC) No 1056/2005.

⁴⁴ Council Regulation (EC) No 1056/2005, Recital 7.

⁴⁵ Council Regulation (EC) No 1056/2005, Article 1.

⁴⁶ Some monetarists attributed the crisis to the rise of money supply the years before the crisis as financial innovation led to the expansion of credit (Issing, 2010; see also, Carmassi, Gros and Micossi, 2009). However, the monetarist doctrine's preoccupation with inflation and the use of meaningless monetary aggregates (due to the complexity of financial innovation) weakened the framework's relevance.

⁴⁷ ECB President Trichet admitted in January 2009 that “the lack of preparation [for a market correction] had its basis in the widely held view that regulation should not stifle financial innovation and that markets knew best and could – for the most part – regulate themselves adequately. The turmoil has shown how complacent and misleading this attitude was” (Trichet, 2009).

⁴⁸ ECB noted that “[p]rice stability fosters an efficient allocation of resources, contains inflation risk premia and longer-term financing costs, and preserves the purchasing power of the euro. In so doing, it supports sustainable growth and employment and contributes to financial stability (2008b: 6-7).

⁴⁹ ECB’s Salines, Glöckler and Truchlewski described the non-standard measures as “a temporary *redirection* of its instruments, that is, the use of a larger spectrum of policy tools aimed at an unchanged ultimate objective” (2012: 668, emphasis in the original).

CHAPTER 6
THE ADAPTATION OF THE SOUND MONEY PARADIGM:
FROM RULES TO INSTITUTIONS

Introduction

The previous chapter explored the effect of the financial crisis on the Sound Money paradigm. I detected the weakening of the fiscal discipline belief and the emergence of the economic logic of constrained discretion as a result of the Keynesian response of Eurozone's policymakers. Given the strong interlinkages between the different cognitive elements of the Sound Money paradigm, this chapter analyses the consequences of the rise of constrained discretion on the rules-based discipline belief. My task is to answer how policymakers tried to implement constrained discretion through the governance structures of the SGP and what were the effects of this process on their taken-for-granted understandings.

My argument in this chapter is that in the course of 2009 the rules-based discipline belief underwent a process of rapid deinstitutionalisation that enabled the strengthening of institutions-based discipline in the first months of 2010. Through the use of process-tracing and organisational discourse analysis, I uncover the particular events that destabilised the cognitive structures of Eurozone decision-makers leaving them unable to provide legitimate explanations of the reality. I find that the decision of policymakers to design fiscal exit strategies in the second half of 2009 in line with the logic of constrained discretion revealed the discrepancy of the rules-based discipline with the post-crisis consensus on the combination of stabilisation and sustainability. Subsequently, I identify the three distinct processes that constituted the institutionalisation mechanism of institutions-based discipline within the social environment of the EMU in 2009-2010: habitualisation, objectification and sedimentation. I argue that the members of the EFC created meaning out of their practice to manage the incompatibility of the SGP framework with the post-crisis reality and that this meaning significantly strengthened the institutions-based belief.

The first part of the chapter analyses the effects of the policymakers' discussions about the Fiscal Exit strategies on the rules-based belief. The second part is devoted to the analysis of the generalisation of meaning mechanism. Initially, I detect three organisational innovations emerging from the practices of the EFC. Then I expose how EFC members engaged in the conceptualisation of the failures of rules-based discipline as generic organisational problems and how they theorised the innovative arrangements as conceptual solutions to those problems. Finally, I trace the transmission of the understandings created within the EFC to other EU policymakers outside the EFC's social environment.

6.1 Fiscal Exit Strategies: The Deinstitutionalisation of Rules-Based Discipline

The application of the sociological institutionalist framework in the case of European Economic Governance begins with the analysis of the Eurozone's social environment in the aftermath of the financial crisis. According to the theory, a weakening of taken-for-granted understandings is the first part of a social process that leads to organisational change. Tracing an erosion of the Sound Money economic policy beliefs involves the detection of problems in the interpretation of the post-crisis reality by Eurozone elites. I argue that the turn to coordinated consolidation in 2009 exposed the limitations of the rules-based approach, constituting a distinct deinstitutionalisation process. As policymakers designed their countries' exit from the fiscal stimulus programmes, they realised the incompatibility of their preferred logic of constrained discretion with the rules-based discipline. One of the core constitutive elements of the Sound Money paradigm became challenged.

After the successful adoption of discretionary fiscal stimulus measures in the first half of 2009 in line with the provisions of the European Economic Recovery Plan, Eurozone elites engaged in a discussion about the shape of the subsequent fiscal consolidation efforts (Council of the European Union, 2009b). In the ECOFIN meeting of July 2009 the finance ministers acknowledged the need to agree upon an exit strategy from fiscal stimulus measures. The ECB promoted the view that the exit strategy had to be compatible with the provisions of the SGP. In the Monthly Bulletin of September 2009 the ECB stressed that the majority of Eurozone countries would breach the deficit reference value in 2009 and that all Eurozone members risked breaching the deficit rule in 2010. In light of those developments, the ECB urged the Eurozone countries to prepare ambitious fiscal exit strategies (European Central Bank, 2009c: 83). The bank underlined the necessity of the strict implementation of SGP provisions and

discouraged any extension of time limits for the correction of deficits. Deadlines could not become “moving targets that are pushed forward” (European Central Bank, 2009c: 84).

On 7 October 2009, the Commission adopted a markedly different approach from the ECB promoting the flexible application of SGP rules. Similarly to the ECB, the Commission acknowledged the substantial deterioration in the public finances of member states but pointed to a medium-term approach to budgetary consolidation strategies: countries would have longer deadlines for the correction of excessive deficits (Commission, 2009a: 3). In this way, the Commission questioned the necessity of the rapid reduction of excessive fiscal deficits enshrined in the SGP rules. Additionally, the Commission challenged the relevance of the other numerical target of the SGP, namely the 60% debt reference value. The Commission issued a Communication on the long-term sustainability of public finances that promoted a relaxed definition of debt sustainability in line with the more flexible perspective adopted in the case of excessive deficits. According to the Commission, “[s]ustainability relates to the ability of a government to assume the financial burden of its debt in the future. There is no defined upper limit to sustainable debt levels” (Commission, 2009b: 3, emphasis in the original). The Commission downgraded the importance of the stock of the government debt noting that a one-off increase would not necessarily put sustainability at risk. The Commission pointed to other factors affecting sustainability such as the trust in a government’s capacity to implement structural reforms and reduce deficits as well as the degree of development of financial markets. This came in sharp contrast to an earlier sustainability report, where the Commission made clear that “*the current stock of government debt is arguably the most important factor*” (2006: 4, emphasis in the original). The Commission clearly argued in favour of a fiscal exit strategy that paid little attention to the agreed rules.

The EFC tried to combine the two views. On 8 October 2009 the EFC members decided that the fiscal exit strategy “should strike a balance between stabilisation and sustainability concerns” in line with the logic of constrained discretion stressing at the same time that the strategy had to be consistent with the SGP (Council of the European Union, 2009c).¹ The finance ministers adopted this approach on 12 October 2009 (Council of the European Union 2009d). The deterioration of the public finances of EU member states, however, surprised EFC policymakers as it challenged their approach. In the beginning of November 2009, the Commission published its autumn economic forecast (Commission, 2009c). While the economy showed signs of stabilisation (GDP growth was expected to drop 4% in 2009 and turn positive by the second half of 2010), public finances were hit harder than expected. The

Commission estimated that the (aggregate) level of general government deficit would reach close to 7% of GDP in 2009 (6.5% for the euro area) and increase further in 2010 (7.5% of GDP for the EU as a whole and 7% for the euro area). Public debt was expected to rise to 84% of GDP for the euro area (80% for the EU).

The declining health of public finances was met with “extreme uneasiness” by the members of the EFC (Anonymous Interviewee 05). The members of the Committee realised that counter-cyclical policies came at a high cost. The sharp increase of government deficits became destabilising for some member states, such as Spain (Anonymous Interviewee 01). According to the Commission, the projected deficit of the country was 11.25% of GDP in 2009. Another surprising element for the EFC members was the dispersion of the fiscal problems across the EU. An interviewee stressed that the dispersion signified an unprecedented situation:

The fiscal policy crisis was playing out before our eyes. Had we have the rules [functioning] the fiscal policy crisis would not have taken place. It was not only Greece. That was just a sign of fiscal policy crisis. It was a Union-wide crisis.

(Anonymous Interviewee 09)

At this point it should be recalled that the Commission’s communication on the European Economic Recovery Plan anticipated that the plan “may lead *some* Member States to breach the 3% GDP deficit reference value” (2008c: 9, my emphasis). Clearly, EFC members were not prepared to deal with the simultaneous breach of deficit rules by nearly all the member states.

A strict application of SGP rules made little sense in the context of the particular situation. Normally the deadline for the correction of the excessive deficit was one year (the year following its identification). Reducing deficits of the level of 7% of GDP or above in such a short period was considered politically unfeasible because such a process would destabilise governments. Additionally, an abrupt adjustment was not sensible from an economic perspective. As von Hagen, Pisani-Ferry and von Weizsäcker (2009a) stress, the simultaneous fiscal consolidation in most EU countries was expected to bring an important drag in demand growth. In reality, the EDP had been designed as an instrument for disciplining a minority of member states. In the absence of strong external demand (due to simultaneous consolidation in almost every member state) it seemed doubtful that the EDP could work. In the context of large scale deterioration of public finances across the Union, a moderate consolidation was

preferable. Adhering to the logic of constrained discretion, EFC members were not prepared to risk the stabilisation of the economies to achieve the necessary fiscal consolidation.

Before the Commission's autumn forecast, Eurozone policymakers believed that the SGP rules disposed enough flexibility enabling them to pursue a more moderate consolidation path (see previous chapter). The reality of skyrocketing deficits, however, shattered this assumption. The specification of the "other relevant factors" provision of the Treaty that was included in the 2005 SGP reform instilling flexibility to the Pact included a significant double condition.² The general government deficit had to remain close to the reference value and its excess over the reference value needed to be temporary. The double condition had to be "fully met" for these factors to be taken into account by the Commission. With a number of member states projecting deficits above 7% (some of them even above 10%) in 2009, compliance with the flexibility clause of the SGP under the rules was not possible. As economists Larch, van den Noord and Jonung accurately note, "[b]ased on the prevailing interpretation of the Pact, a deficit of more than 3% of GDP may not be considered excessive if and only if it stays close to the threshold. In most countries, the excess of the government deficit over the 3% of GDP threshold of the Treaty was far too large in 2009 and 2010 to draw on this provision" (European Commission, 2010b: 22). According to the rules, the Commission was obliged to trigger the EDP for almost every member state.

A different way to achieve a smooth consolidation was to change the adjustment paths. Member states had to make use of an escape clause included in the SGP enabling the Council to set a different deadline for the correction of excessive deficits in the case of "special circumstances".³ In contrast to the "other relevant factors" provision, the legal framework did not specify any conditions for the implementation of the extended deadline. The Council was free to determine whether member states faced special circumstances but the framework placed limits to the extension of the deadline. The limits were included in the Stability and Growth Pact's "Code of Conduct", namely the official guidelines on the implementation of the Pact.⁴ According to the interpretation of the framework included in the Code of Conduct, "[i]n case of special circumstances, the initial deadline for correcting an excessive deficit would be set, *as a rule*, one year later, i.e. the second year after its identification and thus normally the third year after its occurrence" (Council of the European Union, 2005b: 9, my emphasis). In the context of very high deficits in the autumn of 2009, the additional year under the "special circumstances" provision did not enable a smooth fiscal consolidation. Longer adjustment paths required more extended deadlines.

The EFC members concluded that SGP's fiscal rules were overly rigid impeding the implementation of their preferred fiscal exit strategy. It was clear that a smooth transition from stabilisation to consolidation was not possible under the SGP framework. A gradual reduction of deficits through a cautious phasing out of discretionary measures required the abandonment of rules in line with the Commission's approach. One of the interviewees pointed out this shift from the normal application of the SGP to a new approach:

Under a *normal* implementation of the SGP's Excessive Deficit Procedure a return to normality [a reduction of deficits under the 3% benchmark] needed to be done in one year. Then there was a choice to make multiannual adjustments in EDP. So the consolidation would be phased in over a significant period, three years or in some cases four years.

(Anonymous Interviewee 11)

The depth and the dispersion of member states' fiscal troubles in the autumn of 2009 revealed the incompatibility of the rules-based discipline of the SGP with the economic logic of constrained discretion. EFC members quickly recognised that the rules did not enable member states to achieve the fiscal targets within reasonable timeframes. The rigidity of the rules-based approach clashed with the state of the post-crisis fiscal conditions throughout the Eurozone. EFC participants explained the prevailing thinking in the Committee:

The starting point of the discussions was intellectual. The reality did not correspond to the rules. Rules have to conform to reality; the rules need to make sense. So first we observed reality (the rules were not working) and then we proceeded with reverse engineering. How quickly we needed to cut deficit? According to the previous framework [SGP 2005] he had to do that in 18 months. That was not possible, the adjustment path needed to be longer.

(Anonymous Interviewee 10)

When you have 23 Member States in the corrective arm of the SGP, this is not working. The corrective arm should be used in exceptional circumstances; all those members should have been in the preventive part. Thus, all this showed that the rules have been flawed in terms of design and enforcement. So, the rules did not

worth the paper they were written on and something more credible and more concrete had to be designed

(Anonymous Interviewee 17)

Policymakers engaged in a discussion about the extension of the deadlines for the reduction of deficits. Given that rules-based discipline was part of the Eurozone's system of meaning, the rules-based economic policy belief had to be able to interpret the reality and determine legitimate courses of action to policymakers. In other words, rules had to appear to be realistic. If the rules did not make sense, this signified an important weakening of the rules-based discipline cognitive element. By engaging in a discussion about the extension of adjustment paths, the policymakers questioned the economic rationale of fiscal rules: the limits to the discretion of national policymakers were seen as inferior to discretionary fiscal policy. Rather than adhering to the constraints of the fiscal framework, EFC members started to believe in their own ability to strike the right balance between consolidation and stabilisation. The questioning of what was once taken for granted pointed to the erosion of cultural elements exposing a deinstitutionalisation process (see Chapter 3).

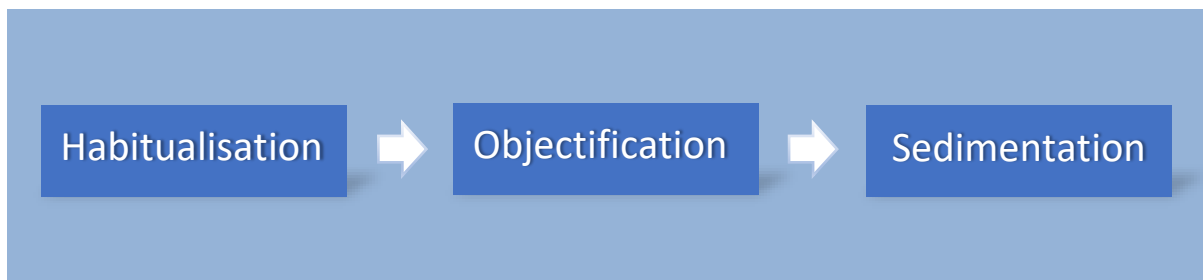
The deinstitutionalisation of the rules-based discipline belief had an immediate effect on the organisational level. At the end of November, the Council issued Recommendations to member states extending the deadlines for the correction of excessive deficits well beyond the normal timeframe of the Pact. At the beginning of December, the ministers were noting that “[o]n the basis of the Commission's autumn economic forecasts, the Council called on Belgium and Italy to reduce their deficits below the 3% of GDP threshold by 2012, the Czech Republic, Germany, Spain, France, the Netherlands, Austria, Portugal, Slovakia and Slovenia to do so by 2013, Ireland by 2014 and the UK by the 2014-15 financial year” (Council of the European Union, 2009e: 11). Thus, instead of setting the deadline for the correction of deficits in 2010 (the year after the identification of the excessive deficit) the Council proceeded to the establishment of multiannual adjustment paths in defiance of the agreed rules.

The delineation of a fiscal exit strategy in the autumn of 2009 revealed important inconsistencies in the economic logic of Eurozone policymakers at the time, which resulted in the weakening of the rules-based element of the Sound Money paradigm. This process enabled the strengthening of other economic policy beliefs.

6.2 The Institutionalisation of Institutions-Based Discipline

My argument here is that the institutions-based economic policy belief became considerably strengthened after the adoption of the Fiscal Exit strategies at the end of 2009. It should be recalled that the sociological institutionalist approach of organisational change concentrates on the creation of meaning. The emergence and the strengthening of cultural beliefs constitutes the essence of the institutionalisation process according to sociological institutionalists. A microinstitutional analysis of the institutionalisation process requires a turn to the generalisation of meaning mechanism. The mechanism consists of three parts: habituation, objectification and sedimentation (Schema 6.1).

Schema 6.1: The Generalisation of Meaning Mechanism in Sociological Institutionalism



In the first stage of the mechanism (habitualisation), patterned behaviours are developed empirically in response to particular organisational problems. Organisational innovation becomes possible as taken-for-granted meanings are either absent or weakened. The deinstitutionalisation of cognitive elements leaves policymakers without available scripts and typifications to guide their actions. At the stage of habitualisation policymakers establish new organisational arrangements as a practical way of dealing with the problems at hand without resorting to significant theorisation of their actions. Based on this, I would expect to find evidence of new organisational arrangements in the EMU shortly after the adoption of the Fiscal Exit strategies and the demise of the rules-based economic policy belief.

In the second stage of the mechanism (objectification), shared definitions of meaning emerge from the habitualised behaviours. Institutional entrepreneurs engage in the identification of persistent organisational failure and the theorisation of the reasons behind this outcome. They develop justifications for the innovative organisational arrangements so that the latter can appear as conceptual solutions to generic organisational problems. Innovative solutions to practical problems transform into taken-for-granted understandings shared by the social

environment. In this context, I would expect to find evidence of significant theorisation activity by institutional entrepreneurs in the ECOFIN and the EFC. Policymakers should appear to develop shared definitions of the problems of rules and proceed to the justification of the turn to institutions based on theoretical concepts.

In the third stage of the mechanism (sedimentation), objectified meaning is transmitted to groups of individuals outside the social environment. These individuals perceive the newly established cognitive elements as social givens. The theorisation activity is low as individuals are unaware of the origins of the new behaviours that they take for granted. In line with this part of the theory I would expect to find evidence of the transmission of the objectified understandings to EU policymakers outside the ECOFIN and the EFC. These individuals should appear to assimilate the understandings created within the EFC without engaging in heavy theorisation of the new concepts.

6.2.1 Habitualisation: The Emergence of Enhanced Surveillance

The analysis of the empirical material revealed the emergence of three important organisational innovations addressing distinct organisational problems in the first few months after the adoption of the Fiscal Exit strategies thereby confirming the presence of a habitualisation process.

Strengthening the assessment of Stability and Convergence Programmes

The suspension of the SGP rules through the extension of the deadlines for the correction of excessive deficits created further organisational problems. EFC members risked creating doubts about their governments' commitment to fiscal sustainability. Given that the Council had pledged only weeks before that the fiscal exit strategy would be consistent with the SGP (see above), the suspension of the EDP could have given the impression of a radical departure from the collective commitment to fiscal discipline.

Not every organisational actor within the EU endorsed the suspension of the EDP. Unremarkably, the new approach was met with reluctance by the ECB. The bank noticed the discordance between the Council's fiscal exit strategy and the provisions of the fiscal framework stressing the possible reputational consequences of that choice. In its Monthly Bulletin of December 2009, the ECB underlined that:

[t]he consistent implementation of the provisions of the EU fiscal surveillance framework, notably the corrective arm of the Stability and Growth Pact, is a key condition for maintaining public confidence in the soundness of current policies. The EU fiscal framework is a cornerstone of economic policy-making in EMU. Any perception that the letter and spirit of the framework is being undermined by lax implementation of the rules risks eroding public confidence in the soundness of fiscal institutions in the euro area.

(European Central Bank, 2009d: 88)

Additionally, the ECB warned fiscal policymakers about potential rapid changes in the sentiment of market participants due to the increased government borrowing requirements. The bank called the governments to address the challenges to fiscal sustainability by proceeding to a swift correction of the fiscal imbalances.

The concerns of the ECB about the potential reaction of the financial markets to the suspension of the EDP were not unfounded. In November 2009, the Financial Times were reporting the investors' increasing nervousness about the burgeoning budget deficits of EU member states (Oakley, Mackenzie and Whipp, 2009). In December, a few days after the Council decided the extension of the deadlines for the correction of deficits, the credit rating agency Standard & Poor's lowered Spain's debt outlook. The move was seen as a reaction to the failure of Spain to tame its deficit (Mallet and Reuters, 2009). A complete abandonment of the SGP framework would have created shockwaves in the financial markets.

Being aware of the ECB's reservations (the ECB is represented in the EFC) and the sensitivity of the financial markets, the EFC members attempted to bridge the gap between the strategy of smooth consolidation and the upholding of the SGP. To do so, they proceeded to an organisational innovation: the tools of the *preventive* arm of the SGP would be used to secure the *correction* of the excessive deficits. The Council would employ multilateral surveillance in the place of the suspended EDP in order to make sure that governments would reduce their fiscal deficits. This approach presented two important advantages. Firstly, the instruments of multilateral surveillance, namely the Stability and Convergence Programmes, evaluated the medium-term budgetary strategy of the member states and, therefore, were compatible with the medium-term orientation of the fiscal exit strategy. Secondly, the SGP was not entirely abandoned as multilateral surveillance was a constitutive part of the Pact, albeit this instrument had been designed as a tool for the prevention of excessive deficits and not their correction.

The innovation was introduced through the Council Recommendations that were issued in the context of the EDP in the beginning of December 2009.⁵ A recital in the Council Recommendation to Germany read:

Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of the German stability programme which will be prepared between 2010 and 2013 could usefully be devoted to this issue

(Council of the European Union, 2009f: 11)

Identical provisions were included in the Council Recommendations to other member states (only the relevant deadlines differed). The Council clearly linked the extension of the deadline for the correction of the deficits with the upgrade of fiscal surveillance.

Transforming the preventive part of the SGP into a corrective mechanism required the introduction of some changes in the central instrument of multilateral surveillance, namely the Stability or Convergence Programmes. While the Programmes continued to include information about each country's MTO, the real target of the medium-term strategy was to achieve the reduction of the fiscal deficit below the 3% threshold. Member states had to present an adjustment path that would lead to a 3% deficit before the deadline set in the Council Recommendations of December 2009. Rather than merely evaluating the nominal annual targets to determine whether the pace of adjustment to the medium-term objective was adequate, the EFC would proceed to a more in-depth assessment of the feasibility of the underlying measures included in the programmes. In April 2010, the EFC implemented the revised approach to the evaluation of the submitted Stability and Convergence Programmes. The EFC stressed that member states needed to specify concrete measures to guarantee the credibility of the adjustment path and requested more information.

Alignment of fiscal and macroeconomic surveillance

A second organisational problem was the conclusion of the existing ten-year EU structural reform programme, namely the Lisbon Strategy, at the beginning of 2010. As was explained in the previous chapter, before the outbreak of the financial crisis Eurozone elites had considered

structural adjustment as the most important instrument of macroeconomic stabilisation. While the use of fiscal expansionism in the aftermath of the crisis proved to be a necessary tool to stabilise the crisis-hit economies, the adoption of a fiscal exit strategy and the concomitant consolidation of public finances meant that structural adjustment would gradually become once again the primary mechanism to achieve stabilisation. Eurozone policymakers were obliged to establish a new EU framework to support structural adjustment at the national level. At the end of 2009, the European Commission engaged in the process of designing a new structural reform initiative with the name “EU 2020” to replace the expiring Lisbon Strategy. The new strategy would have to be implemented in the context of a particularly challenging environment. High unemployment and constrained public finances complicated the governments’ efforts to increase the flexibility of labour markets, reform the social security systems and promote lifelong learning.

At the end of November 2009, the Commission launched a consultation on the EU 2020 strategy asking member states and the EU Institutions to send their views on the objectives of the new strategy and its governance (Commission, 2009d). Member states sent their reflections by mid-January 2010. National position papers revealed the existence of a clear division among countries on the issue of EU 2020 governance (European Commission, 2010c; see also Copeland and James, 2014). Some member states, such as Portugal, called for greater “complementarity and coherence” between the EU 2020 strategy and the Stability and Growth Pact. Others, such as Belgium, went even further asking the new strategy to shift from “soft law” instruments to “hard law” regulations. Belgium proposed the establishment of governance structures similar to those of the SGP.

Large member states opposed this direction. Germany stressed the need to respect national competence in this field in line with a “partnership-based approach”. Country-specific recommendations had to be adopted with the consent of the relevant member states. Germany’s position paper clearly rejected a substantial strengthening of EU level decision-making in the EU 2020:

We reject the setting of specific objectives for countries or groups of countries at EU level or the setting of growth targets. The national level must decide whether and which national objectives are stipulated for the national level

(Federal Ministry for Economic Affairs and Energy, 2009: 9)

The Italian position paper revealed a similar approach. “[S]trong responsibility and national ownership” had to be maintained (Ministry of Economy and Finance, 2010). The Italian government warned that a mixing of the instruments of the EU 2020 strategy and the SGP could result in the weakening of both processes. The UK also noted the importance of using different governance structures for the monitoring of fiscal policy and structural reforms (HM Treasury, 2010). The Dutch position paper advised against an “unnecessary overlap” between the SGP and the post-Lisbon strategy but did not deny the usefulness of some synergies (Senate of the Dutch Parliament, 2010). The French government supported the strengthening of economic policy coordination and the enhancement of the monitoring of the economic policies but made clear that a transformation of the SGP into an instrument for the surveillance of structural reforms would have been inappropriate. The Open Method of Coordination was the most appropriate way of governing the structural reform process. The ECB asked for the strengthening of country monitoring and pointed to a greater involvement of the Eurogroup. The bank did not take sides on the governance issue indicating that “an ambitious strategy must be matched by an appropriate governance structure” (European Central Bank, 2010b: 2). However, the ECB noted that in cases of “major policy failure” the country-specific recommendations had to become more binding. This indicated the possible transition to a “hard law” approach in those cases.

The gravity of the Greek fiscal troubles in the beginning of 2010 illustrated the necessity of a new structural reform strategy. Given that the Greek fiscal deficit was over 12% of GDP (later on this figure was revised upwards) and the public debt stood at 113% of GDP, policymakers realised that fiscal consolidation was not enough to secure the sustainability of public finances. The Commission proposed the extension of the deadline for the correction of the excessive deficit but at the same time acknowledged that the “risks attached to the medium-term adjustment path are large” (European Commission, 2010d: 13). The magnitude of the adjustment that was required created doubts about the feasibility of the consolidation effort. To mitigate the risks to fiscal adjustment, the country had to complement the fiscal measures with structural reforms (European Commission, 2010d: 18). The Greek Stability Programme recognised the link between fiscal consolidation and structural reform:

Greece today faces a double challenge: to consolidate the country’s fiscal position through effective fiscal *and* structural policies aimed at reducing the budget deficit and lowering the public debt to GDP ratio

(Council of the European Union, 2010a: 4, my emphasis)

Realising the importance of implementing structural reforms to assist the challenging fiscal consolidation path of Greece, the Commission pushed forward a second organisational innovation. In defiance of the objections of many large member states, expressed in the public consultation for the EU 2020 strategy, the Commission promoted the alignment of surveillance instruments. On 3 February 2010, the Commission recommended to the Council the joint deployment of the instruments of economic and budgetary surveillance as a means to address the combination of fiscal and macroeconomic imbalances in Greece. The Commission underlined that “[t]his represents the first time that a Decision giving notice to take action under Article 126(9) and a Recommendation under Article 121(4) are applied together” (European Commission, 2010e: 2). This unprecedented step signified the combination of multilateral surveillance of economic policies under the BEPGs with the fiscal surveillance of the preventive and corrective arms of the SGP. By proposing the merger of three distinct monitoring instruments, the Commission sought to make Council recommendations on structural reforms more binding in line with the suggestions of the ECB and smaller member states.⁶ A few days later, in its decision giving notice to Greece to take measures for the deficit reduction the Council endorsed the rationale of the Commission about the interplay of structural reforms and fiscal adjustment (Council of the European Union, 2010b). The Council asked Greece to include the structural reform measures taken in its reports on the adoption of budgetary measures. In this way, the Council accepted the alignment of fiscal and macroeconomic surveillance.

Informal ex ante consultations on Exit Strategies

A third organisational problem was the emergence of spillovers as a result of the simultaneous consolidation of public finances across the EU. The EFC started reflecting on the issue of spillovers during the discussions on the Fiscal Exit Strategy. A relevant policy paper by Jürgen von Hagen, Jean Pisani-Ferry and Jakob von Weizsäcker presented at the informal ECOFIN meeting at Göteborg on 1st October 2009 underlined the “interdependence of exit policy instruments” (2009b: 2). The economists explained that “a simultaneous budgetary contraction in all major industrialised economies would have a much stronger effect on all economies than a contraction in any single country” (2009b: 18). In other words, a synchronised consolidation across the EU would produce spillovers affecting the level of demand. National fiscal policymakers could not begin designing their fiscal strategies without taking into account the

fiscal plans of their counterparts in the other EU members. The economists proposed the establishment of a mechanism to commit governments to ex ante consultations with the Commission and the other EU governments on the content of the national Exit Strategies.

The EFC acknowledged the necessity of coordinating the exit strategy but did not endorse the establishment of any particular mechanism to organise it (Council of the European Union, 2009c). EFC members opted to coordinate the fiscal exit strategies informally. The relevant habitualised behaviour that inspired the EFC was the coordination of the fiscal stimulus packages in the beginning of 2009 (see chapter 5). The Committee was very actively involved in the management of the EERP by providing EU-level guidance to national authorities ensuring that the designed national expansionary measures were compatible with the common European interests and avoided negative spillovers. EFC members underlined their role in the coordination of fiscal stimulus policies in 2008-2009:

It was natural that the EFC took the lead [in the coordination of EU's response to the collapse of Lehman Brothers].

Sure. [Our involvement] included the expansionary programme. This is what we did. The Recovery programme had degrees of fiscal expansion. But *we* had to see that a *common principle* was maintained. What benchmarks would be maintained. Transparency sometimes has better results than intransparency.

(Anonymous Interviewee 01, my emphasis)

After Lehman Brothers [with the adoption of the stimuli packages] we have an intensification of the Economic and Financial Committee and the Eurogroup Working Group.

In late 2008 and early 2009 and again in 2010 we were in very very regular contact. This was done through teleconference. Before it was usually a meeting per month. So we met, not perhaps on a daily basis but two or three times per week.

(Anonymous Interviewee 08)

We didn't seek more powers, it [the coordination of the EERP] was thrust upon us, I mean the EFC and in particular the EWG [Eurogroup Working Group]. In effect, there was no other body really capable of coordinating economic policies.

(Anonymous Interviewee 15)

6.2.2 Objectification: Theorising the Shift to Institutions

The analysis of the empirical material unveiled the conceptualisation of particular weaknesses of fiscal rules and the theorisation of institutions-based solutions to address them.

Not enough room for manoeuvre during the good times

In the first months of 2010 the EFC participants engaged in the process of creating shared understandings about the problems of the SGP rules. The first weakness that Eurozone elites identified was that the rules had not directed member states to create enough room for manoeuvre during the good times to prepare for adverse conditions. While the rules appeared overly restrictive during the period of the crisis (see above), they seemed rather lax during the pre-crisis boom period. Interviewees stressed the frustration of the EFC with the function of the SGP in the pre-crisis period:

While most countries retained their deficit below the 3% threshold they did not do enough in good times [to prepare for the more difficult days]. Countries needed encouragement also in good times

(Anonymous Interviewee 08)

The issue was how to make sure that we build room for manoeuvre for the bad times. At that point there was no room, (most) countries had deficit all the time
(Anonymous Interviewee 09)

Even though the majority of member states were abiding by the rules before the crisis, the post-crisis steep rise of fiscal deficits across the Eurozone provided a strong indication of large-scale policy failure. Respecting the rules (avoiding the Excessive Deficit Procedure) did not

guarantee sufficient preparation. EFC participants noted that many member states had been running small deficits all the time. Small scale but persistent fiscal deficits (under the 3% limit) impeded the creation of room for manoeuvre for the bad times. In reality, the rules failed to drive member states to implement cyclically adjusted consolidation. During the good times there were not enough incentives for the member states to increase their fiscal effort in line with the doctrine of the constrained discretion. States failed to achieve their MTOs and adopted pro-cyclical policies (Anonymous Interviewee 10). Countries could get away just by avoiding the EDP. As one policymaker noted:

There was discordance with the 60% and 3% rules. There was a possibility to live with the commitment if you remedied the discrepancy

(Anonymous Interviewee 11)

While the EFC members confirmed the value of countercyclical fiscal expansion as a means of stabilising the economy in the aftermath of the crisis, they regretted the fact that the fiscal framework had not pushed the countries towards greater fiscal consolidation during the boom years. Relying on the EDP was clearly not enough as the sanctioning mechanism kicked in at a very late stage. The limited room for manoeuvre made Eurozone elites doubt the compatibility of rules-based discipline with the economic logic of constrained discretion.

Prominence of prevention (medium-term fiscal surveillance)

To deal with the issue of insufficient fiscal effort during the good times, a new consensus emerged around the need to modify the timing of fiscal consolidation. The EFC members concluded that the imposition of strict discipline had to take place earlier in the SGP process. Making a greater fiscal effort during the good times and avoiding pro-cyclical fiscal policies meant that member states had to respect the Medium-Term Objectives. Interviewees underlined the rising prominence of prevention in their thinking:

The logic was that we don't want to be confronted with the problems through the EDP, it would be preferable to prevent problems before happening

(Anonymous Interviewee 09)

It is better to address the problems before they erupt. Previously there were only fines at the end of the process

(Anonymous Interviewee 19)

The logic was the logic of prevention. Acting beforehand is better. The clear objective was to have more control over fiscal policies

(Anonymous Interviewee 04)

The financial crisis showed the need to improve surveillance. We needed to act earlier on the budget side

(Anonymous Interviewee 16)

That strengthening of the preventive dimension of the framework drew on the enhanced role of the Stability and Convergence Programmes in the context of the fiscal exit strategy (see previous section). The habitualised behaviour of strengthening fiscal surveillance became invested with socially shared meaning: prevention was not only an appropriate solution in the context of a *particular* situation (the fiscal exit strategies of 2010) but constituted a *generic* solution to a wider problem (creating room for manoeuvre to enable constrained discretion). The European Commission codified the new shared understanding of Eurozone decision-makers. In its May 2010 Communication on reinforcing economic policy coordination, the Commission underlined that: “[p]revention is more effective than correction” (European Commission, 2010f: 8, emphasis in the original). The Commission called for the “decisive strengthening” of the Stability and Convergence Programmes to incentivise member states to make sufficient progress towards their medium-term objectives (MTOs) in good times.

The development of a shared understanding on the need to enhance the preventive elements of the fiscal framework increased the institutionalisation of the institutions-based discipline belief. As was explained in the previous chapter, the system of multilateral surveillance (the preventive arm of the SGP) had been the embodiment of institutions-based discipline. While the MTOs ostensibly constituted numerical benchmarks, in reality they relied heavily on EU institutions. The use of MTOs was linked to the use of high-quality forecasts (Ljungman, 2007).

The Commission and the EFC engaged with the assessment of the country-specific MTO and the adjustment path towards it. The evaluation of economic projections and planned measures was an inherently vague process. The legal text of the SGP revealed the discretionary nature of surveillance:

Based on assessments by the Commission and the Committee set up by Article 114 of the Treaty [namely, the EFC],⁷ the Council shall, within the framework of multilateral surveillance under Article 99 of the Treaty,⁸ examine the medium-term budgetary objective presented by the Member State concerned, *assess* whether the economic assumptions on which the programme is based are *plausible*, whether the adjustment path towards the medium-term budgetary objective is *appropriate* and whether the measures being taken and/or proposed to respect that adjustment path are *sufficient* to achieve the medium-term objective over the cycle.

(Article 5, Council Regulation (EC) No 1466/97, as amended by Council Regulation (EU) No 1055/2005, my emphasis)

Institutions enjoyed great discretion to assess member states' compliance with their medium-term fiscal obligations (whether a member state presented "significant divergence of the budgetary position from the medium-term budgetary objective").⁹ That was a very different exercise from the examination of the existence of excessive deficits under the EDP as the latter was based on outcomes, not assumptions and evaluations.

The replacement of mechanical limits with judgement is at the heart of the institutions-based approach to fiscal discipline (Wyplosz, 2005: 74). The economic rationale behind the use of judgement refers to the recognition of a complex trade-off between sustainability and stabilisation (Ayuso-i-Casals et al., 2009: 10-11). Sustainable policies are not necessarily optimal and numerical targets designed to achieve sustainability fail to produce satisfying results in other fields (Hallerber, Strauch and von Hagen, 2009: 171). The existence of various policy goals has led many economists to support the use of judgement. Assessing the compliance of short-term policy goals with longer term objectives is widely seen as one of the primary tasks of the independent fiscal institutions (Krogstrup and Wyplosz, 2009; Debrun, Hauner and Kumar, 2009; Calmfors, 2011; von Hagen, 2013). Medium-term fiscal objectives are highly compatible with an enhanced role of fiscal institutions as they enable them to accommodate various objectives in the short-term. The EFC's consensus on the strengthening of the MTOs within the fiscal framework of the EMU signified the turn to judgement and the

weakening of automaticity. Thus, by endorsing the need to strengthen prevention within the framework of fiscal governance, Eurozone policymakers legitimised the enhancement of the role of EU institutions in imposing fiscal discipline.

Exclusive focus on fiscal imbalances

A further weakness of the rules was their exclusive focus on fiscal imbalances. The crisis made evident that macroeconomic imbalances could have significant adverse effects on fiscal policies. The EFC participants realised that the rules were unable to detect fiscal imbalances of a structural nature. Strong fiscal results in the pre-crisis period had been based on macroeconomic imbalances in the fields of housing, construction and financial services. “[R]evenue windfalls during asset price boom periods” were misread “as durable improvements in the underlying budget position” (Commission, 2009e: 7). In reality, tax revenues had been artificially boosted due to the booming economy but collapsed after the eruption of the crisis revealing weaker underlying fiscal positions (European Commission, 2010f: 3). EFC members became particularly concerned with the inadequate monitoring of structural fiscal imbalances in the system of surveillance:

In 2009, it became obvious that there was a bigger structural problem with fiscal surveillance; this problem was not understood before. There were the classic examples of Spain and Ireland with strong growth and strong public finances, but this was due to the property market. When the values dropped then the two countries went in EDP

(Anonymous Interviewee 15)

In the boom period ministers thought they did a fine job, the Pact was working! With the crisis, the surpluses were gone, it was revealed that there was no central or structural preparation. Now there were deficits.

We thought: “How good are the rules that do not work”? The SGP didn’t prevent the crisis

(Anonymous Interviewee 10)

There was uncertainty on the structural measurement, accepting the figures at face-value gave misleading results, it indicated that there was no problem

(Anonymous Interviewee 17)

The grave effects of macroeconomic distortions on the soundness of national fiscal policies led EFC members to challenge the appropriateness of the SGP rules. The fiscal troubles of Spain and Ireland, two countries that had been considered champions of fiscal soundness before the crisis, created shockwaves within the EFC unveiling the failure of the rules-based discipline to prepare countries for bad times. The two countries were “flawless in SGP terms” before the crisis but were forced to run enormous deficits afterwards due to the problems in the private sector of the economy (Anonymous Interviewee 11). Structural imbalances, such as the accumulation of private debt, the unsustainable levels of consumption, the housing bubbles and the decreasing competitiveness had been building up gradually but ended up placing a huge burden on the public coffers after the crisis. Bank bailouts and increasing welfare costs due to rising unemployment pushed public expenditure upwards. The rules-based approach did not provide any mechanism to prevent these imbalances or even trace their effects on public finances at an earlier stage.

Integrated economic surveillance

Realising the need to mitigate the adverse effects of macroeconomic imbalances on fiscal policymaking, the EFC participants adopted a shared understanding on the need to upgrade macroeconomic surveillance. They agreed on a more candid assessment, better discussions and policy advice and country surveillance focused on macroeconomic issues. Interviewees stressed the interplay between fiscal and macroeconomic policies:

There is an understanding that the fiscal and macroeconomic policies are complementary

(Anonymous Interviewee 17)

Fiscal and economic policies cannot be divided. Some colleagues used the example of Chancellor Schroeder. He did not act on the deficit, so Germany faced problems with the fiscal deficit in 2003, but he passed huge reforms that in the long term had

strong effect on deficit reduction. This means that there is an interaction between fiscal and economic policies

(Anonymous Interviewee 16)

The concept was to bring the different strands of surveillance together. We called it integrated economic surveillance. Until then the Stability and Growth Pact and EU 2020 were treated separately. The Commission has always been trying to bring together the Open Method of Coordination and fiscal surveillance. The Open Method of Coordination was considered to be in a second league

(Anonymous Interviewee 11)

The necessity of the integration of fiscal and macroeconomic surveillance constituted another case of objectified meaning. The habitualised behaviour of aligning fiscal and macroeconomic surveillance offered a way forward. The simultaneous deployment of fiscal and macroeconomic monitoring instruments was not only effective in the Greek situation, but emerged as an appropriate solution to a more general problem: the insufficient attention of the European fiscal framework to macroeconomic imbalances. The EFC members created meaning out of their habitualised behaviour. Integrated surveillance was a precondition for macroeconomic stability and had to be applied on every member state. In its May 2010 Communication on reinforcing economic policy coordination, the Commission noted that “[t]o prevent the occurrence of severe imbalances within the euro area, it is therefore important to deepen the analysis and expand economic surveillance beyond the budgetary dimension to address other macroeconomic imbalances, including competitiveness developments and underlying structural challenges” (European Commission, 2010f: 6).

The new consensus on the combination of the fiscal and macroeconomic surveillance instruments was reflected in the policy documents on EU 2020 that were issued in the spring of 2010. In its March 2010 Communication on EU 2020, the Commission proposed the launching of country-specific recommendations to member states focusing on macroeconomic issues. The Commission noted that “the Europe 2020 and Stability and Growth Pact (SGP) reporting and evaluation will be done simultaneously to bring the means and the aims together” (European Commission, 2010g: 27). The Commission was clearly expecting that the alignment of the surveillance instruments would lead to the strengthening of the governance of the EU

2020 strategy. The thinking was that country-specific recommendations for structural reforms would become more binding if they were linked to fiscal policy recommendations. The Council adopted the Commission's approach committing to ensure the conformity of country-specific recommendations under the BEPGs with "national and EU fiscal frameworks and public finance constraints" (Council of the European Union, 2010c: 5).

The development of a shared understanding regarding the integration of economic surveillance through the alignment of different policy instruments enhanced the institutionalisation of the institutions-based discipline. Decision-makers agreed that a deeper analysis of underlying economic conditions in member states' economies would be a substantial step towards the prevention of macroeconomic imbalances and their destabilising effects on national budgets. However, the vague and undetailed monitoring approach of the Broad Economic Policy Guidelines and the weak coordination of the peer pressure mechanism (the Open Method of Coordination) were incompatible with the new consensus on the provision of surveillance based on deep economic analysis at the EU level. The ECB highlighted this incompatibility stressing that macroeconomic surveillance had to be more targeted and intrusive (2010c). A more in-depth analysis of country-specific macroeconomic developments required more detailed assessments by the EU institutions. The monitoring of "developments in current accounts, net foreign asset positions, productivity, unit labour costs, employment, and real effective exchange rates, as well as public debt and private sector credit and asset prices" could not rely on peer reviews and required the involvement of the Commission (European Commission, 2010f: 7). The latter had to advance its capabilities to guarantee the comparability of facts and figures (Pisani-Ferry, 2010). The assessment would be qualitative (Anonymous Interviewee 12). Indicative benchmarks could be used but the surveillance would be based on an overall evaluation of the economy taking into account fiscal developments. EU institutions would have to use economic judgement in their assessments. This would give them increased discretion over the application of more stringent monitoring instruments. One of the interviewees noted that the broadening of surveillance signified a break from the rules-based approach:

There was a loss of focus on rules-based fiscal surveillance, the latter providing predictability, visibility, clarity. When the surveillance is broadened then it becomes less predictable. Those insisting on the Maastricht doctrine they insist on rules, not evaluation.

(Anonymous Interviewee 11)

It became obvious that adding a “real economy” perspective to the system of surveillance went hand in hand with the upgrading of the role of the EU institutions in macroeconomic surveillance. Therefore, the consensus on the integration of economic surveillance legitimised the shift towards institutions-based discipline.

Neglecting the risk of spillovers

A particularly problematic aspect of the rules-based approach to fiscal surveillance was that it overlooked the spillover of a country’s economic policy decisions to other member states and the Eurozone as a whole. The crisis proved that economic developments in one country of the Eurozone could have significant effects on the other member states. Problems could transmit through various channels, such as capital flows or the rising cost of public and private debt financing, in the interconnected Eurozone economies. EFC participants underlined that the Committee came to realise the significance of spillovers:

The logic was simple. We share a common currency, we have a common monetary policy, individual actions of a member state have spillover effects on the destiny of other member states. You cannot have a group of countries working (and others not)

(Anonymous Interviewee 05)

There was an understanding that the spillover effects of a member’s policy on other member states were not taken into account

(Anonymous Interviewee 17)

The spillover effects of national fiscal policies became apparent with the Greek debt crisis.¹⁰ As the Greek state gradually lost access to the financial markets and proved unable to refinance its debt in the spring of 2010, investors became increasingly worried about the prospect of contagion. The Financial Times were reporting the fears of the market participants about the contagion from Greece to other member states, such as Portugal and Spain (Alloway, 2010;

Shellock, 2010; Oakley and Atkins, 2010; Tett, 2010). As a result of those concerns, the yields on the sovereign bonds of the Eurozone peripheral states rose to record levels. The channel of contagion was the banking system. Big private banks of core Eurozone states, such as Germany and France, had become significantly exposed to the sovereign debt of Greece and the rest of the Eurozone periphery in the pre-crisis period (Lapavitsas et al., 2010). In the event of a default in the spring of 2010, those banks would incur heavy losses and would need to be bailed out by their respective national governments (Ewing, 2010; Economist, 2010). Market participants suddenly realised the interconnectedness of the Eurozone economies due to the integration of the financial markets. The Commission was aware of the systemic nature of the problem that was revealed by the Greek crisis. In February 2010 President Barroso was noting that “the situation in Greece posed a systemic problem, not only for the euro zone but for the European Union as a whole. European economies and financial systems were very interdependent, a factor which had been further emphasised by this crisis” (European Commission, 2010h: 15). EFC members closely followed the developments in the financial markets and reached similar conclusions:

In early 2010 it became apparent that Greece would not be able to finance itself. That happened in April, but Euro area had no means of support (...). There was also contagion: Spain, Portugal, Ireland all of them were linked through the banks.

(Anonymous Interviewee 15)

In a letter to the President of the Eurogroup on 6 May 2010, the Chair of the EFC highlighted that the situation with the Greek government debt was “perceived as a matter of concern for the euro area as a whole”.

Rules-based discipline neglected the effects of the increased interdependence of the European economies. The rules-based approach established a framework of surveillance focused on individual countries. The SGP was based on the national responsibility for fiscal policymaking (see chapter 5). National fiscal authorities were expected to “keep their own houses in order”. That framework, however, created “a general bias towards not seeking to intervene in other countries’ policy decisions” (European Central Bank, 2010c: 4). As one member of the EFC explained:

The member states sought to protect the national interest and did not look at the Eurozone (interest) as a whole.

(Anonymous Interviewee 10)

The Greek sovereign debt crisis made evident that national fiscal authorities were much more tightly linked than it was believed before. The EFC understood that the integration of financial markets and the function of the banking systems meant that the fiscal problems of one state could easily spillover to other states and risk the integrity of the Eurozone. In this context, the rules-based principle of national responsibility for fiscal policymaking was not relevant any more. The Greek crisis proved that the rules-based ex post coordination of national budgetary policies was highly problematic. In the Greek case, the imposition of sanctions after the breach of rules would have been pointless and harmful. Eurozone decision-makers could have imposed sanctions on Greece in the spring of 2010 but at that point those sanctions would have aggravated the country's fiscal problems. In parallel, those sanctions would have increased the pressure on other countries of the Eurozone periphery and some core European banks exposed to peripheral sovereign debt. Certainly, this type of late (ex post) coordination proved to be unable to contain the contagion of fiscal troubles to other member states.

Genuine EU-level guidance (ex ante coordination)

Confronted with the issue of spillovers the EFC members concluded that national policies had to be shaped in line with the Eurozone interest. The idea that national economic policies needed to be treated as an issue of common concern that had been included in the Maastricht Treaty gained new impetus. The EU level coordination of national fiscal and structural policies would have to take place ex ante rather ex post. Governments would be required to engage in meaningful discussions about their budgetary plans before they implemented them to ensure the coherence and consistency of their policies with the overall objectives of the EMU. In reality, Eurozone decision-makers realised that countries needed guidance to design EMU-compatible policies. Interviewees highlighted this turn to guidance:

The SGP logic was based on the outcomes (...). The logic of the EFC then was that “we will tell countries what to do”. Under the new logic, specific measures are prescribed from the EU level. This goes a level deeper.

(Anonymous Interviewee 02)

We thought that countries should *not* be left alone to take decisions (...) The new framework changes the way in the thinking of member states to put “Europe first”, to borrow from Trump.

(Anonymous Interviewee 10)

In [the SGP reform of] 2005 the philosophy was pretty the opposite. The crisis pushed members to accept that guidance. Before it was inconceivable. Then [in 2005] budgets were not checked by the Commission.

(Anonymous Interviewee 04)

Again, the enhancement of EU-level guidance was based on an earlier practice of the EFC. The EFC’s experience with the EERP increased the confidence of its members regarding their ability to coordinate national fiscal policies. The habitualised behaviour of guiding national fiscal policies during the Keynesian turn of 2009 became invested with socially shared meaning. Guidance of national fiscal policies was not only useful in the context of the fiscal stimulus programmes, but constituted a remedy for the more generic problem of spillovers. In its 12 May 2010 Communication on reinforcing economic policy coordination, the Commission revealed the new social consensus: coordination at EU-level would be required to address the issue of spillovers (European Commission, 2010f: 2). The Commission stressed that “[t]he currently missing *ex-ante* dimension of budgetary and economic surveillance would allow the formulation of genuine guidance, taking into account the European dimension, and their subsequent translation into domestic policymaking” (2010f: 8, emphasis in the original).

The newly adopted consensus was already put in practice. A few days before, on 6 May 2010 the EFC had asked those member states suffering from the reaction of the markets (due to the Greek turmoil) to announce additional consolidation measures (accompanied by reform measures to promote competitiveness). On 9 May 2010, the ECOFIN welcomed “the commitment of Portugal and Spain to take significant additional consolidation measures in 2010 and 2011 and present them to the 18 May ECOFIN Council” (Council of the European Union, 2010d: 6). In the subsequent meeting, ministers decided that the adequacy of those

measures would have to be assessed by the Commission (Council of the European Union, 2010e). In June 2010, the Commission evaluated the measures stressing that

[t]his assessment should be *considered as early guidance of next year's budget*.

This is very much in line with proposals on reinforced economic governance which foresees early guidance in order to ensure a sound articulation between the European and national budgetary process

(European Commission, 2010i: 5, my emphasis)

The shared understanding of the need of policy guidance enhanced the institutionalisation of the institutions-based discipline belief. EFC members agreed on the establishment of a process that would ensure the incorporation of EU-level policy recommendations into national policymaking. To do so, they acknowledged the need to intervene in the national budgetary processes to increase the influence of EU-level decision-making on the final decisions over the composition of the national budgets. It should be recalled that the reform of the budgetary process constitutes the core element of the institutions-based approach to fiscal discipline (von Hagen and Harden, 1995). As Eichengreen and von Hagen stress, the institutional approach is based on the premise that fiscal obligations can be met “by procedure, prescribing how the agent is to make decisions but not the outcome” (1996: 16). Interviewees confirmed the EFC’s preoccupation with the budget procedures:

The rationale of ex ante coordination was that policy advice had to be more relevant and more timely. In the past bad timing did not enable to incorporate European evaluation to national policy. Back then the programmes were submitted in December and the Commission and the Council did not issue an evaluation until the half of next year. In that way, we were losing a year (or a year and a half), before having an assessment on the budget.

(Anonymous Interviewee 10)

if the parliaments decide on the budget then how you are going to influence it? The logic was that national parliaments should take into consideration the guidance. Otherwise there is the issue of national sovereignty

(Anonymous Interviewee 14)

There was wish for long time that EU-level discussion would influence the national level of policymaking. The idea was to have another rendez-vous, to evaluate whether budget plans were in accordance with the Council recommendations (issued in May/June). So the concept was to exert influence in the right time.

(Anonymous Interviewee 11)

The provision of fiscal guidance by central institutions was firmly embedded in the institutions-based approach. The relevant literature on the institutions-based discipline advocated the centralisation of the budgetary process through the introduction of hierarchical procedures. At the national level, the proposed reforms included the tipping of the balance of power between the executive and the legislature in favour of the former and the enhancement of the position of the finance minister within the government (von Hagen and Harden, 1995). The proponents of institutions-based discipline paid particular attention to the initial stage of the budgetary process (the planning stage) promoting the delegation of strategic powers to a “fiscal entrepreneur”, namely the finance minister, who could set the agenda by issuing guidelines to other ministers. At the subsequent legislative approval stage, the economists supporting the institutions-based approach sought to limit the parliamentary amendments to protect the finance minister’s proposed budget and even endorsed the finance minister’s ability to veto the budget approved by the parliament (von Hagen, 2002; Hallerberg, Strauch and von Hagen, 2007).

At the EU level, the centralisation of the budgetary process promoted by the advocates of institutions-based discipline pointed to the ex ante coordination of national fiscal policies. The assessment of the sustainability of national fiscal policies would be delegated to an independent Sustainability Council (Fatás et al., 2003; Hallerberg, Strauch and von Hagen, 2009: 191-198). Again, the focus was on the initial stage of the budgetary process. Countries would be expected to submit their annual and medium-term fiscal plans in the early phase of the budgetary process. The Sustainability Council would use judgement to evaluate the compatibility of these plans with the sustainability of the countries’ public finances. In this way, the institution would be able to deal with the issue of spillovers as it could evaluate the trade-offs between the pan-European policy goals and the national objectives (von Hagen and Mundschenk, 2002: 181). The institution would be able to veto the plans and demand adjustments. Clearly, the

expectation was that the Sustainability Council would shape the national budgetary process by providing guidance to national governments.

The EFC's consensus on the use of EU level guidance to design national fiscal policies endorsed some core features of the institutions-based discipline such as the centralisation of budgetary procedures and the delegation of parts of fiscal policymaking to independent institutions. Genuine EU-level guidance signified a significant shift to the institutions-based approach.

Institutional entrepreneurs

The theorisation activity within the EFC was a collective endeavour. Interviewees underlined that solutions emerged as a result of "intensive discussions" (Anonymous Interviewee 05). The fact that the participants in the EFC are all trained economists with deep knowledge of economic theory *and* practical understanding of economic reality due to their position within national finance ministries attests to their ability to contribute constructively in the relevant discussions. Additionally, the working methods of the EFC, which create an environment conducive to open discussions, led its members to exchange ideas about the nature of the weaknesses of fiscal governance and the appropriate solutions. It is indicative that EFC members are prohibited from reading out speaking points (Anonymous Interviewee 03). The discussions should be frank and open. Members are expected to find solutions to common problems. Sometimes members even deviate from the official position of their government. Having developed a collective identity, the EFC participants were able to proceed in the theorisation of weaknesses and solutions.

However, the analysis of the empirical material revealed that some actors were particularly active in the theorisation process. The Director-General of European Commission's DG ECFIN, Marco Buti, and the Deputy Director-General of the same DG, Servaas Deroose, had a major contribution to the objectification of institutions-based discipline. Under their leadership, DG ECFIN produced a number of significant communications and reports that informed the discussions of the EFC. On 7 October 2009 the Commission's "Annual Statement on the Euro Area 2009" (Commission, 2009a) identified the fundamental weaknesses of the SGP framework:

- the limited room for manoeuvre (due to insufficient fiscal effort in good times) preventing member states from adequately responding to the crisis,

- the existence of broader macroeconomic imbalances (large current account deficits and rapid growth of the financial sector) leading to a sharp drop of GDP in some countries,
- the lack of early and comprehensive coordination despite the close economic and financial interlinkages of the member states

The statement was based on the analytical work of the “Annual Report on the euro area 2009” prepared by DG ECFIN under the supervision of Marco Buti and the executive responsibility of Servaas Deroose (Commission, 2009f). The Commission officials made sure to summarise the “lessons learned for governance” (2009a: 8):

- deeper fiscal surveillance could balance the concerns about stabilisation and sustainability
- broader macroeconomic surveillance would be needed to provide a coordinated policy response to the competitiveness problems (covering also financial market developments)
- the crisis confirmed the need for Eurozone to strengthen the position of the Eurogroup in surveillance

A few days later, a DG ECFIN note explained how independent domestic fiscal institutions and hierarchical procedures at the domestic level could contribute on medium-term consolidation (Council of the European Union, 2010f). The above concepts were repeated in the Commission’s “Public Finances in EMU Report 2009”.

Through the above reports and policy notes, economists Buti and Deroose engaged in the identification of persistent organisational failures within the framework of fiscal governance and engaged in the conceptual justification of practical solutions. While those solutions had featured in various Commission reports in the past (Commission, 2001; 2004), the two economists managed to relate them to the particular events of the Eurozone reality of 2009-2010. In this way, they played a significant role in the creation of meaning by the EFC.

Tracing the economic beliefs of Buti and Deroose reveals their attraction to the institutions-based approach. Both economists were well aware of the relevant academic work on institutions-based discipline. They have even endorsed some elements of the institutions-based approach in their own academic work. For example, in 2002 Servaas Deroose (together with Sven Langedijk) was arguing in favour of “the *principle of informing beforehand* other members of the euro area and the Commission, before adopting important economic policy

measures” (2002: 217, emphasis in the original). He underlined the importance of analysing economic policies on the basis of the overall situation of the Eurozone stressing that “[p]rior consultation would alert policy makers to potential and self-defeating conflicts, such as inconsistent budgetary programmes” (ibid). In the same year, Marco Buti (together with Gabriele Giudice) reviewed the work of authors promoting institutions-based discipline and even found the delegation of parts of fiscal policymaking to independent experts “*intellectually seductive*” (Buti and Giudice, 2002: 843-844, my emphasis).¹¹ In 2000, Buti together with Michael Artis were the first that introduced the concept of creating room for manoeuvre during the good times to allow for the use of fiscal policy as a stabilisation tool during periods of cyclical slowdown (Artis and Buti, 2000). The implication of their argument was that attention needed to shift from the nominal deficit target of the SGP to MTOs. Finally, in April 2009 Buti together with Paul van den Noord were calling for the integration of structural and fiscal surveillance. The two economists noted that the rules-based principle of subsidiarity was unfit for purpose (Buti and van den Noord, 2009).

6.2.3 Sedimentation

The analysis of the empirical material uncovered the transmission of the objectified meanings to EU policymakers outside the EFC and the ECOFIN.

Transmission to the European Parliament’s Committee on Economic and Monetary Affairs

The setting of the European Parliament’s Committee on Economic and Monetary Affairs (ECON) is markedly different from that of the EFC. While most of the ECON Committee’s members had received training in economics and some of them even had relevant professional appointments before becoming MEPs, their strong political commitments, their focus on diverse policy issues and the lack of awareness about the practical problems that the managers of national finance ministries were dealing with, did not enable them to engage in deep theoretical discussions about the necessity of the constrained discretion and its incompatibilities with the rules-based framework. The politicised environment of a Parliamentary Committee is not conducive to frank, in-depth discussions about the nature of economic problems.¹² Certainly, some Committee members were keen to inject some flexibility into the system of fiscal governance as they valued discretion, but they were the minority (Anonymous Interviewee 20). The majority in the Committee (and the Plenary)

remained faithful to the constraining logic of rules-based discipline. In this context, the adoption of understandings that rivaled the rules-based approach can be explained as a transmission of taken-for-granted meaning from the EFC to the ECON Committee.

The members of the ECON quickly endorsed the objectified meanings of the EFC. In response to the engagement of the Commission and the Council with the economic governance reform (proven by the relevant Commission's Communication of May 2010 and the Council's decision to establish a Task Force on Economic Governance), the members of the ECON Committee decided to produce an own-initiative report to shape the European Commission's legislative proposals. On 25 June 2010, Rapporteur Diogo Feio presented a draft report including specific recommendations to the Commission (European Parliament, 2010a). The report called for a stronger commitment by the member states to adhere to the MTO and for the establishment of a more robust evaluation process of the Stability and Convergence Programmes. Also, it noted that the member states should consider "their economic policy as a matter of common concern" stressing the need to coordinate the economic policies of member states "at Union level" (European Parliament, 2010a: 5). Taking into account the "Union dimension" of national fiscal and macroeconomic policies justified "a requirement for Member States to inform each other and the Commission before taking economic policy decisions with expected tangible spill-over effects" (European Parliament, 2010a: 9). This would mean the establishment of "stronger links" between EU level surveillance and the design of national fiscal policies. These provisions were aligned with the newly created meaning within the EFC about the prominence of medium-term surveillance and the necessity of genuine EU-level guidance of national fiscal policies.¹³

The theorisation of the newly adopted understandings remained low within the ECON but it was not absent. The members of the Committee consulted the relevant Communications and Reports produced by the Commission, the Council and the ECB that articulated the new shared concepts. Before the adoption of the final version of the Feio Report, the ECON invited a couple of prominent proponents of the institutions-based approach to contribute to the work of the Committee. In September 2010 Charles Wyplosz wrote an analytical note on multilateral surveillance advocating the reform of national budgetary procedures and the establishment of independent fiscal institutions (Wyplosz, 2010). On 15 September 2010 Bruegel's André Sapir participated in a Committee public hearing and promoted "a different kind of surveillance" based on the preservation of the "common good of the euro area" (Sapir, 2010). The expert explained that a more intelligent system of surveillance required the granting of more

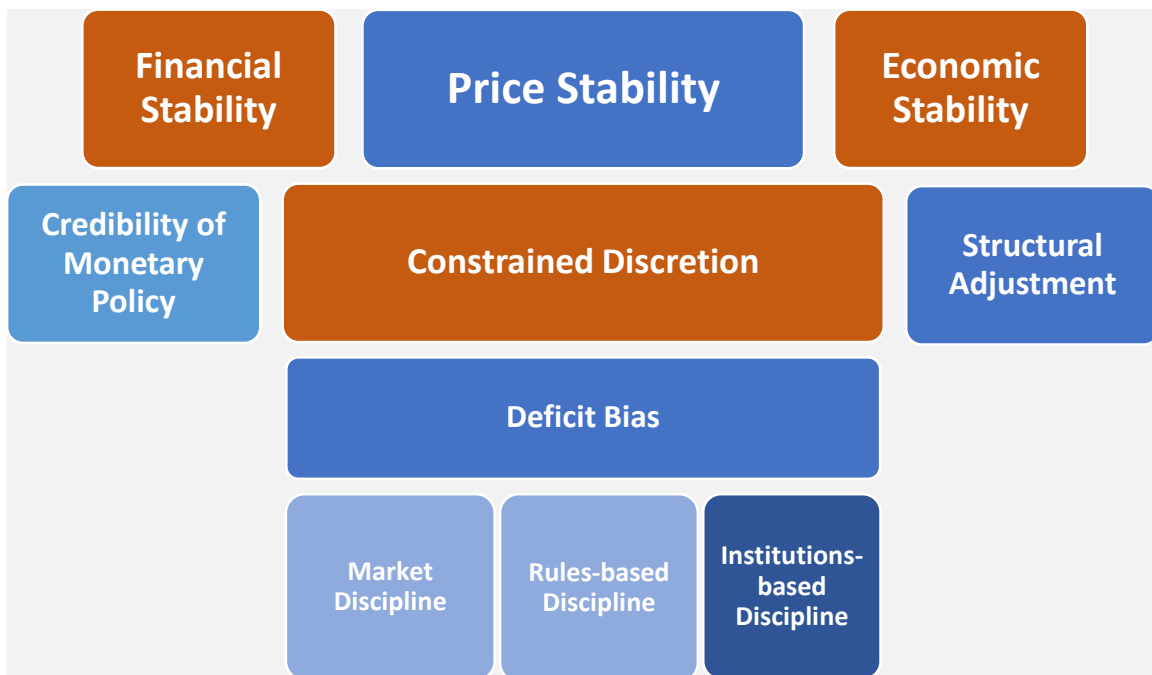
independence to European Commission's DG ECFIN. Wyplosz and Sapir enhanced the taken-for-grantedness of the transmitted understandings. Strengthening the independence of fiscal institutions appeared as the "natural" way forward.

Transmission to the European Parliament's Plenary

A part of the EFC's shared understandings was transmitted directly to the Plenary of the European Parliament. In March 2010, the three largest political groups of the European Parliament at the time issued a joint motion for a resolution calling for the strengthening of the governance of the EU 2020 strategy (European Parliament, 2010b).¹⁴ On 10 March 2010, the European Parliament passed a resolution that urged for the abandonment of the "Open Method of Coordination" and noted the need to increase the coherence of the EU 2020 strategy with the SGP (European Parliament, 2010c). On 16 June 2010, a new resolution requested the establishment of stronger links between the Europe 2020 and the SGP highlighting the need to integrate the two instruments (European Parliament, 2010d). The Parliament underlined that more effective economic governance entailed the enhancement of the role of the Commission in the management of structural reforms. These resolutions were clearly in accordance with the shared understanding within the EFC about the necessity of integrating economic surveillance. Again, the theorisation activity was low. MEPs referred to the Communications and Reports of the other European Institutions. The endorsement of the integrated economic surveillance consolidated the taken-for-granted status of the institutions-based discipline.

The sedimentation of the institutions-based discipline marked a significant adaptation of the Sound Money paradigm for a second time after the outbreak of the financial crisis. It should be recalled that the Eurozone's system of meaning had already undergone a first adjustment in 2008 with the shift from fiscal discipline to constrained discretion and the emergence of financial stability and economic stability as distinct economic policy beliefs (see Chapter 5). The restructuring of the Eurozone's economic policy beliefs signified the evolution of the currency union's social legitimacy (see Schema 6.2).

Schema 6.2: The post-crisis Sound Money paradigm



Conclusion

This chapter provided an analysis of the adaptation of the Sound Money paradigm in the period 2009-2010. The chapter focused on two economic policy beliefs: rules-based discipline and institutions-based discipline. I argued that the emergence of the logic of constrained discretion in the aftermath of the financial crisis led to the eventual deinstitutionalisation of the rules-based belief. Following the logic of constrained discretion, in the autumn of 2009 Eurozone policymakers engaged in the design of Fiscal Exit strategies that would gradually replace the fiscal stimulus policies that provided counter-cyclical stabilisation to the European economies in 2008-2009. That exercise unveiled the incompatibility of rules-based discipline with the logic of constrained discretion. In the context of skyrocketing deficits, rules appeared to be less relevant as they proved to be overly rigid.

The deinstitutionalisation of rules opened the way for the adoption of competing cultural elements. I argued that the institutions-based belief became considerably strengthened. The analysis of the empirical material revealed the presence of the generalisation of meaning mechanism. Initially, the EFC proceeded in organisational innovations to deal with the pressing organisational problems caused by the abrupt deterioration of public finances. The strengthening of the assessment of Stability or Convergence Programmes, the alignment of

fiscal and macroeconomic surveillance and the informal ex ante consultation on Fiscal Exit strategies became habitualised behaviours. Subsequently, the EFC created shared definitions of meaning out of the habitualised behaviours. In this way, Eurozone policymakers transformed their practical solutions into objectified understandings: the prominence of prevention, the integration of economic surveillance and the necessity of genuine EU-level guidance to national budgetary policies. The fact that these understandings were compatible with the strengthening of independent fiscal institutions signified the shift to institutions-based discipline. Finally, the transmission of the objectified understandings to other EU policymakers outside the EFC's social environment provided the necessary element of exteriority that solidified the new meaning as a taken-for-granted understanding.

The next chapter proceeds to the analysis of organisational change within EMU between 2010 and 2013. It explores the links between the newly created meaning and the particular organisational arrangements that composed the Six Pack, the Two Pack and the Fiscal Compact.

¹ According to the Agenda of the 143rd meeting of the EFC, the Committee dealt with the issue of fiscal exit strategies on the 8th of October 2009.

² See Council Regulation (EC) 1056/2005, Article 1.

³ Article 3 of Council Regulation (EC) 1467/97 as amended by Council Regulation (EC) 1056/2005.

⁴ The Code of Conduct had been drafted by the EFC and was endorsed by the ECOFIN.

⁵ Speaking to the College of Commissioners, Commissioner Almunia (Economic and Monetary Policy) explained that "the price of this short-term flexibility was more demanding medium-term recommendations and objectives" (Commission, 2009g: 24).

⁶ The three instruments were: a recommendation under Article 121(4), a notice to take action based on Article 126(9) and an opinion on the January 2010 update of the stability programme pursuant to Regulation (EC) No 1466/97.

⁷ TEC Treaty, now Article 134 TFEU.

⁸ TEC Treaty, now Article 121 TFEU.

⁹ Article 6 of Council Regulation (EC) 1466/97.

¹⁰ Eichengreen and Wyplosz (1998: 78) provided a remarkable foresight of relevant events by identifying the banking system as a possible channel of contagion and underlining the link between sovereign debt and the stability of the banking system.

¹¹ In the context of the academic discussion on the reform of the SGP in 2004, Marco Buti (together with Lucio Pench) promoted the rearrangement of the national economic policy cycles that would enable "a more effective incorporation of the results of the multilateral surveillance at European level in national budgetary choices (Buti and Pench, 2004: 1031). That was clearly in line with the institutions-based approach to discipline.

¹² This is also true about the "Special Committee on the Financial, Economic and Social Crisis" that had been established by the European Parliament in 2009. The relevant report that became adopted in October 2010 did not manage to provide in-depth analysis of Eurozone's fiscal problems (European Parliament, 2010e).

¹³ These concepts were included in the final version of the report (European Parliament, 2010f).

¹⁴ Those political groups were the European People's Party, the Progressive Alliance of Socialists and Democrats and the Alliance of Liberals and Democrats for Europe.

CHAPTER 7
ORGANISATIONAL ADAPTATION:
THE REFORM OF EUROPEAN ECONOMIC GOVERNANCE

Introduction

The previous chapters analysed the changes in the system of meaning of the EMU after the financial crisis. The emergence of the concept of “constrained discretion” led to the eventual strengthening of the institutions-based discipline belief within EMU’s social environment. This chapter explores the effects of the post-crisis adaptation of the Sound Money paradigm on the organisational structure of the EMU. I seek to uncover the links between the policymakers’ revised economic policy beliefs regarding the issue of fiscal discipline and the particular organisational arrangements that emerged in the complex legislative process. To do so, I attempt to answer two questions. Firstly, how did the strengthened institutions-based belief shape the formal negotiations on the reform of the Eurozone? Secondly, did the final outcome of the negotiations conform to the adjusted post-crisis social legitimacy of the EMU?

My argument in this chapter is that the reform of European Economic Governance between 2010 and 2013 can be best understood as an organisational adaptation to the post-crisis adjusted Sound Money paradigm. The argument evolves in three steps corresponding to the chapter’s three distinct parts. In the first part, I claim that the Six-Pack constituted a genuine process of alignment of the Eurozone’s organisational structure with the strengthened institutions-based discipline belief. I find that the social environment rewarded arrangements that conformed to three particular cognitive scripts: the integration of economic surveillance, the emphasis on prevention and the centralisation of budgetary procedures. After the adoption of the Six-Pack, the reform proceeded in a less linear way due to the resistance of the German political system. In the second part, I examine how the parallel negotiation on the establishment of the permanent financial support mechanism opened the way for a distinct social process: coercive isomorphism. I show how the German Parliament attempted to reverse the centralisation of fiscal coordination by imprinting domestic legitimisation schemas on the Eurozone governance. The German coercive pressures took the form of the proposed Fiscal Compact. I argue that EMU’s social legitimacy led policymakers to defend the centralisation of fiscal surveillance

and amend the German proposals. In the third part, I turn to the analysis of the Two-Pack. I argue that the latter was a further response to the German challenge. I find that the social environment of the Eurozone rewarded arrangements that consolidated the centralisation of fiscal surveillance and protected EMU's knowledge structures.

Within each part my analysis begins with the assessment of the effect of the social legitimacy on the formal negotiations and proceeds with the testing of the compliance of the final provisions with institutions-based discipline. I employ process-tracing and discourse analysis to identify the impact of cognitive scripts on the distinct phases of formal negotiations and use discourse analysis to uncover the links between the final legal provisions and the adjusted social legitimacy.

7.1 The Six-Pack Reform

My argument in this section is that the Six-Pack reform constituted a process of alignment of the organisational structure of European Economic Governance with the adjusted social legitimacy of the Eurozone. I show how the social environment rewarded the integration of economic surveillance, the emphasis on prevention and the centralisation of budgetary procedures in compliance with the strengthening of the institutions-based discipline belief. Through the use of process-tracing and discourse analysis, I detect the effects of the shared understandings in three stages of the negotiation process: the agenda-setting phase, the intergovernmental discussions within the Council, the inter-institutional negotiations between the Parliament and the Council. I find the presence of a broad consensus on the direction of the reform and detect a few areas of controversy related to the short-term political interests of some governments. In parallel, I unveil the leading role of three unexpected actors: Luxembourg, the ECB and the European Parliament. Subsequently, I turn to the organisational structure established by the Six-Pack and test its compliance with the adjusted Sound Money paradigm. Through the use of discourse analysis, I find that every significant provision of the Six-Pack reflects the shift to institutions-based discipline.

7.1.1 Social Legitimacy Shaping the Formal Negotiations: Rewarding Prevention, Integration and Centralisation

The sociological institutionalist approach expects that an organisation's taken-for-granted meanings have significant effects on formal decision-making as they construct the preferences and the very identity of the individuals within the organisation. New organisational structures are adopted to protect the cognitive framework from competing causal beliefs. Given the significant change in the Eurozone's system of meaning with the strengthening of the institutions-based discipline, a sociological institutionalist explanation anticipates the broad reorganisation of the structures of European Economic Governance. Considering the direction of the EMU's legislative negotiations, what matters is the proximity of the reform proposals to the underlying consensus established by the (adjusted) Sound Money paradigm. Social legitimacy rewards certain organisational forms over others, such as fixed numerical targets or the economic judgement of independent bodies. Proposals promoting the strengthening of prevention, the integration of fiscal and structural surveillance or the centralisation of budgetary procedures in line with the institutions-based discipline belief are expected to be adopted. In contrast, proposals impeding the direction towards an institutions-based framework are expected to be rejected. The effect of the social legitimacy on negotiation proposals should be traceable in the distinct phases of EU legislative decision-making: the setting of the agenda, the debate in the Council and the inter-institutional negotiations between the two primary legislative bodies in the EU, namely the Parliament and the Council.

Setting the Agenda (I): The Commission Prioritises the Integration of Fiscal and Structural Surveillance and Places Emphasis on Prevention

The analysis of the empirical material provides sufficient evidence on the alignment of the Commission's legislative initiative with the adjusted Sound Money paradigm. The Commission promoted the integration of fiscal and structural surveillance and the enhancement of prevention but showed considerable reluctance to push for the centralisation of budgetary procedures. The lack of full compliance with the underlying consensus can be attributed to the strategic considerations of the Commission.

The Commission presented the Six-Pack legislative package on 29 September 2010. Its proposals were building on two Communications issued in May and June 2010 (European Commission, 2010f; 2010ia). The Commission proposed the amendment of the SGP, the

establishment of minimum requirements for national fiscal frameworks and the creation of a new system of macroeconomic surveillance (European Commission, 2010ia).

Considering the SGP reform, the Commission promoted the upgrading of the Stability and Convergence Programmes. Instead of just tracking the headline annual adjustment towards the medium-term target, the assessment would include the monitoring of expenditure growth. To strengthen the credibility of the multilateral surveillance the Commission proposed the introduction of sanctions -for the first time- in the preventive arm of the SGP. In parallel, the Commission promoted some noticeable changes to the corrective arm of the SGP. The proposal enabled the extension of the deadlines for the correction of the excessive deficits but linked any extension to the examination of the development of expenditure, thereby basing the EDP on multilateral surveillance (the preventive arm of the SGP). Following the same logic of prevention superiority, the Commission called for the introduction of a new set of financial sanctions in the early stages of the EDP. Also, the Commission sought to operationalise the debt criterion to activate sanctions for insufficiently diminishing public debts. However, the sanctioning mechanism would not be triggered automatically but only after the consideration of “relevant factors” (European Commission, 2010ib).

The Commission’s proposals on national fiscal frameworks complemented the promoted changes to the SGP and focused on ensuring the upgrading of prevention. The adoption of multiannual fiscal planning at the national level was expected to ensure the achievement of MTOs. Also, the Commission encouraged the member states to provide a breakdown of projected revenue and expenditure to improve the assessment of the adjustment path (European Commission, 2010ic; 2010f).

The Commission proposed the creation of a system of macro-structural and macro-financial surveillance based on a scoreboard of indicators to alert for emerging imbalances (European Commission, 2010f). A more in-depth analysis of the developments in particular countries would follow the scoreboard evaluation. The detection of imbalances would be accompanied by early warnings and Council Recommendations.

A closer examination of the above proposals reveals traces of particular cognitive scripts. The Commission gave substance to the EFC’s understanding on the primacy of prevention. Discussing the direction of the proposed reforms in the College of Commissioners, Commissioner Rehn acknowledged that “the Communication as a whole reflected the viewpoint that prevention was better than correction” (European Commission, 2010id: 23). The

President of the Commission endorsed this view noting that “the main thrust of the proposals was to reinforce the preventive dimension” (European Commission, 2010id: 24). Indeed, most of the proposed reforms concentrated on the strengthening of the preventive arm of the SGP. Even the amendment of the EDP and the establishment of requirements for national fiscal frameworks were directed towards the advancement of prevention. A distinct cognitive script was the need to integrate macroeconomic surveillance. The broadening of surveillance through the enhancement of the macroeconomic component was another element of the adjusted social legitimacy. The June 2010 Communication included a clear reference to this taken-for-granted understanding:

The EU needs stronger macro-economic country surveillance integrating all relevant economic policy areas. Macroeconomic imbalances should be looked at jointly with fiscal policy and growth-enhancing structural reforms (European Commission, 2010ia: 3)

The College of Commissioners expressed “widespread support for the integrated approach proposed on surveillance” noting the need for adequate human resources to put it into action (European Commission, 2010id: 20). An interviewee presented the Commission’s approach in the legislative proposals:

the rationale of the Six Pack reform was based on the analysis of the financial crisis and the debt crisis. Due to large accumulated imbalances, we needed to *extend surveillance* from fiscal to macroeconomic surveillance. Therefore, firstly we had the Macroeconomic Imbalances Procedure. Secondly, fiscal surveillance was not so effective, so we needed convincing tools to achieve medium-term stability. Thirdly, we needed to reinforce national mechanisms

(Anonymous Interviewee XX)¹

The interviewee explained that for the Commission the establishment of macroeconomic surveillance was more important than the changes in the SGP:

Macroeconomic ex ante monitoring was more important but more qualitative [as opposed to the quantitative assessment of the SGP]. My own country had many current account crises in the past, which led to currency devaluations. Fiscal surveillance was more quantitative, so it was easier to operationalise. That is why the public focuses more on the fiscal part (...)

The new framework adopted a real economy perspective, this is fundamentally more important.

(Anonymous Interviewee XX)²

The above cognitive scripts shed light upon the Commission's proposals. By requesting the upgrade of Stability or Convergence Programmes and the creation of the Macroeconomic Imbalances Procedure the Commission took important steps towards the establishment of institutions-based discipline. However, the hierarchical dimension of the institutions-based discipline was missing. Therefore, the sociological explanation needs to be complemented with a different approach. The analysis of the empirical material reveals the existence of strategic considerations in the Commission's negotiation position. It seems that the Commission's considerable reluctance to ask for new powers and position itself at the centre of surveillance was linked to the fear of a backlash in the Council:

The big risk of the reform was that the member states would start to organise the coordination outside the EU framework. The Commission feared that if the coordination got to be too political, maybe that could be done by another international institution. So, the real risk was that a parallel system could be established, a system departing from the EU framework.

(Anonymous Interviewee 04)

Thus, while the orientation of the Commission's proposals aligned with the change in the social legitimacy, strategic considerations restricted the ambition of the Commission in the initial phase of negotiations.

Setting the Agenda (II): Luxembourg and the ECB Promote Centralisation

The analysis of the empirical material proves that two actors determined crucial aspects of the legislative agenda: Luxembourg and the ECB. The two actors promoted the centralisation of fiscal coordination in compliance with the adjusted Sound Money paradigm. Their proposals covered a significant gap in the Commission's legislative initiative.

The combination of sequence and account evidence reveals that the government of Luxembourg under Prime Minister Jean-Claude Juncker intervened very early in the formal decision-making process by proposing the establishment of the European Semester

(Anonymous Interviewees 10 and 12). The Semester was an old Commission idea that had been tabled in 2004 in the context of the 2005 SGP reform (Commission, 2004). Juncker was holding the presidency of the Eurogroup since 2005 and, as a result, he was closely engaged in the previous SGP reform negotiations. Juncker and his senior staff in the finance ministry reviewed past reform proposals and resurrected the idea of an “EU Semester”. The Commission supported the proposal and included it in its May 2010 Communication on “Reinforcing economic policy coordination” (European Commission, 2010f). The ECB endorsed the substance of the proposal (European Central Bank, 2010c). In sharp contrast to the 2005 reform, the Council quickly agreed the adoption of the European Semester. On 8 July 2010, the EFC endorsed the introduction of the European Semester in the form of a modification of the SGP’s Code of Conduct and prepared the relevant ECOFIN conclusions (Council of the European Union, 2010g). On 13 July 2010, the ECOFIN authorised the EFC to amend the Code of Conduct and include the Semester (Council of the European Union, 2010h). On 7 September 2010, the ECOFIN endorsed the modifications prepared by the EFC (Council of the European Union, 2010i). The rapid adoption of the Semester by the Council meant that the relevant organisational change took place *before* the official triggering of the negotiation process with the presentation of the Commission’s six legislative proposals on 29 September 2010. The Commission accepted the Council’s “light approach” and did not include the Semester in the legislative proposal for the amendment of the preventive arm of the SGP. The Semester became operational in the spring of 2011 while legislative negotiations were still under way.

The successful agenda-setting by Luxembourg in the case of the European Semester can be attributed to the proposal’s compliance with the adjusted system of meaning. The analysis of the documents promoting the European Semester reveals clear traces of a particular cognitive script: the need for genuine EU-level guidance. Luxembourg’s proposal of 12 March 2010 for the establishment of a European Semester concentrated on the interaction between EU-level guidance and national budgets. The timing of the assessment of Stability or Convergence Programmes did not allow for the incorporation of EU-level recommendations in national budgets as the advice came either too late (national budgets were already adopted) or too early (before the beginning of national budgetary discussions, so it was outdated). The country admitted that the proposal constituted an effort to reform national budgetary procedures:

This process would be structured around two semesters. One at the European level (...) [t]he other at Member State level (...). This new European approach of economic and budgetary coordination and programming would allow for greater

interaction between EU procedures and national decisions (...) [s]uch a system would turn the drafting of stability and convergence programmes into *one of the stages of the national budget's preparatory work*

(Permanent Representation of Luxembourg to the European Union, 2010, my emphasis)

The proposal complied with the prevailing social legitimacy within the EMU. The repeated references to EU-level guidance or ex ante coordination indicated the compliance of the Semester with the institutions-based belief.³ Similarly, when the Head of DG ECFIN, Marco Buti, presented the concept of the European Semester to the EFC on 4-5 May 2010 he pointed to the alignment of the “SCP [Stability and Convergence Programmes] and NRP [National Reform Programmes] processes with a view to enhancing the *interaction with national budgetary procedures*” (Economic and Financial Committee, 2010a: 3, my emphasis).⁴ The Commission’s Communication of June 2010, which followed-up the May 2010 Communication on “Reinforcing economic policy coordination”, was explicit about the link between the Semester and the provision of EU-level policy guidance for the design of national budgets:

The core objective of the proposal is to give a clear ex ante-dimension to economic policy coordination in the EU and the euro area. Under the European Semester, complementarity of national economic policy plans will be ensured at European level through policy guidance before final decisions on the budget for the following year are taken in Member States.

(European Commission, 2010ia:11)

The ECB even asked for the establishment of common (EU-level) responsibility for national fiscal policies. While the ECB’s policy note did not mention the Semester, it clearly advocated the use of EU-level guidance to shape national fiscal policies:

the Eurogroup should assume a shared responsibility for sound national fiscal policies. The Eurogroup, as the guardian of fiscal sustainability, should review in detail national budgetary plans, consider the risk of adverse spill-over effects and agree on a number of precise *ex ante* fiscal policy guidelines to ensure compliance with the EU fiscal framework which euro area countries would be invited to follow when drafting their budgets for the forthcoming year.

(European Central Bank, 2010c: 5, emphasis in the original)

The intention of intervening in national budgetary procedures by adjusting the timing of EU-level surveillance was echoed in the September 2010 amendment of the SGP's Code of Conduct:

Under the European Semester, the Commission and the Council shall assess Stability and Convergence Programmes before key decisions on the national budgets for the following years are taken, to provide policy advice on fiscal policy intentions.

(Council of the European Union, 2010i: 10)

The rapid adoption of the European Semester and its concomitant absence from the Six-Pack proposals can be explained by the Council's underlying consensus on the need for ex ante coordination. Given that the Semester sought to establish EU-level guidance to national budgets, it was imbued with social legitimacy. The endorsement of Luxembourg's proposal became possible as the new organisational form was accepted as legitimate by the member states. By shaping the actors' perception of rationality, the social legitimacy affected their negotiation preferences. The origin of the proposal (it came from a small member state) did not make it less convincing. What mattered was the Semester's alignment with the system of meaning. Indeed, the participants of the Eurozone's social environment perceived the Semester as a meaningful and logical step:

The Semester was important; it created a good framework for ex ante coordination.
The Semester established the main pillars of the coordination process

(Anonymous Interviewee 05)

The Semester was given priority because it constituted *the foundation of the new approach*. So, you begin with ex ante [coordination]. The revision of the Code of Conduct was an easy way to proceed with the Semester. Nobody raised any objections. There was a preference for practical solutions. There was a demand for actions [by member states]. So, the Commission proposed to move with the revision of the code of conduct and there was no push back.

(Anonymous Interviewee 07)

In view of the above, agreement on the amendment of the Code of Conduct was easy (Anonymous Interviewee 01). The member states' choice to implement the Semester in the form of a semi-formal practice rather than a legislative instrument is not a paradox from a sociological institutionalist perspective. SI proponents stress that in cases of very high institutionalisation, practices do not require the "protection" of organisational adaptation (on this, see Chapter 3: Theory). The consensus on the Semester was solid as it relied on the highly institutionalised element of EU-level guidance. There was no doubt in the Council that the members would implement the new approach.

The ECB was another actor that shaped crucial aspects of the negotiations by intervening early in the process. The analysis of the empirical material revealed that the ECB was responsible for promoting the Reverse Qualified Majority Voting (RQMV) and the Excessive Imbalance Procedure in the agenda of the Six-Pack reform. The ECB's policy note of June 2010 titled "Reinforcing Economic Governance in the Euro Area" advocated a "quantum leap" in the institutional foundations of the EMU (European Central Bank, 2010c). The ECB's concern was the creation of a more robust system of sanctions. The ECB pushed for the strengthening of the role of the Commission in fiscal surveillance through the use of RQMV in relevant Council decisions. In the same vein, the ECB wanted to limit the governments' ability to impede the EDP by placing the burden of proof on the Council: "the Council would only be able to stop the escalating provisions under the EDP on the basis of an explicit decision" (European Central Bank, 2010c: 5). Additionally, the ECB proposed the establishment of a corrective mechanism similar to the EDP in the field of macro-structural coordination (Anonymous Interviewee 04). The central bank called for an "excessive vulnerability procedure" to address emerging imbalances. The Commission endorsed the ECB's proposed policy arrangements and included them in the Six-Pack legislative proposals. RQMV would be used in both arms of the SGP, while the so-called "Excessive Imbalance Procedure" proposed by the Commission was a rebranding of ECB's "excessive vulnerability procedure" (European Commission, 2010ie; 2010if).

The ECB's successful agenda-setting can be explained by the presence of a particular cognitive script. The ECB's policy note of June 2010 referred to the need to limit *political* discretion regarding the enforcement of sanctions, praising the value of *independent* fiscal and structural surveillance. The bank favoured the enhancement of the role of the Commission in line with

the institutions-based discipline belief. An interviewee confirmed the ECB officials' turn to independent institutions:

...the spirit in house [the ECB] was the need to strengthen the Commission vis-à-vis the political dynamics in the Council. The ECB saw the Commission as an *independent institution*. The ECB trusted the Commission to act independently. So the idea was to make it more independent in applying the SGP. That would happen through the RQMV.

The ECB believed that this would depoliticise an area that was too politicised (...). By empowering an independent institution, the spirit was that we could depoliticise fiscal policy

(Anonymous Interviewee 21)

The Commission acknowledged that the ECB invoked meaningful arguments promoting the Commission's position in the emerging structure of economic governance. Speaking to the College of Commissioners, Economic and Monetary Affairs Commissioner Olli Rehn found that the ECB's call for a genuine system of sanctions "legitimised and reinforced the Commission's action" (European Commission 2010id: 23). Following the cognitive script, the Commission even proceeded to an internal organisational rearrangement to boost the independence of the assessment process. The analytical base of the fiscal and structural assessments would be prepared under the authority of the Commissioner of economic and monetary affairs and, contrary to the established practice, the relevant document would not be submitted to the College of Commissioners for adoption (European Commission, 2010ig). Thus, taking on board the ECB's proposals appeared as a logical step for the Commission, given the appropriateness of independent evaluation.

Intergovernmental Negotiations: Broad Consensus on the Direction of the Reform but Scepticism over the Sanctions

The analysis of the empirical material detects evidence of a broad underlying consensus in Council discussions over the direction of the reform but reveals three heavily contested issues due to the interests of particular member states.

Initially, the Council agreed with the direction put forward by the Commission in the Six-Pack legislative proposals. Informal intergovernmental discussions over specific policy

arrangements took place in the context of the so-called Task Force on Economic Governance (TF) that had been established by the European Council in March 2010.⁵ The Task Force presented its final report in October 2010 (Van Rompuy, 2010). The TF supported all the key proposals of the Commission, namely the upgrading of multilateral fiscal surveillance (including the assessment of expenditure growth), the earlier imposition of sanctions (in both the preventive and the corrective arms of the SGP), the new framework for macroeconomic surveillance, the reform of national fiscal frameworks and the operationalisation of the debt criterion. Crucially, the TF endorsed the ECB's proposals for the strengthening of the sanctioning mechanism through the use of RQMV and the establishment of a corrective mechanism to complement macroeconomic surveillance. The analysis revealed the presence of an institutions-based discipline cognitive script explaining the endorsement of the Commission's proposals:

Reinforcing the role and *independence* of the European Commission on matters of fiscal and macroeconomic surveillance is key for the credibility of the new framework (...) The role of the Council and the Eurogroup in implementing the new surveillance and policy coordination framework in the EU and the euro area respectively will be essential

(Van Rompuy, 2010: 11, my emphasis)

As intergovernmental negotiations proceeded to their formal phase with the creation of an Ad-Hoc Working Group on Economic Governance (Council of the European Union, 2010ia), some member states raised concerns over particular issues. Italy questioned the necessity of the expenditure benchmark in the preventive arm of the SGP and disputed the numerical benchmark on debt reduction. Germany argued against the symmetric treatment of macroeconomic imbalances: current-account surpluses needed to be treated differently from deficits. France moved quickly to undermine the introduction of RQMV: an October 2010 statement by French President Sarkozy and German Chancellor Merkel at the summit of Deauville called for the use of Qualified Majority Voting (instead of RQMV) in the preventive arm of the SGP (Heritage, 2010; Folketing, 2010; Anonymous Interviewee 12). The statement also included the German claim for suspension of voting rights for member states seriously violating basic principles of the EMU. This created a backlash by smaller member states (Anonymous Interviewee 07).

The traced divergence of member states in particular issues did not reflect a wider objection over the overall direction of the reform. In contrast, the member states' concern was the avoidance of sanctions, which could have serious domestic political repercussions. Each member state tried to amend those parts of the proposed legislation that could lead to the sanctioning of its own behaviour. Italy sought to remove sanctions for excessive expenditure and debt, Germany sought to remove current-account surpluses from the index of indicated imbalances, France tried to avoid being sanctioned about its fiscal adjustment effort by changing the voting rule and smaller countries, such as Greece, tried to avoid political sanctions in the form of suspended voting rights. As a result, the overall consensus was upheld but the Council's general approach to the Commission's proposals included necessary political compromises. To accommodate the Italian government, the Council agreed to include private debt in the "relevant factors" used for the assessment of debt reduction. To satisfy Germany, the reference to current-account surpluses would be removed. To take France on board, the Council opted to replace RQMV in the preventive arm of the SGP with the so-called comply-or-explain principle. The Council undertook a political commitment to support the Commission's recommendation regarding the imposition of sanctions (Euro Summit, 2011a: 4). In parallel, it was agreed that the sanctioning process of the preventive arm would include additional steps, thereby becoming more complex.

The above developments reveal the presence of a case-specific mechanism that complements the sociological institutionalist explanation: the increased politicisation of the issue of sanctions. Interviewees mentioned the involvement of Heads of State or Government in parts of the negotiation due to their increased –political– interest. The case of France is indicative:

Sherpas took a lot of decisions. I remember many joined Sherpa and EFC meetings. (...) We had a shift of power away of ministers of finance that was outside the normal preparation of dossiers.

Heads of State or Government were taking over. This is what happened in Deauville with Merkel and Sarkozy.

Sarkozy especially had the opinion that finance ministers were idiotic technocrats and that the leaders needed to deal with the issue directly.

In some cases, prime ministers and ministers of finance had close relationships. In other cases, there was great divergence. In France, for example, the finance minister was saying one thing and the President another.

(Anonymous Interviewee 10)

The French focused on avoiding sanctions. Their government could not stand to be sanctioned in the light of upcoming elections

(Anonymous Interviewee 14)

The above accounts suggest that leaders were less affected by the social legitimacy of the EMU and their intervention in the negotiation process was driven by exogenous interests. However, their involvement should not be exaggerated. The bulk of negotiated texts were agreed at lower levels, in line with the normal practice of the Council – European Council function (Hayes-Renshaw and Wallace, 1995; Lewis, 2003).

Inter-institutional Negotiations: The European Parliament Keeps the Council on Track

The examination of the empirical data reveals that the Parliament endorsed the organisational elements that were in line with the underlying social consensus and even sought to expand them moving further than the Commission, the Council or the ECB. In contrast, the Parliament firmly opposed those aspects of the Council's negotiation position deviating from Eurozone's adjusted legitimacy. Inter-institutional agreement on almost every element was achieved quickly but disagreement on the use of RQMV persisted leading to a three-month delay of the passage of legislation.

The Parliament's response to the Commission's legislative proposals was to consider them as a starting point and undertake the task of improving them. The six ECON Committee Rapporteurs responsible for drafting the relevant reports "decided to work together and consider these proposals as a whole" (European Parliament, 2011a: 34). The consideration of the six proposals as a package (hence the name Six-Pack) and the commitment of Rapporteurs belonging to four different political groups to cooperate closely was unprecedented.⁶ The Rapporteurs agreed to push for the inclusion of the European Semester in the legal texts. Corien Wortmann-Kool (EPP, Netherlands), who was the responsible Rapporteur for the amendment

of the preventive arm of the SGP, drafted the text of the Semester and included it in the relevant Committee reports (European Parliament, 2010g; 2011b). The other Rapporteurs also included references to the Semester in their amendments of the other parts of the legislative package. By doing so, they sought to establish the Semester as an overarching surveillance framework. The Plenary quickly endorsed this position and requested the codification of the European Semester in February 2011 (European Parliament, 2011c).

In parallel, the Rapporteurs requested some important changes in the preventive and corrective arms of the SGP and the macroeconomic surveillance framework. Regarding the preventive arm of the SGP, Wortmann-Kool sought to establish multilateral surveillance as a shared activity of the Council *and* the Commission. She asked for the use of RQMV in the assessment of stability or convergence programmes, thereby enhancing the position of the Commission in the evaluation process. Additionally, she proposed an elaborate significant deviation procedure, modelled upon the EDP, to limit the political interference of the Council in the sanctioning mechanism of the preventive arm (RQMV would be used here as well). Also, the Rapporteur tried to increase the discretion of the Commission by including an “unusual events” escape clause that would be added to the “severe economic downturn” clause proposed by the Commission. Considering the corrective arm of the SGP, Diogo Feio (EPP, Portugal) put forward the use of RQMV in the early steps of the EDP and not just in the imposition of sanctions (as it had been proposed by the Commission) (European Parliament, 2011d; 2011e). Regarding the macroeconomic surveillance framework, Elisa Ferreira (S&D, Portugal) sought to include a diverse list of scoreboard indicators in the legislation to enable the Commission to proceed to “thorough economic analysis” of the macroeconomic situation rather than tie it into an automatic reading of thresholds (European Parliament, 2011f). Carl Haglund (ALDE, Finland) promoted the earlier imposition of sanctions in the Excessive Imbalance Procedure by introducing an interest-bearing deposit for member states not complying with Council Recommendations (European Parliament, 2011g).

Informal negotiations among the Parliament, the Council and the Commission, the so-called trilogues, started in May 2011.⁷ The main issues were three: the codification of the European Semester, the extension of the use of the RQMV and the specification of the scoreboard. The Council preferred its own “light approach” to the Semester but quickly backed down as the Parliament was adamant about the inclusion of the Semester in the legislation. Considering the scoreboard, the Council resisted the inclusion of particular indicators in the legislation as

governments thought that this process might “contaminate” the instrument and divert it from the identification of imbalances. A member of the EFC explained the concerns of the Council:

Yes member states were sensitive. It was about indicators. What about social indicators? Should they be included? It was important that only what was absolutely necessary was included. The Macroeconomic Imbalance Procedure had to keep a balance. Remember the context. It contained primary and secondary indicators. If we were to keep adding, what was then the purpose of including indicators? And once we included them, then what? Inclusion was not an exercise, [not] an end in itself! If imbalances were to be found then corrective action should be taken and even the imposition of sanctions. But if we, for example, included poverty indicators, then to manage to deal with poverty in just two or three years is nearly impossible. So the logic was to keep it balanced, to adopt something manageable. Otherwise it would be superfluous, irrelevant

(Anonymous Interviewee 05)

Some member states were more sensitive than others: Germany was particularly disturbed by the inclusion of current account balance in the list of indicators and the Parliament’s reference to the necessity of symmetry in the interpretation of numerical thresholds. Germany with the support of the ECB strongly insisted that current account surpluses were different from deficits (Anonymous Interviewees 12, 14, 16, 19). The Parliament’s Rapporteur and the Commissioner wanted a more symmetrical treatment of current account divergences. The most significant point of disagreement, however, was the extension of the RQMV. The Parliament made clear that RQMV constituted an absolute red line. Some member states were equally uncompromising: Italy and particularly France rejected the extension of RQMV in the preventive arm of the SGP.

The Parliament and the Council failed to reach a comprehensive compromise in July 2011. While the two EU Institutions managed to agree on the issue of the scoreboard, the differences on the RQMV issue proved insurmountable. The Council accepted the incorporation of a list of scoreboard indicators in the legal text (including the current account balance) in exchange for the removal of the symmetry requirement. Germany and the Commission agreed that in the case of current account balance the legitimate margins would be a 4% deficit and a 6% surplus (the upper margin was equivalent to Germany’s current account surplus at the time) (Anonymous Interviewees 08, 18). France, however, resisted any attempt to include the RQMV

in the preventive arm of the SGP. In response to this, the European Parliament postponed the vote on the legislative proposals thereby putting the Six-Pack on hold. In this way, the Parliament defied the European Council's request to pass the legislative package by the summer of 2011 (European Council, 2010).

Inter-institutional agreement on the Six-Pack was finally achieved in September 2011 as the European Parliament and the Council compromised on the issue of RQMV (European Commission, 2011a). The new decision-making procedure would be further extended to the Excessive Imbalance Procedure to cover the early imposition of interest-bearing deposits but would not be used in the preventive arm of the SGP. In that case, a different decision-making procedure would be employed: Reverse Simple Majority Voting (RSMV). Inter-institutional negotiations ended with the Parliament gaining major concessions from the Council. The legislation of the European Semester as an overarching surveillance framework and the significant deviation procedure in the preventive arm of the SGP, the specification of the scoreboard indicators in macroeconomic surveillance and the widespread use of RQMV in the sanctioning mechanisms were all due to the Parliament's tough stance.

The Parliament's intervention surprised governments as they did not perceive the European legislature as a major actor in European economic governance (Anonymous Interviewee 02). Given that the EP is a highly heterogeneous institution bringing together individuals with different political and social backgrounds, the level of its internal cohesion on certain aspects of the negotiation cannot be easily understood and troubled Council officials. Indeed, a member of the ECON Committee explained that the liberal majority of the MEPs belonging to the EPP and ALDE groups prioritised the issue of compliance with the governance framework and tried to strengthen sanctioning mechanisms, while the S&D members attempted to inject some Keynesian elements in the governance arrangements (Anonymous Interviewee 20). Controversial issues, such as the introduction of a substantial Eurozone budget or the issuing of Eurobonds mutualising debt emerged in the discussions. However, it seems that the Parliament's significant internal ideological divisions that were reflected on the public statements of the Parliamentary Groups and the voting behaviour of the MEPs in the Committee and the Plenary did not affect the negotiation position of the EP vis-à-vis the Council (see O'Keefe, Salines and Wieczorek, 2016).

In this context, the examination of the underlying consensus can offer a way forward. The European Parliament's unexpected negotiation stance can be attributed to the existence of a

particular cognitive script legitimising the above policy proposals. The Parliament's reports highlighted the value of increasing the *independence* of the Commission in the surveillance procedures:

In order to strengthen surveillance in the preventive arm, assessments and decisions on compliance by the Commission should be taken more *independently* from the Council.

(European Parliament, 2010g: 48, my emphasis)

A stronger and more *independent* role of the Commission in the surveillance procedure. This concerns country specific assessments, monitoring, missions, recommendations, warnings and sanctions. The Commission should take decisions as regards the compliance with EU rules more independently from the Council.

(European Parliament, 2010h: 22, my emphasis)

The rapporteurs favour therefore an extensive reform of the governance framework based on the Community (Union) method and a strong and *independent* Commission as overseeing and giving directions in the new deeper and wider economic policy surveillance framework.

(European Parliament, 2011e: 35, my emphasis)

The Commission should have a *stronger role* in the enhanced surveillance procedure as regards assessments that are specific to each Member State, monitoring, missions, recommendations and warnings (...) [the alert mechanism] should be based on use of an indicative and transparent scoreboard comprising indicative thresholds, combined with economic *judgment*. This judgement should take into account inter alia nominal and real convergence inside and outside the euro area.

(European Parliament, 2011h, my emphasis)

In line with the revised social legitimacy of the EMU, the Parliament promoted the strengthening of the role of the Commission in the system of surveillance and resisted any attempts of the Council to deviate from this path, especially on the issue of sanctions. The strengthening of the Commission appeared to be a *meaningful* outcome for MEPs shaping their negotiation preferences. An ECON Committee member confirmed that the enhancement of the Commission through the increase of its discretion appeared as the natural way forward:

The problem of Eurozone is that of contagion risk. A risk in one Eurozone country is a risk for Eurozone as a whole. Having the Commission to set the pace for decision making *makes sense*. To begin the surveillance process [the Semester] with the Annual Growth Survey [issued by the Commission] was very important. The scoreboard was put in place so that the Commission could have some intelligence and create some understanding. Some room for manoeuvre was necessary

(Anonymous Interviewee 20, my emphasis)

As the Parliament's position conformed with the underlying social legitimacy it gained wider support. The ECB urged the Council to compromise on the RQMV issue, while the Commission praised the Parliament's amendment as a genuine attempt to reinforce economic governance.

7.1.2 Examining the Compliance of the Six-Pack Provisions with the Adjusted Social Legitimacy

The sociological institutionalist explanation of organisational change expects that the adaptation of social legitimacy has significant effects on the organisational form. Apart from affecting the structure and content of EMU reform negotiations, the adjusted Sound Money paradigm must be apparent in the adopted legislation. Through the use of discourse analysis of the legal texts I confirm the compatibility of most of the Six-Pack instruments with the institutions-based discipline belief. While rules-based discipline is not absent, its effect on the organisational form of the Six-Pack is very limited.

European Semester: Integrating Economic Surveillance and Re-organising the System of EU-level Guidance

The Semester codified the EFC’s shared understanding on the necessity of ex ante coordination (EU-level guidance) and the indispensability of integrated economic surveillance. Regulation No 1175/2011 established the European Semester as an umbrella coordination process of multiple surveillance instruments: i) the Stability or Convergence Programmes of the Stability and Growth Pact, ii) the Broad Economic Policy Guidelines, iii) the Employment Guidelines, iv) the National Reform Programmes supporting the Union's Strategy for Growth and Jobs and v) the Macroeconomic Imbalance Procedure.

Table 7.1: The European Semester Cycle

November	The Commission publishes the Annual Growth Survey (AGS) and the Alert Mechanism Report (AMR). In the former, the Commission presents its assessment of the economic situation of the EU and sets out the economic priorities for the following year (budgetary policies and structural reforms). In the latter, the Commission identifies which countries require particular attention.
January	The Council discusses the AGS and the AMR and reports on its conclusions to the European Council.
February	The Commission releases Country Reports for all Member States in the form of Staff Working Documents (SWD). [*] The Reports assess the Member States’ progress in advancing reforms and include the In-Depth Reviews (IDRs) for those Member States facing macroeconomic imbalances.
March	The European Council adopts economic priorities based on the AGS.
April	The Member States submit the Stability and Convergence Programmes and the National Reform Programmes.
May	The Commission presents an assessment of each country’s plans (in the form of a Staff Working Document). The Commission proposes Country-Specific Recommendations for every Member State, which include a proposed Opinion on the Stability or Convergence Programme. The Commission provides an assessment of the euro area as a whole (in the form of a Staff Working Document) and proposes a distinct Recommendation for the euro area. ^{**}
June	The Council discusses the proposed Country-Specific Recommendations and finalizes them. The European Council endorses the final Country-Specific Recommendations. The Council formally adopts the Country-Specific Recommendations.
Notes:	[*] Before 2015 Country Reports (SWDs) were issued together with the Country-Specific Recommendations in May. Only the In-Depth Reviews (IDRs) were issued (in March). ^{**} Since 2016, the Commission provides the assessment of the euro area (SWD) and proposes the Recommendation for the euro area at the same time as the issuing of the Annual Growth Survey in November.

Source: Own construction based on Union secondary law and European Commission documents (Regulation No 1175/2011; Regulation No 1176/2011; European Commission, 2015a; 2015b; 2017d: 24).

During the first six months of the year, compliance with the preventive arm of the SGP (budgetary policies) is assessed in parallel with the monitoring of structural policies and the monitoring of economic developments for the detection of macroeconomic imbalances. At the end of the process, member states receive *integrated* Country-Specific Recommendations (CSRs).⁸ Crucially, the surveillance process includes an analysis of the euro area economy as a whole that leads to a distinct Recommendation for the euro area. Table 7.1 presents the European Semester cycle.

The creation of the European Semester reflects the strengthening of the institutions-based belief. The intervention in the budgetary process through the amendment of the timing of EU-level discussions and the issuing of guidance before the approval of budgets by national parliaments are clearly in line with the institutions-based approach to fiscal discipline. The legal text of the Semester underlines that

Member States shall take due account of the guidance addressed to them in the development of their economic, employment and budgetary policies *before* taking key decisions on their national budgets for the succeeding years. Progress shall be monitored by the Commission

(Article 2-a, Regulation No 1466/97 as amended by Regulation No 1175/2011, my emphasis)

In reality, governments are expected to incorporate EU-level policy guidance into their national budgetary plans. Hence, the timing of fiscal and macroeconomic surveillance is not a trivial issue but forms part of a wider understanding. The submission of Stability or Convergence Programmes (SCPs) and National Reform Programmes (NRPs) long before the time of the year that most member states finalise their decisions on budgetary issues (usually in autumn) allows for the conduct of meaningful discussions on the course of national fiscal policies in the Council and the EFC ensuring the provision of *relevant* EU-level policy guidance. For this reason, the Semester sets mid-April as the deadline for the submission of Stability or Convergence Programmes (or the 30th of April at the latest) noting that the submission of National Reform Programmes has to be aligned with the SCPs.

Shaping the agenda-setting regime of early budgetary discussions certainly conforms to the idea of reforming budgetary procedures that has been advocated by the proponents of the

institutions-based approach. It is indicative that in 2003 Antonio Fatás and colleagues included a strikingly similar provision in their proposal for an EMU-wide “Sustainability Council”:⁹

The national governments would have to submit their annual and medium-term fiscal plans to the Sustainability Council in the early phase of their budgetary processes, usually in March or April of the year preceding the budget year under consideration.

(Fatás et al., 2003: 70)

Additionally, the Semester promotes the reform of the national budgetary procedures by incorporating an EU-dimension to national fiscal policies. Governments need to take into account the effects of their budgetary policies on the Eurozone as a whole. The Semester includes the issuing of a distinct Council Recommendation for the euro area indicating the appropriate aggregate fiscal stance. In this way, the common challenges of the Eurozone frame the subsequent discussions on Country-Specific Recommendations (Council of the European Union, 2016: 2). This constitutes a substantial intervention in the national budgetary process as member states are required to shape the design of their national fiscal paths according to the common Eurozone interest. The provision of guidance on the aggregate fiscal stance undermines the rules-based organisational principle of national responsibility for fiscal policymaking (the “own house in order” doctrine). As was explained in Chapter 5, the proponents of the rules-based approach vehemently opposed any reference to the aggregate fiscal stance of the Eurozone as they feared that such a step could lead to the loss of clarity and the blurring of individual governmental responsibility (see Stark, 2001; Alesina et al. 2001). Therefore, the Council Recommendation for the Eurozone is another indication of the institutions-based underpinning of the European Semester.

In parallel, the European Semester advances the centralisation of the budgetary process in line with the institutions-based approach. The inclusion of the so-called “comply or explain principle” in the legal text of the Semester points to the establishment of hierarchical procedures in the budgetary negotiation regime. The principle enhances the role of the Commission vis-à-vis the Council:

The Council is expected to, as a rule, follow the recommendations and proposals of the Commission or explain its position publicly

(Article 2-ab, Council Regulation No 1466/97 as amended by Regulation No 1175/2011)

The Legal Service of the Council acknowledged the enhancement of the Commission's position in relation to the Council due to the above principle:

a number of measures have been agreed during the last years to the effect of reinforcing the Commission's power of initiative in this particular field [the SGP], thus making it more difficult to the Council to oppose or to modify the Commission's recommendations and proposals. This is notably the case of the "comply or explain" rule

(Council of the European Union, 2015: 6)

The Semester boosts the use of economic judgement by the EU institutions as it integrates the macrofiscal and macrostructural monitoring. The integration of the surveillance procedures highlights the complexity of the trade-off among distinct economic policy goals. The EU-level guidance to national authorities has to balance the pursuit of short-term fiscal discipline with the designation of structural reforms that guarantee the long-term health of public finances. Given that the surveillance of structural reforms requires the use of qualitative assessments rather than quantitative targets, the Semester strengthens the use of judgment in the monitoring process.

Stability or Convergence Programmes: Upgrading the Assessment of the Adjustment Path towards the MTO

The in-depth monitoring of national medium-term fiscal strategies was shaped by the EFC's consensus on the prominence of prevention. The reformed framework obliges member states to include detailed information about the planned growth path of government expenditure and the planned growth path of government revenue in the Stability Programmes.¹⁰ In this way, the EU-level assessment of the Stability Programmes submitted by national governments is not limited to the monitoring of the general balance of the medium-term budgetary plans but involves the evaluation of the underlying expenditure and revenue measures. By focusing on the composition of policy plans, the assessment exercise shifts from the monitoring of headline numerical targets to the examination of the feasibility and the effectiveness of *specific* policy decisions.

The upgrade of the evaluation of the Stability or Convergence Programmes¹¹ includes some elements of the rules-based approach but is mostly in line with the strengthening of institutions-based discipline. Following the rules-based approach, the reformed regulation provides for the introduction of an expenditure benchmark to assist the Council and the Commission in evaluating whether the member states achieved sufficient progress towards their MTO. The benchmark is in reality a numerical target:

- (a) for Member States that have achieved their medium term budgetary objective, annual expenditure growth does not exceed a reference medium-term rate of potential GDP growth
- (b) for Member States that have not yet reached their medium-term budgetary objective, annual expenditure growth does not exceed a rate below a reference medium-term rate of potential GDP growth

(Article 5(1), Council Regulation No 1466/97 as amended by Regulation No 1175/2011)

Despite the existence of the expenditure benchmark, the measurement of the adequacy of the progress towards the MTO is mostly based on the discretionary assessment of the EU Institutions. Firstly, there is no equivalent benchmark for the measurement of the growth of the revenue. The sufficiency of the revenue measures in relation to the projected expenditures (whether the planned revenue matches the planned expenditure) needs to be evaluated by the Commission and the Council through the use of judgment. Secondly, the reformed Regulation retains an escape clause that was introduced in the 2005 amendment allowing a temporary deviation from the MTO or the adjustment path towards it for member states undertaking major structural reforms. Again, the Council and the Commission need to employ judgement to evaluate the gravity of the structural reform and the potential long-term positive fiscal effects justifying the deviation. Thirdly, the reformed Regulation introduces a new escape clause specifically designed for periods of crisis. The legal text reads as follows:

In the case of an *unusual event* outside the control of the Member State concerned which has a major impact on the financial position of the general government or in *periods of severe economic downturn* for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective (...) provided that this does not endanger *fiscal sustainability in the medium term*.

(Article 5(1), Council Regulation No 1466/97 as amended by Regulation No 1175/2011, my emphasis)

Clearly the above escape clause points to the use of judgement by the Council and the Commission given that the terms “unusual event”, “severe economic downturn” and medium-term “fiscal sustainability” are inherently vague.¹²

While the introduction of the expenditure benchmark provides an anchor to the monitoring exercise of the SCPs in line with the rules-based approach, the widespread application of judgement by the Council and the Commission confirms the institutions-based dimension of the multilateral surveillance. It should be recalled that the proponents of the latter approach have advocated the use of judgement as a solution to the trade-off between the maintenance of fiscal discipline and other economic policy objectives, such as the stabilisation of the economy.

In this context, the enhanced role of the Commission in the assessment of SCPs is not surprising. Given that the preventive arm of the SGP relies on the evaluation of national fiscal strategies on the basis of projections, assumptions and estimates, rather than real facts, it follows that the reform strengthens the role of the EU-level actor that produces all these forecasts, namely the European Commission. Indeed, the reformed Council Regulation No 1466/97 gives equal footing to the Council *and* the Commission in the examination of Stability Programmes (Article 5, Council Regulation No 1466/97 as amended by Regulation No 1175/2011). In contrast, the original regulation of 1997 and its 2005 amendment clearly stated that the Council alone would undertake the examination of the Stability Programmes.

Significant Deviation Procedure: Following-Up the Implementation of Stability or Convergence Programmes

The creation of the Significant Deviation Procedure (SDP) was driven by the EFC’s consensus on the prominence of prevention and the need for genuine EU-level guidance. The SDP constitutes an “enforcement mechanism” introducing sanctions to the preventive part of the SGP. Regulation No 1175/2011 and Regulation No 1173/2011 present the different parts of the mechanism but the term “Significant Deviation Procedure” is not found in the legislation as it appeared later in relevant Commission and Council documents implementing the sanctions. The identification of a significant divergence of the budgetary position from the MTO or the adjustment path towards it relies on two criteria: a change in the structural balance over 0.5% of GDP per year or an expenditure growth net of discretionary revenue and one-off measures

that has an impact on the government balance of at least 0.5% of GDP per year. The steps of the SDP are presented in Table 7.2.

Table 7.2: The Steps of the Significant Deviation Procedure

Step 1	The Commission addresses a Warning to a Member State projecting a Significant Deviation from the adjustment path towards the MTO.
Step 2	The Commission proposes to the Council the adoption of a Recommendation on the necessary policy measures and the setting of a deadline.
Step 3	The Council examines the situation and adopts a Recommendation on the necessary policy measures. The Council establishes a deadline for action to be taken.
Step 4	Within the deadline, the Member State concerned reports to the Council on action taken in response to the Council's Recommendation.
Step 5	The Commission assesses whether effective action has been taken. If the Member State concerned fails to take appropriate action within the deadline, the Commission shall immediately recommend to the Council to adopt a decision establishing that no effective action has been taken. The Commission may propose the adoption of a revised Recommendation on necessary policy measures.
Step 6	If the Council does not adopt a decision on the Commission's recommendation and the concerned Member State persistently fails to take appropriate action, the Commission shall recommend (for the second time) to the Council to adopt the decision establishing that no effective action has been taken. The Commission may propose the adoption of a revised Recommendation on necessary policy measures.
Step 7	The Council's Decision on the establishment of no effective action is deemed to be adopted unless the Council decides by simple majority to reject the Commission's Recommendation (Reverse Simple Majority Voting). The Council may adopt a Revised Recommendation on necessary policy measures.
Step 8*	The Commission Recommends that the Council requires from the Member State concerned the lodgement with the Commission of an interest-bearing deposit (0.2% of GDP).
Step 9*	The Council's Decision on the lodgement is deemed to be adopted unless the Council decides by qualified majority to reject or amend the Commission's Recommendation (Reverse Qualified Majority Voting).
Step 10*	If the situation of the Significant Deviation from the adjustment towards the MTO no longer exists, the Commission shall recommend to the Council to decide the return of the deposit (including the accrued interest).
Step 11*	The Council may decide the return of the deposit to the Member State concerned or amend the Commission's Recommendation.
Notes:	<i>*Provisions applying to Eurozone Member States</i>

Source: Own construction based on Union secondary law (Regulation No 1175/2011; Regulation No 1173/2011).

The establishment of the Significant Deviation Procedure (SDP) is in line with the institutions-based discipline but includes some important provisions that are inspired by the rules-based approach. The criteria for the identification of a significant deviation constitute numerical

targets and, as a result, are inspired by the rules-based logic of ensuring fiscal discipline. However, the imposition of sanctions is not automatic. Firstly, relevant calculations about the level and nature (permanence) of revenue by the EU institutions involve the use of judgement. This can have substantial effects on the expenditure indicator. Secondly, a “crisis” escape clause similar to the one discussed above enables the EU institutions to ignore the significant deviation in cases of “unusual events” outside the control of the member state or “severe economic downturns” for the Eurozone or the EU as a whole. Thirdly, the evaluation of the sufficiency of the member state’s response to the Council’s recommendation to adopt measures to remedy the situation relies on the judgement of the EU institutions. In particular, the Commission’s recommendation for the establishment of “no effective action” is an essential step for the imposition of interest-bearing deposits.

The Commission acknowledges the presence of economic judgement in the application of the Significant Deviation Procedure. In a reply to a report of the European Court of Auditors, the Commission highlighted the SDP’s lack of automaticity:

Firstly under Article 6(3) of Regulation 1466/97, the Commission *has a margin of discretion* when considering departures from the fiscal adjustments implied by the matrix. In this regard, there is *no automaticity* in the Regulation in reaching the conclusion of a significant deviation. Secondly, the SGP, including the preventive arm, should not be understood as merely a static set of individual rules to be mechanically applied to any given event (...) it is important for the Commission to use its *economic judgement* to ensure a sensible application of the rules, rather than engaging in a purely mechanical approach that is divorced from the prevailing macroeconomic circumstances.

(European Commission, 2018a: 7, my emphasis)

At this point, it is important to note that the institutions-based nature of the SDP is evident not only in the internal workings of the mechanism (as was shown above), but also in its effect on other elements of the revised framework. In particular, the introduction of sanctions in the preventive arm increases the hierarchical character of the other surveillance instruments. Ignoring the Country-Specific Recommendations issued by the EU institutions in the context of the European Semester can prove very costly for the member states as the imposition of sanctions relies heavily on the judgment of the Commission and the Council. The SDP increases the prescriptive nature of the policy guidance addressed to member states. In this way

the SDP enhances the centralisation of the budgetary process in line with the institutions-based approach to discipline.

Requirements on National Budgetary Frameworks: Promoting National Ownership of EU-level Rules and Procedures

The adoption of changes in national budgetary frameworks derives from the EFC's consensus on the need to promote the national ownership of the adjusted framework. The national-level arrangements were necessary to complement and reinforce the reforms at the EU-level. Council Directive 2011/85/EU established particular requirements for national budgetary frameworks. These requirements cover three areas: numerical fiscal rules, national budgetary procedures and forecasts. Numerical fiscal rules need to have country-specific targets that are compliant with the reference values of the EU framework. Additionally, the evaluation of compliance with the rules has to be based on the analysis of independent bodies, while the rules should also specify the consequences in case of non-compliance. Escape clauses are permitted but they shall be applicable to a limited number of specific circumstances. National budgetary procedures should establish a medium-term budgetary framework based on multiannual fiscal planning. The procedures should promote the use of multiannual budgetary objectives on government deficits, public debt and expenditure. The procedures need to include projections of each major revenue and expenditure item in combination with a description of medium-term policies and their impact on public finances. Arrangements on forecasts should ensure that fiscal planning relies on reliable analysis. As a result, national macroeconomic and budgetary forecasts have to be compared with the Commission's forecasts and those of other independent bodies.

The requirements for the national budgetary frameworks present strong elements of both the rules-based dimension and the institutions-based version of fiscal discipline. The provisions on national numerical targets reveal the reproduction of the rules-based approach with the setting of explicit limits and the specification of consequences for any breach of these limits. In contrast, the requirements on budgetary procedures and forecasts focus on the reform of the structure of the budgetary preparation process in accordance with the institutions-based discipline.¹³ For example, the legal text underlines that "revenue and expenditure projections and priorities resulting from the medium-term budgetary framework as set out in Article 9(2) shall constitute the basis for the preparation of the annual budget" (Article 10, Council

Directive 2011/85/EU). The promotion of the medium-term approach to national fiscal planning is another indication of the institutions-based belief.

Excessive Deficit Procedure: Operationalising the Debt Criterion and Extending Deadlines for the Correction of Deficits

The EFC's shared understanding on the importance of medium-term surveillance did not only influence the organisational arrangements of the preventive part of the SGP, but also shaped the reform of the Excessive Deficit Procedure (EDP). Council Regulation No 1177/2011 amended the corrective arm of the SGP by operationalising the debt criterion and by extending the deadlines for the correction of deficits. Table 7.3 presents the steps of the reformed EDP. The decision about the existence of an excessive deficit that triggers the Excessive Deficit Procedure includes the assessment of the evolution of public debt and does not rely solely on the examination of the level of fiscal deficit. Detecting a debt level in excess of the 60% of GDP reference value is not enough to signal a lack of compliance with budgetary discipline, however. According to the Treaty, if the debt ratio proves to be "sufficiently diminishing and approaching the reference value at a satisfactory pace" then the relevant member state would be complying with the debt rule (Article 126, TFEU). The regulation clarifies the vague concept of "sufficiently diminishing public debt" by setting concrete conditions:

"if the differential with respect to the reference value has decreased over the previous three years at an average rate of one twentieth per year as a benchmark"

or, alternatively

"if the budgetary forecasts of the Commission indicate that the required reduction in the differential [one twentieth per year] will occur over the three-year period encompassing the two years following the final year for which the data is available"

(Article 2 (1a), Council Regulation No 1467/97 as amended by Council Regulation No 1177/2011)

Additionally, the new Regulation facilitates the extension of the deadlines in two ways. Firstly, the Regulation redefines the concept of "effective action" (compliance with the Council Recommendations and Notices) enabling the Council to adopt revised Recommendations and Notices with extended deadlines for the correction of deficits (see Steps 8 and 13, Table 7.3). The Regulation introduces annual budgetary targets for the government expenditure and

revenue and targets for the discretionary measures. These structural targets are added to the headline annual fiscal targets for the correction of deficits in the initial Recommendations and Notices (Articles 3 and 5, Council Regulation No 1467/97 as amended by Council Regulation No 1177/2011). While the deadline for the correction of headline deficits remains “one year as a rule”, in reality, the presence of the more specific annual targets (for expenditure, revenue and discretionary measures) points towards *multiannual* consolidation paths. Secondly, the Regulation includes a “crisis” escape clause allowing the extension of the deadlines to member states that have failed to take effective action.¹⁴ In the case of “severe economic downturn in the euro area or the Union as a whole” the Council can adopt a revised Recommendation or Notice that essentially functions as “a waiver to the obligation to show effective action” (European Commission, 2013: 71). The only condition to the extension of the deadline is that the latter will not “endanger the fiscal sustainability in the medium term”.

The reform of the EDP reflects the strengthening of the institutions-based belief. While the introduction of the numerical benchmark for the debt reduction complies with the increased automaticity of the rules-based approach, other elements of the reform point in the opposite direction. When examining a member state’s compliance with the debt criterion (see Step 1, Table 7.3), the Commission has to take into consideration “all relevant factors”.¹⁵ The Regulation refers to developments in the medium-term economic position, the medium-term budgetary position and the medium-term government debt position. As the European Court of Auditors noted in a relevant report, “[t]he number of relevant factors (...) that the Commission can take into account in its analysis is potentially unlimited” (European Court of Auditors, 2016: 48). The multiplicity of factors that could be taken into consideration in the evaluation of compliance enhances the Commission’s discretion to use economic judgement in line with the institutions-based approach.¹⁶

In parallel, the EU Institutions’ ability to extend the deadlines for corrective action on the basis of their discretionary judgement signifies the strengthening of institutions-based discipline. This might seem paradoxical given the introduction of the structural targets (see above). It should be noted, however, that the redefinition of the “effective action” according to the achievement of the structural targets for the expenditure, the revenue and the discretionary measures make the evaluation of compliance less straightforward and more conducive to the interpretation of the actor conducting the evaluation. As it is stressed by the European Court of Auditors, “[t]he increased complexity of the rules for assessing effective action has widened

the Commission’s scope for interpretation and discretion” (European Court of Auditors, 2016: 61).

Table 7.3: The Steps of the Excessive Deficit Procedure after the Six-Pack Reform

Step 1	The Commission issues a Report on the existence of an excessive deficit.
Step 2	The Economic and Financial Committee formulates an Opinion on the Commission’s Report.
Step 3	The Commission addresses a Proposal to the Council and an Opinion to the Member State concerned.
Step 4	The Council decides on the existence of an excessive deficit. If it finds that there is an excessive deficit, the Council addresses Recommendations to the Member State concerned. The Council establishes a deadline for effective action to be taken by the Member State concerned.
Step 5* **	If the Member State has lodged an interest-bearing deposit with the Commission (sanction in the preventive arm of the SGP) or if the Commission has identified a particularly serious non-compliance with the budgetary policy obligations, the Commission shall recommend the lodgement of a non-interest-bearing deposit (0.2 % of GDP).
Step 6*	The Council’s Decision on the lodgement is deemed to be adopted unless the Council decides by qualified majority to reject or amend the Commission’s Recommendation (Reverse Qualified Majority Voting).
Step 7	Within the deadline (Step 4), the Member State concerned reports to the Council and the Commission on action taken in response to the Council’s Recommendation.
Step 8	The Council considers whether effective action has been taken. If effective action had been taken in compliance with the Council’s Recommendation, the Council may decide, on a Recommendation from the Commission, to adopt a revised Recommendation (or hold the procedure in abeyance). Otherwise the Council issues a Decision establishing that the Member State concerned has failed to take effective action.
Step 9*	If the Council decides that the Member State has not taken effective action, the Commission shall recommend the imposition of a fine (0.2% of GDP).
Step 10*	The Council’s Decision on the imposition of the fine is deemed to be adopted unless the Council decides by qualified majority to reject or amend the Commission’s Recommendation (Reverse Qualified Majority Voting).
Step 11	The Council decides to give Notice to the Member State concerned to take measures to reduce the deficit and sets a deadline. For Eurozone member states the Notice includes annual budgetary targets (0.5 % of GDP minimum annual improvement).
Step 12	The Member State concerned shall report to the Council and the Commission on action taken in response to the Notice.
Step 13	The Council considers whether effective action has been taken. If effective action had been taken in compliance with the Council’s Notice, the Council may decide, on a Recommendation from the Commission, to adopt a revised Notice (or hold the procedure in abeyance).
Step 14*	The Council decides to impose sanctions to the Member State in response to the latter’s failure to act in compliance with the Council’s successive acts.

Step 15*	The Council assesses annually whether the participating Member State concerned has taken effective action in response to the Council’s Notice. If the Council finds that the participating Member State has taken effective action, it abrogates the decision on the existence of an excessive deficit. Otherwise, the Council shall decide to intensify the sanctions.
Step 16*	If the Council decides to abrogate some or all of its decisions, any non-interest-bearing deposit lodged with the Commission (Step 5) is returned to the Member State.
Notes:	*Provisions applying to Eurozone Member States **If the provisions of this step are not applicable, the EDP proceeds to Step 7

Source: Own construction based on Union primary and secondary law (Treaty on the Functioning of the European Union, Article 126; Regulation No 1173/2011; Council Regulation No 1177/2011; Council Regulation No 1467/97; Council Regulation No 1056/2005).

The centralisation of the sanctioning mechanism is a further indication of the influence of the institutions-based belief on the EDP. The use of the Reverse Qualified Majority Voting (RQMV) in the Council’s Decisions on the imposition of financial sanctions significantly strengthened the agenda-setting role of the Commission vis-à-vis the Council. Creating hierarchical structures within fiscal governance via delegation is a central element of the institutions-based approach. It is no coincidence that the use of RQMV was included in the “Sustainability Council” proposal of 2003:

The Sustainability Council should have the sole right to propose the imposition of the financial fines under the EDP to the ECOFIN Council (...) To make the process most effective, the ECOFIN Council should be required to reject the Sustainability Council’s proposal to impose financial fines by a qualified majority

(Fatás et al., 2003: 72-73)

Macroeconomic Imbalance Procedure: Broadening Surveillance beyond Budgetary Monitoring

The Macroeconomic Imbalance Procedure (MIP) was built upon the EFC’s understanding of the necessity to broaden surveillance beyond national budgetary policies. The MIP is devised to examine the national structural and macro-financial policies to identify potential imbalances that could threaten the health of public finances. According to Regulation No 1176/2011, the MIP proceeds in two stages: the Alert Mechanism Report (AMR) and the In-Depth Reviews (IDRs). In the first stage, the Commission examines national economic policies to identify those member states that are affected by imbalances or could suffer from imbalances in the future. The analysis has to be based on the so-called “scoreboard”, a set of indicators and indicative thresholds that are used as a tool to assist with the identification and monitoring of

imbalances. In the second stage, the Commission undertakes an In-Depth Review for every member state facing imbalances. The Commission has to trace the origin of the imbalances and evaluate the possible spillover effects on other member states or the Union (or the Eurozone) as a whole due to financial and trade interlinks. At this stage, the Commission evaluates the gravity of imbalances and even carries out surveillance missions to assess the economic situation on-site. The procedure ends with the endorsement of Country-Specific Recommendations by the Council after the proposal of the Commission.

The establishment of the Macroeconomic Imbalance Procedure constitutes another manifestation of the institutions-based approach. Following the latter, the function of the MIP is based on the use of judgement. While the scoreboard includes a number of numerical thresholds providing an anchoring mechanism that points towards the rules-based approach, in reality the evaluation of the structural and macro-financial policies of member states relies on the discretionary assessment of the EU institutions. The legal framework underlines the absence of automaticity in the use of the scoreboard:

Conclusions *should not be drawn* from an *automatic* reading of the scoreboard: economic *judgement* should ensure that all pieces of information, whether from the scoreboard or not, are put in perspective and become part of a comprehensive analysis.

(Regulation No 1176/2011, Recital 14, my emphasis)

The Commission's annual [Alert Mechanism] report shall contain an economic and financial assessment putting the movement of the indicators *into perspective*, drawing, if necessary, on *other relevant* economic and financial indicators when assessing the evolution of imbalances. Conclusions shall *not be drawn* from a *mechanical* reading of the scoreboard indicators.

(Regulation No 1176/2011, Article 3(2), my emphasis)

In parallel, the Regulation stresses the qualitative dimension of the assessment process (Articles 3(1) and 5(1) of Regulation No 1176/2011). This type of evaluation means that the EU institutions enjoy wide discretion to determine the nature and severity of imbalances on a case-by-case basis. The “real-economy” perspective of the surveillance procedure clearly

undermines the predictability of the monitoring process, a key professed value for the proponents of the rules-based approach. A member state can be found to suffer from macroeconomic imbalances even if the values of the numerical indicators are within the thresholds of the scoreboard. The inclusion of particular fiscal developments in the analysis of structural or macro-fiscal policies can lead to the detection of imbalances. General EU or EMU-wide macroeconomic developments may also justify the enhancement of surveillance in particular member states.

A key feature of the MIP that reflects the institutions-based belief is the enhanced role of the Commission in the monitoring of national economic policies. The MIP is significantly different from the peer review process that took place before. The depth and the sophistication of the required economic analysis go hand in hand with a higher degree of centralisation. Indeed, the Regulation underlines that:

The Commission should have a stronger role in the enhanced surveillance procedure as regards assessments that are specific to each Member State, monitoring, onsite missions, recommendations and warnings.

(Regulation No 1176/2011, Recital 6)

The Commission is responsible for the composition of the scoreboard and the setting of the indicative scoreboard thresholds, the drafting of the Alert Mechanism Report, the selection of the countries that will undergo an In-Depth Review, the drafting of the In-Depth Reviews and the proposal of Country-Specific Recommendations to the Council. The turn to independent institutions for the evaluation of economic developments that ultimately can have significant budgetary repercussions is a clear indication of the institutions-based approach.

Excessive Imbalance Procedure: Introducing Sanctions in Macro-structural and Macro-financial surveillance

The EFC's consensus on the necessity of broadening surveillance to include macro-structural and macro-financial developments affected the organisational form of the corrective arm of economic governance. Regulation No 1176/2011 and Regulation No 1174/2011 establish the Excessive Imbalance Procedure (EIP) as an enforcement mechanism for the correction of excessive macroeconomic imbalances. As a concept, the Excessive Imbalance Procedure draws on the Excessive Deficit Procedure. The EIP introduces sanctions in the coordination of structural policies as insufficient progress with structural reforms can be considered as an

important source of imbalances. At the heart of the mechanism is the Corrective Action Plan (CAP). After the identification of excessive imbalances by the Commission (in the context of the IDRs) and the endorsement of this assessment by the Council, the latter invites the member state concerned to submit a Corrective Action Plan. The Council assesses the appropriateness and the implementation of the CAP on the basis of the Commission's close monitoring and decides on the imposition of financial sanctions for the member states of the euro area. The steps of the EIP are presented in Table 7.4.

Table 7.4: The Steps of the Excessive Imbalance Procedure

Step 1	The Commission, in the context of its In-Depth Review evaluation, considers that a Member State is affected by excessive imbalances and informs the Council, the European Parliament and the Eurogroup.
Step 2	The Commission proposes to the Council the adoption of a Recommendation on the existence of excessive imbalances.
Step 3	The Council considers the Recommendation of the Commission and decides on the existence of excessive imbalances. If the Council accepts the Commission's evaluation, it adopts a Recommendation establishing the existence of excessive imbalances and invites the Member State to take corrective action. The Recommendation includes a description of the nature of imbalances, the specification of a set of policy recommendations to be followed and the indication of a deadline within which the Member State has to submit a Corrective Action Plan (CAP).
Step 4	Within the deadline set by the Council, the Member State concerned submits a Corrective Action Plan articulating specific policy actions accompanied by a timetable for these actions. The Plan must be consistent with the Broad Economic Policy Guidelines (BEPGs) and the Employment Guidelines.
Step 5	The Commission issues a Report on the Corrective Action Plan.
Step 6	The Council proceeds to the evaluation of the Corrective Action Plan on the basis of the Commission's Report. If the Council finds the plan sufficient, it issues a Recommendation endorsing the Plan, listing the required actions and setting out the timetable for surveillance. If the Council considers that the Plan is insufficient, it adopts a Recommendation addressed to the Member State to submit a new CAP.
Step 7*	If two subsequent Corrective Action Plans are considered insufficient by the Council, the Commission should Recommend to the Council the imposition of a fine. The Council's Decision on the fine is deemed to be adopted unless the Council decides by qualified majority to reject it (Reverse Qualified Majority Voting).
Step 8	The Member State presents Progress Reports to the Commission and the Council at regular intervals. The Commission monitors the implementation of the Council's Recommendation (on the CAP) and may carry out enhanced surveillance missions to the Member State concerned.
Step 9	In the event of major changes in the economic circumstances the Council can amend its Recommendation [Step 6] and even invite the Member State to revise its CAP. The Council decides on a Recommendation of the Commission.

Step 10	The Council assesses whether the Member State has taken corrective action. If the Council considers that the Member State has not taken corrective action, the Commission addresses a Recommendation to the Council on a Decision establishing non-compliance and setting new deadlines for taking corrective action. The Commission's Recommendation establishing non-compliance is deemed to be adopted unless the Council decides by qualified majority to reject it (Reverse Qualified Majority Voting). If the Council considers that the Member State has taken corrective action, the EIP is held in abeyance. Monitoring continues in line with the timetable [Step 6].
Step 11*	After the Council's Decision establishing non-compliance, the Commission recommends to the Council the imposition of an interest-bearing deposit. The Decision is deemed to be adopted unless the Council decides by qualified majority to reject it (Reverse Qualified Majority Voting).
Step 12*	If two successive decisions are adopted by the Council establishing non-compliance, the Commission should recommend to the Council the imposition of a fine. The Council's Decision on the fine is deemed to be adopted unless the Council decides by qualified majority to reject it (Reverse Qualified Majority Voting).
Step 13	When the Member State is no longer affected by excessive imbalances, the Council, on a recommendation from the Commission, abrogates the relevant Recommendations.
Notes:	*Provisions applying to Eurozone Member States

Source: Own construction based on Union primary and secondary law (Treaty on the Functioning of the European Union, Article 121; Regulation No 1176/2011; Regulation No 1174/2011; Regulation No 1175/2011).

The creation of the Excessive Imbalance Procedure complies with the enhancement of the institutions-based belief. This instrument presents a notable difference from the EDP: the EIP does not include any reference to numerical targets. The Commission enjoys wide discretion to evaluate whether the imbalances identified in the context of the In-Depth Reviews constitute excessive imbalances. Most importantly, the Commission has the discretion to trigger the EIP by issuing a Recommendation to the Council. In its reply to a Report of the European Court of Auditors on the Macroeconomic Imbalance Procedure, the European Commission acknowledged that the legal framework gives the Commission great leeway regarding the launch of the EIP:

The Commission is not therefore bound to initiate the procedure once certain circumstances [excessive imbalances] arise since under Article 121(4) TFEU the monopoly of initiative of the Commission, that the Treaties otherwise guarantee, remains intact. The Commission keeps its *discretion to initiate or not to initiate the procedure*.

(European Commission, 2018b: 8, my emphasis)

The use of judgement is not limited to the initial stages of the EIP, though. The evaluation of the sufficiency of the Corrective Action Plan, the establishment of non-compliance to Council Recommendations and the revision of the Council's Recommendation due to "major changes in economic circumstances" are based on the use of discretionary judgement, not on particular rules. The centralisation of the sanctioning mechanism via the widespread use of the Reverse Qualified Majority Voting is an additional indication of the institutions-based underpinning of the EIP. The enhancement of the agenda-setting role of the independent European Commission complies with the institutions-based discipline.

7.2 The Fiscal Compact

The Six-Pack legislative package constituted a major reform of the structures of European economic governance. The previous section has shown that the reform reflected a change of direction towards the centralisation of European fiscal and macroeconomic coordination. In this context, the adoption of the Fiscal Compact in March 2012 appears to be a paradox: why was another reform of the framework of European fiscal governance necessary just a few months after the passage of the Six-Pack? Given that the latter conformed to the adjustment of the system of meaning, namely the strengthening of institutions-based discipline, the emergence of the proposal for a new fiscal reform cannot be attributed to the alignment of the organisational structure with the EMU's social legitimacy.

To explain the creation of the Fiscal Compact, it is necessary to consider the effects of a significant development in EMU decision-making in 2011-2012. National parliaments emerged as influential actors for a brief period due to their role in the establishment of financial assistance instruments. The negotiation of the Treaty on the European Stability Mechanism and the concomitant necessity of parliamentary ratification in the context of a continuously unfolding sovereign debt crisis made the EMU resource dependent. Sociological Institutionalism expects that resource dependent organisations can borrow cultural elements from other organisations through the process of coercive isomorphism.

I argue that the call for a fresh reform of the framework of European economic governance can be attributed to the German parliament's attempt to imprint domestic legitimisation schemas on the Eurozone governance favouring the creation of decentralised fiscal discipline mechanisms in exchange for the authorisation of the European Stability Mechanism (ESM). Subsequently,

I show how the EMU's adapted social legitimacy led the other governments and the EU Institutions to resist the decentralisation of fiscal surveillance and amend the German proposals to align the Fiscal Compact with institutions-based discipline. In the final part of this section, I test the compliance of the Fiscal Compact's provisions with the adjusted Eurozone social legitimacy.

7.2.1 Coercive Isomorphism: German Domestic Social Legitimacy Shaping Negotiations

The change of organisational structure is not always a product of institutionalised schemas created within a given organisation. Sometimes organisations borrow cultural elements from other organisational settings. A large part of the early sociological institutionalist literature focused on the diffusion of norms among organisations resulting in the adoption of similar organisational structures (isomorphism). Sociological institutionalists have identified coercive isomorphism as a distinct process of diffusion: resource-dependent organisations incorporate social elements from other organisations to avoid sanctions. Given that the EMU depended on the national parliaments of the creditor states to commit substantial financial resources for the creation of the permanent financial assistance mechanism (the ESM), a sociological institutionalist explanation of the Fiscal Compact would anticipate the existence of coercive pressures for the imposition of particular cultural norms on the framework of European economic governance. Due to the necessity of additional financial contributions, the parliaments of the creditor states were in position to influence the agenda of economic governance negotiations in the period before the establishment of financial assistance arrangements.

Setting the Agenda: The Bundestag and the Diffusion of the German Debt Brake

The analysis of the empirical material reveals the existence of pressures for the diffusion of organisational structures that conform to the domestic social legitimacy of Germany. Pattern evidence points to the linkage of the establishment of the permanent financial assistance instrument with the demand to strengthen national fiscal rules by EMU's political leaders. The European Council of March 2011 adopted the "Term Sheet on the ESM" setting out the key features of the financial assistance mechanism. In parallel, the European Council endorsed the so-called "Pact for the Euro" (renamed "Euro Plus Pact" after the European Council's endorsement) that had been agreed only days before by the Heads of State or Government of

the Euro Area (European Council, 2011).¹⁷ On 11 March 2011, the Euro Summit had adopted the “Pact for the Euro” or “Competitiveness Pact”, a political document containing vague commitments about the increase of competitiveness with negligible organisational implications for the governance of the Eurozone.¹⁸ The Pact included a commitment about the enhancement of *national* fiscal surveillance via the establishment of national fiscal rules:

Euro area Member States commit to translating EU fiscal rules as set out in the Stability and Growth Pact into national legislation. Member States will retain the choice of the specific national legal vehicle to be used, but will make sure that it has a sufficiently strong binding and durable nature (e.g. constitution or framework law). The exact formulation of the *rule* will also be decided by each country (e.g. it could take the form of a "debt brake", *rule* related to the primary balance or an expenditure *rule*), but it should ensure fiscal discipline at both national and sub-national levels.

The Commission will have the opportunity, in full respect of the prerogatives of national parliaments, to be consulted on the precise fiscal *rule* before its adoption so as to ensure it is compatible with, and supportive of, the EU rules.

(Euro Summit, 2011a: 10, my emphasis)

The pledge for the strengthening of national fiscal rules remained intact in the Euro Plus Pact.

The October 2011 announcement of the Euro Summit’s decision to significantly increase the leverage (and thereby the firepower) of the temporary financial assistance instrument, namely the European Financial Stability Facility (EFSF), was accompanied by the declaration of the leaders’ intention to pursue limited Treaty changes to improve fiscal discipline (Euro Summit, 2011b). This time the commitment on the introduction of national fiscal rules was restated in more concrete terms:

adoption by each euro area Member State of rules on balanced budget in structural terms translating the Stability and Growth Pact into national legislation, preferably at constitutional level or equivalent, by the end of 2012

(Euro Summit, 2011b: 8)

The December 2011 decision of the Euro Summit to accelerate the entry into force of the ESM Treaty and adjust it to enable majority voting and rapid disbursement of assistance incorporated

an agreement on a fiscal compact comprising the establishment of fiscal rules at the national level (Euro Summit, 2011c).

Account evidence from interviews supports the linkage of financial assistance with the strengthening of national fiscal rules. Interviewees stressed the role of Germany in this process:

Germany and other countries demanded the adoption of the Fiscal Compact to instil rigour to the rules. Germany warned that if this was not happening, other things would not happen. (...) Germany had de facto veto due to the firewall [the EFSF/ESM]. They were saying: “solidarity in return for solidity”. Solidity had a purely fiscal nature.

(Anonymous Interviewee 01)

we tried to achieve certain elements that we didn't manage to incorporate in the Six-Pack, such as the golden rule, that countries should have a balanced budget. This was *in exchange of* setting up the ESM. We had the thinking of incorporating this into primary law, we were optimistic about a Treaty change

(Anonymous Interviewee XX)

There was an implicit threat in the case of the Fiscal Compact that the funding of the ESM would be limited [if Fiscal Compact was not approved]. But there was no explicit link.

(Anonymous Interviewee 17)

Even the European Commission acknowledged the political linkage between the provision and extension of financial assistance and the establishment of budget rules in national legislation (European Commission, 2017e).

The reason for the above linkage and the German government's active role in it can be found in the domestic politics of Germany. One interviewee explained how the German attempt to promote the introduction of fiscal rules was not triggered by efficiency concerns but as a result of political considerations:

The bailout created tensions in my country. It was not popular. So, there was increased pressure for additional safeguards. There is duplication [between the Six Pack and the Fiscal Compact]. We thought to bring budget rules in line within the EMU and make them more stable and fit but we also created extra complexity. Complication means less.

(Anonymous Interviewee XX)¹⁹

The German government faced notable resistance from the German parliament on the issue of financial assistance in the second half of 2011 (Peel, 2011a; Peel et al., 2011; Bulmer and Paterson, 2019: 186-187). The Financial Times were reporting the imposition of a political veto on the government by the Bundestag regarding various aspects of the financial assistance arrangements (Peel, 2011b). The politicisation of the creation of the ESM and the strengthening of its forerunner, the EFSF, risked destabilising the German government. In this context, the German leader tried to legitimise the establishment of permanent financial assistance mechanisms *within* the German political system by invoking the ordoliberal belief of rules-based fiscal discipline (on the effect of ordoliberalism on German domestic politics at the time, see Bulmer, 2014). It should be noted that Germany had already passed a constitutional amendment in June 2009 establishing a “debt brake” replacing the pre-existing “golden rule” (International Monetary Fund, 2009: 40; Hamker, 2012). The debt brake found wide support from almost every segment of the political spectrum. Chancellor Merkel’s initiative to pursue the creation of a “fiscal union” in EMU via the reform of the Treaties and the imposition of national debt brakes or similar fiscal rules was a strategy that complied with the *domestic* social legitimacy of the German political system. The seemingly bold initiative sought to address domestic political concerns (Peel and Wiesmann, 2011; Chibber, 2011). A member of the EFC stressed that the German proposal for the Fiscal Compact was in reality an attempt to impose German domestic arrangements on other Eurozone countries:

The Fiscal Compact was a nightmare, it was stupid.

It was a German-led effort related to the debt brake. They [the German government] had the idea to *apply the debt brake on a pan-European basis*.

It came from the Heads of State or Government, not the finance ministers. The finance ministers thought that it was problematic.

(Anonymous Interviewee 17, my emphasis)

The attempted diffusion of the debt brake to the other members of the EMU complied with the domestic social legitimacy of Germany but was incompatible with the adapted social legitimacy of the Eurozone. The decentralised approach to fiscal discipline promoted by the German political system in 2011 undermined the centralisation direction of the Six-Pack. This reality created frustration among finance ministers and EFC members. The negotiations can be divided in two phases. In the first phase, the negotiations were conducted by the leaders and their personal representatives (Sherpas). In the second phase, the EFC and the COREPER took over and finalised the legal text.

European Council and Sherpa Negotiations: Coercion Works

The empirical material shows that the German domestic social legitimacy was very influential in the first phase of Fiscal Compact negotiations. The German proposals formed the basis of the tentative agreement on the establishment of decentralised fiscal surveillance mechanisms following the paradigm of the German debt brake. The linkage of the ESM creation with the establishment of the Fiscal Compact enabled the coercion of almost every other government unleashing strong isomorphic pressures.

In the initial phase of Fiscal Compact negotiations, which lasted from November to mid-December 2011, the leaders and their representatives explored the prospect of Treaty reform seeking to translate the substance of the German proposals into EU primary law provisions. The EU Institutions attempted an early strike against the German initiative via the distribution of the Interim Report of the President of the European Council on “Stronger Economic Union” a couple of days before the European Council of December 2011 (Van Rompuy, 2011). The Report proposed the adoption of the Fiscal Compact through a combination of revising the Treaty Protocol on the EDP, promoting secondary legislation (see section 7.3) and passing some limited changes to the Treaty through the simplified revision procedure. This technical option would boost the role of the EU Institutions, promote compliance with the pre-existing Six-Pack and facilitate domestic approval procedures but at the same time it would lower the profile of the political initiative. It is no surprise that the Report irritated the German Chancellor (Ludlow, 2012: 10-15).

In the European Council of 8/9 December 2011 it became clear that the Prime Minister of the UK, David Cameron, would not accept the reform of the Treaty without some significant concessions regarding financial regulation. While some interviewees pointed to the strategic

considerations of the British government (Anonymous Interviewee 15) and stressed its intention to “hold-hostage” to achieve more important priorities (Anonymous Interviewee 18), one interviewee highlighted the domestic political problem linked to Treaty reform: changes of EU primary law required the approval of the UK Parliament (Anonymous Interviewee 19). It seems that the Prime Minister of the UK feared that he would not be able to secure the consent of the House of Commons to a reform that sought to address German concerns. However, Cameron’s request for a new Protocol imposing limits on further financial regulation and securing exceptions for London-based financial institutions was deemed unacceptable by the other leaders as it would distort the Single Market (European Commission, 2011b: 16). The leaders decided to overcome the British veto by adopting the Fiscal Compact via an International Agreement (IA) outside the EU law (Euro Summit, 2011c).

The initial phase of Fiscal Compact negotiations was concluded on 16 December 2011 with the drafting of an early text of an “International Agreement on Reinforced Economic Union” by the Sherpas with the help of the Council Legal Service (Anonymous Interviewees 11 and 19). The text relied heavily on the Euro Summit Statement of 9 December and a letter sent by the German Chancellor and the French President to the President of the European Council on the 7th of December (French Embassy in London, 2012). The Agreement (Article 3) included a Balanced Budget rule:

- a) Revenues and expenditures of the general government budgets shall be balanced or in surplus. The Contracting Parties may temporarily incur deficits only to take into account the budgetary impact of the economic cycle and, beyond such impact, in case of exceptional economic circumstances, or in periods of a severe economic downturn, provided that this does not endanger budgetary sustainability in medium term.
- b) The rule under point a) above shall be deemed to be respected if the annual structural deficit of the general government does not exceed a country-specific reference value, which ensures an adequate safety margin with respect to the 3 % reference value mentioned under Article 1 of the Protocol (No 12) on the excessive deficit procedure annexed to the Treaty on European Union and to the TFEU (hereinafter 'Protocol No 12') as well as rapid progress towards sustainability, also taking into account the budgetary impact of ageing. The Contracting Parties shall

ensure convergence towards their respective country-specific reference value. As a rule, the country specific reference value shall not exceed 0.5 % of nominal GDP.

c) Where the debt level is significantly below the 60 % reference value mentioned under Article 1 of Protocol No 12, the country-specific reference value for the annual structural net deficit may take a higher value than specified under point b).

(TheJournal.ie, 2011: 4)

Additionally, Article 3 of the Agreement provided for the introduction of an automatic correction mechanism at the national level:

The Contracting Parties shall in particular put in place a correction mechanism to be triggered automatically in the event of significant deviations from the reference value or the adjustment path towards it. This mechanism shall be defined at national level, on the basis of commonly agreed principles. It shall include the obligation of the Contracting Parties to present a programme to correct the deviations over a defined period of time. It shall fully respect responsibilities of national Parliaments.

(TheJournal.ie, 2011: 4)

Other important elements were the introduction of the RQMV in the rest of the steps of the EDP (see Table 7.3) and the provision for the submission of Economic Partnership Programmes (EPPs) containing structural reform plans by member states subject to the EDP.

The core provisions of the draft International Agreement, namely the Balanced Budget rule and the automatic correction mechanism, were in line with the domestic social legitimacy of the German political system as they promoted a decentralised rules-based approach to fiscal discipline. The analysis of account evidence confirms the existence of a rules-based cognitive script behind the German proposals for the Fiscal Compact. The familiar ordoliberal concept of using the constitutional framework to constrain economic policy is easily recognisable:

It was the dream of the Germans, their sense of *rules and laws* being *fundamental to economic policy*. There was discussion on the issues of structural deficit and debt. Colleagues and I came in to give it legal standing. Germany insisted that this commitment would be enshrined in *the constitutional order* of member states. The negotiation was about this commitment to be reflected in the text.

(Anonymous Interviewee 18, my emphasis)

Those provisions undermined the centralisation of fiscal surveillance that had been established by the Six-Pack reform. A member of the EFC underlined how the logic of the Fiscal Compact contrasted with the role of the Commission:

The Fiscal Compact approach was that there should be rules, but not necessarily the same rules for every country. The rules should be enforced by local institutions, so in this way there is smaller role for the Commission. Essentially the Fiscal Compact provides for several “mini-Commissions”.

(Anonymous Interviewee 02)

As the social elements underpinning the German proposals clashed with the adjusted Sound Money paradigm, the respective organisational arrangements proved unstable. Coercive pressure through the linkage of the Fiscal Compact with the establishment of the ESM was not enough to persuade the UK government to accept Treaty reform. Coercion worked in the case of the other governments and the EU Institutions during the first phase of the negotiations. As the negotiations progressed, however, coercion proved less effective.

7.2.2 EMU’s Social Legitimacy Shaping the Formal Negotiations: Defending Centralisation

Sociological Institutionalism predicts that the incorporation of externally institutionalised elements can lead to conflicts with an organisation’s internally developed taken-for-granted meanings. In turn, this can result in the establishment of inconsistent organisational structures within the organisation. Sociological institutionalists (Meyer and Rowan, 1991; Boxenbaum and Jonsson, 2008) have described how this clash between cultural elements leads to the emergence of gaps within the organisational structure as pre-established routines prevail over the newly created symbolic structures that conform to external legitimacy requirements (decoupling). The sociological institutionalist explanation anticipates that despite the presence of coercive pressures by the German political system, the Eurozone’s adapted social legitimacy is expected to shape the Fiscal Compact negotiations. The organisational-level prediction is that the system of meaning led Eurozone policymakers to resist any attempts to dismantle the centralisation of fiscal policies that had been established with the Six-Pack in compliance with

institutions-based discipline. Again, what matters is the proximity of the proposals to the underlying consensus (centralisation of fiscal policies) and not their origin.

Ad Hoc Working Group Negotiations: Watering Down German Proposals

The examination of the empirical evidence shows that during the second phase of Fiscal Compact negotiations national governments and EU Institutions managed to water down German proposals that promoted a decentralised approach to fiscal discipline. The European Commission led the effort of amending the proposed rules-based elements (golden rule, debt brake) so that the Fiscal Compact would comply with the prevailing institutions-based belief of the adjusted Sound Money paradigm.

The second phase of the Fiscal Compact negotiations lasted from mid-December 2011 till the end of January 2012. An ad hoc “Working Group on Fiscal Stability Union” was formed in the framework of the Eurogroup Working Group to conduct the negotiations and draft the legal text (Council of the European Union, 2012a: 3; European Commission, 2011c: 33-34). The new ad hoc Working Group was chaired by the President of the EFC, Thomas Wieser, and included the members of the EFC representing the participating member states. The European Commission was represented by the Director-General of DG ECFIN, Marco Buti, the Head of the Commission’s Legal Service, the President’s representative in COREPER II and members of the President’s cabinet. The ECB sent a couple of representatives, while the President of the European Council was also represented by members of his cabinet. Notably, the European Parliament was represented by three high-profile MEPs: Elmar Brok (EPP), Roberto Gualtieri (S&D) and Guy Verhofstadt (ALDE). The synthesis of the Working Group reveals that the Fiscal Compact negotiations were conducted by several people adhering to the institutions-based discipline belief.

The Commission became actively engaged in the discussions within the ad hoc Working Group. Its priority was to ensure the compliance of the Agreement with the EU law including the recently adopted secondary legislation on economic governance (European Commission, 2011c: 34-35). The Commission wanted to prevent the establishment of competing fiscal surveillance structures and new mechanisms. In reality, the Commission’s intention was to turn the Fiscal Compact on its head. To do so, the Commission promoted amendments that aligned the new framework with the European Semester process. The European Parliament supported the Commission’s approach. MEPs participating in the ad hoc Working Group questioned the

added value of the International Agreement insisting that the same goals could be achieved through secondary legislation (Mahony, 2011). In January 2012, the Plenary passed a resolution calling for the new agreement to comply with existing EU legislation and warned against the setting of targets that differed from the SGP (European Parliament, 2012a). The Parliament warned that it would use any legal means to defend EU law and asked the Commission to act according to its role as “guardian of the Treaties”.

EFC’s social legitimacy rewarded amendments that protected the centralisation of fiscal surveillance. The analysis of the drafts produced by the ad hoc Working Group proves that most of its members gradually endorsed the Commission’s approach. The first draft of the Working Group entitled “International Treaty on a Reinforced Economic Union” (REU Treaty) included several references to particular provisions of the amended SGP and the law of the Union (The Telegraph, 2012a). The country-specific reference value of the Balanced Budget rule was linked to the country-specific MTO of the SGP. Similarly, the indicators triggering the (national) automatic correction mechanism (the “reference value” and the “adjustment path” towards it) were identified as the same as those of the SGP. The rather vague references to Economic Partnership Programmes of the International Agreement were complemented by the requirement to follow the Union format and the obligation to submit them to the Commission and the Council for “endorsement”. Later drafts proceeded even further. New amendments provided that the European Commission would propose the timeframe for the convergence towards the MTO (taking into consideration country-specific circumstances) and that the national correction mechanisms would have to follow common principles defined by the Commission. Most importantly, the numerical target of the balanced budget rule, namely the annual structural deficit, lost its centrality and became part of an overall assessment:

Progress towards and respect of the medium-term objective shall be evaluated on the basis of an overall assessment with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, in line with the provisions of the revised Stability and Growth Pact.

(The Telegraph,²⁰ 2012b)

At this point it is useful to recall that the shift from focusing on headline fiscal targets to the analysis of underlying measures had been a central part of the Commission's proposal to reform the preventive arm of the SGP in 2010:

the structural balance has in practice proved an *insufficient measure* of a country's underlying fiscal position, owing to the difficulty of assessing the cyclical position of the economy in real time and to insufficient account being taken of revenue windfalls and shortfalls not directly related to the economic cycle (in particular housing and financial market developments).

(European Commission, 2010ih: 4, my emphasis)

As was explained in a previous section, the relativisation of headline fiscal targets and the concentration on underlying measures increased the discretion of the Commission in the assessment process. The inclusion of the references to expenditure and revenue reveals clear traces of the attempted redirection of the Fiscal Compact towards the centralisation of fiscal surveillance.

Account evidence confirms the effect of the Commission in the discussions of the Working Group. A Commission official revealed that the Commission managed to shape the Fiscal Compact provisions in such a way that they would resemble the arrangements of the reformed preventive arm of the SGP:

Member states wanted stronger rules as a counterpart to the ESM. It [the Fiscal Compact] was modeled over Germany's debt brake. The idea emerged in these Sherpa groups in reaction to the [interim] four presidents report. Through negotiation we made it 90% like the preventive arm [of the SGP]. In the end, we are not that eager to import it into the Community framework.

(Anonymous Interviewee XX)²¹

7.2.3 Testing the Compliance of the Provisions of the Fiscal Compact with the Adjusted Social Legitimacy

The examination of the outcome of the negotiations on the Fiscal Compact points to a partial alignment of the legal text with the adjusted Sound Money paradigm. Two out of the three most important instruments introduced in the Fiscal Compact comply with the institutions-based

discipline. Only in one case is the rules-based approach the underlying concept behind the policy arrangement.

The Balanced Budget Rule (“Golden Rule”):²² Limiting the Discretion Embedded in the MTOs

The Fiscal Compact established a balanced budget rule that implies a requirement for a balanced budgetary position every year throughout the cycle (TSCG, Article 3). The contracting parties were obliged to transpose the rule into their national legal system through binding and permanent provisions (preferably of a constitutional nature). The “balanced or in surplus” provision is significantly qualified, however, as the Compact links compliance to the above rule with the attainment of the MTO (European Central Bank, 2012: 88). The Compact limits the threshold of the MTO included in the SGP from a range between -1 % of GDP and balance or surplus to a range between -0.5% of GDP and balance or surplus (both in cyclically adjusted terms). This limitation of the MTO threshold does not apply to contracting parties that present a debt to GDP ratio significantly below the 60% benchmark. These countries are only bound by the provisions of the SGP regarding their MTO.

A balanced budget rule is the embodiment of rules-based discipline. Such an instrument signifies the elimination of any kind of discretion in fiscal policymaking. Constraints on short-term fiscal policy are expected to lead to long-term fiscal discipline. National budgets should be balanced or in surplus at any given point in time irrespective of the phase of the economic cycle. The rule introduces a particular reference value (a 0% deficit), which is considered sacrosanct. A budget balance rule would be in conflict with the SGP reforms of 2005 and 2011, while it would be considerably less flexible than the original version of the SGP in 1997 that was abandoned due to the lack of flexibility (according to SGP 1997 the MTO could be “close to balance”). The two most important innovations of the 2005 reform of the SGP that were retained and enhanced in 2011, namely the differential treatment of countries (country-specific MTOs) and the cyclically-adjusted fiscal consolidation, would be effectively abolished by the requirement of a balanced budgetary position.

The Fiscal Compact’s Balanced Budget Rule is a misnomer. Rather than creating a legal obligation for balanced budgets at the national level, the rule promotes the compatibility of national budgetary positions with the MTO. By doing so, the rule accepts the inclusion of discretionary judgement within the MTO surveillance into national legal mechanisms (see the previous section on the Six Pack reform). Admittedly, the rule introduces a stricter numerical

threshold for the MTO, which is in line with the rules-based approach to discipline as it limits the discretion of fiscal authorities. However, the rule incorporates the analysis of the sufficiency of the progress towards the MTO based on the evaluation of the underlying expenditure and revenue measures and the “crisis” escape clause for unusual events. Both provisions are in accordance with the institutions-based approach to discipline as they enable the use of discretionary judgment. Additionally, Article 3(2) of the TSCG provides that the monitoring of compliance with the rules would be undertaken at the national level by *independent institutions*. In practice, the Fiscal Compact’s Balanced Budget Rule complies with the institutions-based discipline even if it promotes the rules-based approach at the declaratory level.

The Correction Mechanism (“Debt Brake”): Increasing Automaticity in Cases of Significant Observed Deviations from the MTO or the Adjustment Path

The Fiscal Compact included a provision for the creation of a Correction Mechanism (CM) at the national level to address significant observed deviations from the MTO or the adjustment path towards it (TSCG, Article 3). The mechanism is triggered automatically and in such a case, the contracting party has to take measures for a defined period. National fiscal correction mechanisms are based on certain common principles determined by the European Commission (2012b).

The Correction Mechanism is following the rules-based approach as it increases the automaticity of the fiscal framework. Given that the aforementioned balanced budgetary rule is linked to the MTO, the CM sets limits to the discretion of national fiscal authorities so that the significant deviation is addressed and the MTO is respected. In reality, the Correction Mechanism constitutes an alternative enforcement process to the SDP. While the latter relies on the use of economic judgement by the Commission to identify significant divergences from the MTO or to assess the compliance of member states with the Council Recommendations to remedy the situation (effective action taken), the CM attempts to get around the discretionary judgement of the EU institutions and establish an automatic process that prevents lasting deviations. In practice, however, the majority of the contracting parties have introduced national fiscal correction mechanisms that depend on the EU institutions for the identification of significant deviations (European Commission, 2017f: 6-8). Still, the CM’s direction towards greater automaticity contrasts with the use of judgement included in the Six-Pack.

Excessive Deficit Procedure: Strengthening the Role of the Commission

The Fiscal Compact amended the EDP by enhancing the position of the Commission in the procedures that follow the breach of the deficit criterion. According to article 7 of the TSCG, contracting parties that are also members of the Eurozone commit to supporting the Commission's proposals in the various steps of the EDP, unless a qualified majority of them is opposed to the recommendation. In reality, under this provision the Council's Decision on the existence of an excessive deficit (Table 7.3, step 4), the Decision on effective action taken (steps 8 and 13), the Decision to give Notice (step 11) and the Decision on the imposition of sanctions (step 14) are all taken according to the Reverse Qualified Majority Voting system (RQMV). Given that the Six-Pack had already established RQMV as the voting rule in steps 6 and 10 of the EDP, the Fiscal Compact completed the transition of the EDP to the RQMV system for Eurozone member states.

The extension of the RQMV to the whole EDP complies with the institutions-based approach to fiscal discipline. As was noted in the previous section, the strengthening of the agenda-setting role of the Commission is clearly in line with the delegation of parts of fiscal policymaking to independent institutions. The RQMV creates a hierarchical structure within the EDP putting the Commission at the helm of the process. Rather than enhancing automaticity, this organisational arrangement promotes the use of economic judgement. As was explained in the previous section, the legal framework enables the Commission to use discretionary judgement in the evaluation of "effective action" or the identification of a "severe economic downturn". These provisions allow the Commission to propose the extension of deadlines. Only the identification of the excessive deficit (Table 7.3, step 4) becomes more automatic given the existence of a double condition (the deficit remaining close to the reference value and the excess being temporary) restricting the consideration of "relevant factors" for the assessment on the basis of the deficit criterion. The subsequent steps of the EDP rely heavily on the Commission's evaluation.

7.3 The Two-Pack Reform

The adoption of the Two-Pack in May 2013 completed the reform of the framework of European Economic Governance that had been launched in 2010. While the passage of the Two-Pack took place more than a year after the signing of the Treaty on Stability, Coordination and Governance that incorporated the Fiscal Compact, the two reform proposals emerged

almost at the same time. The underlying tension between the German Bundestag and the EU Institutions regarding the direction of the fiscal surveillance, which resulted in the establishment of Fiscal Compact, has also triggered the mechanism for the creation of the Two-Pack.

My argument in this section is that the Two-Pack reform was a response to the German attempt to re-impose decentralised fiscal discipline on other Eurozone governments. The adjusted Sound Money paradigm rewarded the consolidation of the centralisation of fiscal surveillance as a way of protecting EMU's knowledge structures from the destabilising effects of the coercive pressures emanating from the German political system. Eurozone policymakers sought to complete the system of EU-level policy guidance by adding a "National Semester" to the European Semester process. Additionally, they tried to incorporate the provisions of the Fiscal Compact into Union law to guarantee their compatibility with the reformed framework of European Economic Governance. The sterilisation of the Six-Pack reform was accomplished with the alignment of the ad hoc monitoring provisions to support the financial stability of certain member states (countries receiving financial assistance) with the institutions-based fiscal surveillance. In the first part of this section I present the effects of Eurozone's social legitimacy on the content of negotiations. Subsequently, I examine the final Two-Pack provisions and test their compliance with institutions-based discipline.

7.3.1 Social Legitimacy Shaping the Formal Negotiations: Consolidating Centralisation

Sociological Institutionalism understands the change of organisational structure as a way of protecting the system of meaning within the organisation. Following the German parliament's attempted imposition of different cultural elements (ordoliberal rules-based discipline) on other Eurozone countries, the adjusted Sound Money paradigm became challenged. As it was shown in the previous section, the Eurozone's social legitimacy led policymakers to amend the Fiscal Compact in a way that it would be compatible with the Six-Pack reform. Steering the Fiscal Compact negotiations towards centralisation did not preclude other forms of defending the system of meaning. A sociological institutionalist explanation anticipates the existence of wider efforts to support the adjusted Sound Money paradigm. The organisational-level prediction is that Eurozone's social legitimacy led policymakers to proceed to a further reorganisation of the structures of European Economic Governance to consolidate the centralisation of fiscal coordination via secondary legislation.

Setting the Agenda: The Commission Seeks to Consolidate Centralisation

The examination of the empirical data reveals that the Commission took the initiative to protect the centralisation of fiscal coordination by reinforcing the framework of European fiscal governance via secondary law. The German parliament would be outflanked as it could not use its veto over financial assistance to shape the outcome of the negotiations.

The Commission presented the Two-Pack legislative package on 23 November 2011. The package was building upon a Communication that had been released on 12 October 2011 entitled “A roadmap to stability and Growth” (European Commission, 2011d). The first proposed regulation promoted the creation of a “National Semester” to complement the European Semester process. The Commission proposed the annual submission of draft budgetary plans to the Commission for assessment and the establishment of a common budgetary timeline for Eurozone member states. The Commission would be able to ask for a revised draft budgetary plan if the latter did not comply with the member state’s obligations under the SGP. The Commission could issue an Opinion on the draft budgetary plan. Those Opinions would be taken into consideration in the context of EDP reports, effectively becoming part of the EDP process.

The second proposed regulation sought to incorporate the ad hoc surveillance practices applied to those member states receiving (or being on the verge of receiving) financial assistance into the European legal framework. Eurozone member states facing problems with their financial stability (or receiving financial assistance on a precautionary basis) would be subject to tighter monitoring or “enhanced surveillance”. This type of monitoring would supplement the Semester system by establishing a more streamlined assessment mechanism. Review missions of the Commission in liaison with the ECB would provide more in-depth and more timely information about the development of the state’s financial situation. In contrast, surveillance of the Eurozone member states receiving financial assistance would be conducted on the basis of a macroeconomic adjustment programme, in line with the IMF practice. To avoid duplication of surveillance mechanisms and acknowledging the intrusiveness of the macroeconomic adjustment programmes, the Commission proposed the suspension of every fiscal or structural monitoring mechanism included in the framework of European Economic Governance for those states. Post-programme surveillance would be introduced as a “probation” period with enhanced surveillance applied on “excommunicated” member states before they could be allowed to return to the usual Semester monitoring.

Sequence and trace evidence signal that the Commission's legislative proposal emerged as a response to the evolving discussions on Treaty reform. The Commission's Communication of 12 October 2011 announcing its intention to present a new legislative package came out before the Euro Summit of 26 October 2011 that declared the necessity of Treaty revisions. The Commission's document included references to Treaty revisions proving that the Commission's initiative was linked to the Treaty reform debate:

This [the Treaty revision] would not serve as an immediate response to the current crisis which must be addressed through the swift and decisive implementation of the measures presented in this Communication. Once this has been done, Treaty changes could be envisaged to consolidate and give even greater impact to the new Community architecture that is now being put in place via secondary legislation.

(European Commission, 2011d: 8)

The Commission presented the Two-Pack proposals on 23 November 2011, just a few days before the European Council of 8-9 December 2011 that was due to discuss the revision of the Treaty. The debate of the College of Commissioners of 30 November 2011 on the preparation of the European Council is revealing. The new economic governance package was clearly framed as part of the Commission's attempt to resist the amendment of the Treaty promoted by the German government:

The PRESIDENT thanked the speakers for their comments and contributions. He noted that the prevailing mood as regards any revision of the Treaty was one of scepticism (...) [a]lthough the Commission could not oppose a decision which was ultimately the sole prerogative of the Member States, it could not absent itself from this debate and had a duty to communicate clearly with the general public on these issues and, at the same time, *on the measures* it had adopted and *was proposing to strengthen the governance of the euro area*.

(European Commission, 2011e: 22-23, my emphasis)

The Eurozone's social legitimacy rewarded a further organisational change. The examination of the texts of the Two-Pack proposals unveils the existence of a particular cognitive script: the necessity for EU-level guidance (ex ante coordination) to prevent spillovers. In line with the institutions-based approach, the Commission promoted the centralisation of the budgetary process:

Each of the Member States whose currency is the euro should consult the Commission and other Member States whose currency is the euro before the adoption of any major fiscal policy reform plans with potential *spillover effects*, so as to give the possibility for an assessment of possible impact for *the euro area as a whole*. They should consider their budgetary plans to be of *common concern* and submit them to the Commission for monitoring purposes *in advance* of the plans becoming binding. The Commission should be in a position, if necessary, to adopt an opinion on the draft budgetary plan, that the Member State and in particular budgetary authorities should be invited to take into account in the process of the budget law adoption. Such an opinion should ensure that *Union's policy guidance* in the budgetary area is appropriately integrated in the *national budgetary preparations*.

(European Commission, 2011f: 2-3, my emphasis)

A Commission official confirmed that the Two-Pack reform was about enhancing ex ante coordination:

We promoted the Two-Pack to have more meaningful ex ante surveillance. Also, to facilitate reforms and engage in early prevention

(Anonymous Interviewee XX)

In full compliance with the institutions-based discipline, the Two-Pack proposal promoted the hierarchical dimension of budgetary procedures as member states would have to send budgetary plans to the Commission for assessment. Also, the timing of the Commission's evaluation of the plans before the finalisation of the budgets by national parliaments served the goal of framing parliamentary discussions and limiting parliamentary amendments. These measures would constitute a significant consolidation of the centralisation approach to fiscal coordination within the EMU. Other measures would support the preservation of centralised fiscal discipline indirectly. The Commission tried to close the intergovernmental loopholes to the framework of European fiscal governance. The provisions on enhanced surveillance and IMF-type reinforced surveillance clarified the modifications of and exceptions from the standard European Semester framework. At this point it must be recalled that the adjustment programmes accompanying the provision of financial assistance continued to rest outside the legal system of the EU raising criticisms about their compliance with the formal structures of

economic governance. By seeking to incorporate the ad hoc intergovernmental arrangements into the fiscal framework in a way that did not violate the essence of the Semester monitoring, the Commission aspired to shield centralised fiscal coordination from the pressures of national political systems.

Intergovernmental Negotiations: Broad Consensus in the Council

The examination of the empirical material points to the existence of a broad consensus on the Two-Pack reform in the Council. The idea of sending draft budgetary plans to the Commission was not new, as it had emerged during the discussions of the Task Force on Economic Governance in 2010 (Anonymous Interviewees 02 and 07). However, by the beginning of 2012 it gained new impetus. The Council discussed whether only Eurozone member states subject to the EDP should submit their draft budgetary plans for assessment (Council of the European Union, 2012b). Most member states agreed that all Eurozone member states had to submit their budgetary plans for evaluation. The analysis of the empirical material confirmed the presence of a cognitive script. EU-level guidance (ex ante coordination) led Eurozone policymakers to think about the Eurozone as a whole:

The submission of budgets is the essence of *ex-ante* coordination. It would *not make any sense* for some countries to submit. If only a group of countries submitted, that would be opposite to the objective we tried to achieve, that is the consistency in fiscal policy making. It would *not make sense* to have submission for only those [member states] in EDP. If only those in EDP submitted, then *ex-ante* coordination would disappear. *Ex-ante* coordination is an approach consistent of *Eurozone as a block*. It is not a bus in which some go off, some on.

(Anonymous Interviewee 05)

The above cognitive script legitimised the Two-Pack reform in the eyes of Eurozone policymakers. Sending draft budgetary plans to the Commission appeared as “the next logical step” and the “appropriate thing to do” (Anonymous Interviewee 17).

A separate issue discussed by the Council was whether, on the basis of a Commission proposal, it could recommend to a member state to seek financial assistance. Germany expressed some reluctance as it would not like to see the Council’s recommendation preempt the decision of the ESM on the granting of financial assistance. Another aspect was the sensitivity of the

information related to a member state's market access. The Council decided to delegate this issue to the experts.

The ad hoc Working Group, which was set up to negotiate the Commission's legislative proposals, reached a technical agreement in little more than a month (Council of the European Union, 2012c). The Working Group endorsed the Commission's proposals and proceeded to minor additions. The most substantial amendment was the Working Group's effort to incorporate provisions of the draft Fiscal Compact, such as the Economic Partnerships Programmes or the obligation to report national debt issuance plans, in the secondary legislation (Council of the European Union, 2012d). At this point, it should be noted that the two working groups discussing the Fiscal Compact and the Two-Pack were running the same period (January 2012) with similar membership. The negotiations of that phase were concluded on 20 February 2012 with the Council adopting a general approach for the inter-institutional negotiations.

Inter-institutional Negotiations: The European Parliament Locks-In Centralisation, The Council Resists Debt Mutualisation

The European Parliament endorsed the direction of the Two-Pack reform promoted by the Commission and the Council but demanded further steps towards the centralisation of fiscal coordination. Inter-institutional negotiations proceeded smoothly with the Council accepting the Parliament's relevant amendments. However, a complete agreement between the two legislators was delayed because of the Parliament's attempt to extract concessions from the governments on the issue of debt mutualisation. That attempt failed as the creation of common debt instruments was not part of the EMU's social legitimacy.

The Parliament moved quickly to complement the Commission's proposals. The Rapporteur responsible for the proposed Regulation on Draft Budgetary Plans, Portuguese MEP Elisa Ferreira (S&D), sought to include a coherence clause in the legislation stipulating that national budgetary procedures had to be consistent with the EU-level guidance provided in the context of the European Semester (European Parliament, 2012b). Also, the MEP demanded that the Commission would always issue an Opinion on every Draft Budgetary Plan and not just on those plans with problems. The Commission's overall assessment of the budgetary situation of the euro area (issued at the same time as the Commission's Opinions on individual countries) would be linked to the following year's European Semester (in the Annual Growth Survey). In this way, the European Semester and the assessment of Draft Budgetary Plans would feed into

each other creating a circle of EU-level guidance procedures throughout the year. Ferreira included a number of amendments transposing provisions of the Fiscal Compact into secondary law: the Economic Partnership Programmes, the need for member states to report their debt issuance plans and the formulation of the golden rule (member states would be obliged to establish fiscal rules enforcing the MTO as it was defined in the EU legislation, not to set balanced budget fiscal rules). Other MEPs proceeded even further and included a formulation of the Fiscal Compact's national Correction Mechanism in the proposed legislative package (European Parliament, 2012c). Parliamentary discussions in the ECON Committee and the Plenary resulted in the introduction of a series of amendments moving beyond the centralisation of fiscal coordination to cover the centralisation of debt issuance. The Parliament proposed some radical measures: the obligation of the Commission to present a roadmap for the creation of euro area Stability Bonds, the establishment of a European Redemption Fund based on joint liability aiming to reduce the accumulated debt and the setting up of a European Debt Authority coordinating national debt issuance (European Parliament, 2012d).

Trilogue meetings began in July 2012 (Council of the European Union, 2012e). The European Parliament and the Council reached a relatively quick agreement on the establishment of the "National Semester" and the transposition of Fiscal Compact arrangements in the Union law. By the end of November 2012, the legal text on those issues was already agreed (Council of the European Union, 2012f). However, discussions on the mutualisation of debt and the centralisation of debt issuance proved highly divisive. The Council could not accept the Parliament's attempt to include debt mutualisation in the reform. In turn, the Parliament delayed the adoption of the legislation to exert pressure on the Council to compromise. An interviewee noted how the ALDE parliamentary group led the effort to block a final agreement unless those measures would be included in the reform (Anonymous Interviewee 18). In February 2013 the Parliament backed down and accepted the removal of the debt mutualisation provisions from the legal package. In return, the Commission would undertake the task of bringing together an expert group to examine the merits of joint issuance of debt in the Eurozone (Council of the European Union, 2013).

The existence of an underlying consensus on the centralisation of fiscal coordination can explain the Parliament's stance in the negotiations. Complementing the European Semester with an assessment of national budgets appeared as a meaningful next step to ECON Committee members. A cognitive script paved the way for the approval of the National Semester: the necessity of EU-level guidance for the prevention of negative spillovers. The

cognitive script is easily identifiable in the text of the European Parliament's proposed amendment of the Two-Pack:

Member States whose currency is the euro generate or are affected by spill-over effects from their budgetary and macroeconomic policies. Spill-over effects should therefore be identified and addressed within the framework of country-specific surveillance procedures as well as in the overall assessment of the budgetary situation and prospects in the euro area as a whole. That assessment should identify, on a country-by-country basis, potential negative spill-over effects on the sustainability of public finances of the Member States generated by their private sector or by other Member States (...) [e]ach of the Member States whose currency is the euro should consult the Commission and other Member States whose currency is the euro before the adoption of any major economic and fiscal policy reform plans with potential spill-over effects, so as to give the possibility for an assessment of possible impact for the euro area as a whole.

(European Parliament, 2012d)

A member of the ECON Committee underlined that the DBPs relied on the idea that national budgets should be a common concern and that their consistency appeared as a rational objective to MEPs:

The regulation on the DBPs was necessary so that countries did not produce budgets that were *inconsistent between themselves*. In theory this *makes sense*, but you do not have an (economic) understanding behind it.

(Anonymous Interviewee 20)

The MEP noted that DBPs “became adopted very quickly”, which is indicative of the underlying consensus on the issue.

The shared understanding between the Parliament and the Council about the need of EU-level guidance led the two EU Institutions to reach a quick agreement on the issues of the DBPs and the incorporation of Fiscal Compact provisions, such as the Economic Partnership Programmes, into the Union law. In the case of the latter, the Parliament wanted to ensure the cohesion of the arrangements that were included in the intergovernmental agreement with the system of *ex ante* policy guidance set up by the European and the National Semesters. In

contrast, the absence of a shared cognitive script in the case of debt mutualisation impeded the compromise between the two legislators. While the issue of debt mutualisation became a recurring theme in parliamentary discussions in the period 2010-2012, it did not gain significant impetus in the Council. The EFC did not include the absence of debt mutualisation in the definition of the problems of the European economic governance framework and, as a result, it did not formulate a relevant economic policy belief. As debt mutualisation remained excluded from EMU's system of meaning, the creation of common financing instruments was never part of the appropriate solutions promoted by the Eurozone policymakers. In view of the above, the compromise between the Council and the Parliament that emerged in February 2013 excluded any substantial legal provision on common debt issuance.

7.3.2 Testing the Compliance of the Two-Pack Provisions with the Adjusted Social Legitimacy

The examination of the legal text of the Two-Pack confirms the compliance of most provisions with the institutions-based belief. The analysis did not detect any rules-based elements. Some instruments rely on entirely different underlying logics, such as financial stability and loan repayment.

The Assessment of Draft Budgetary Plans (the “National Semester”): Ensuring the Incorporation of EU-level Guidance into National Fiscal Policies

Regulation No 473/2013 established the assessment of Euro area countries' Draft Budgetary Plans (DBPs) by the European Commission. The DBPs complete the surveillance cycle of the European Semester by assessing the implementation of the budgetary component of the Country-Specific Recommendations and the general guidance issued by the Council at the beginning of the cycle in national budgetary preparations. In reality, the DBPs formalise the expectation of incorporating EU-level policy guidance into national budgetary decision-making that had been included in the legal text of the European Semester (see Article 2-a, Council Regulation No 1466/97 as amended by Regulation No 1175/2011). The European Semester surveillance process taking place in the first half of the year is followed by a “National Semester” exercise that is undertaken every autumn. Table 7.5 presents the phases of the DBP assessment.

The Commission evaluates the DBPs and assesses the risk of non-compliance linked to the attainment of the targets. Submitted DBPs include: the targeted budget balance as a percentage of GDP by subsector, the targets for expenditure and revenue, the projections for general government expenditure and revenue (at unchanged policy, without discretionary measures), a description of discretionary measures (in the revenue and expenditure side) to bridge the gap between the targets and the projections at unchanged policy, relevant information on the methodology, economic models and assumptions underpinning the produced forecasts. Most importantly, the Commission evaluates the compliance of the DBPs with the Recommendations issued at the end of the European Semester. In case of serious non-compliance, governments are expected to revise those plans along the lines of the Commission’s assessment. At the end of the process, the Commission unilaterally adopts an Opinion on the DBPs. The Council is not included in the National Semester.

Table 7.5: The Assessment of the Draft Budgetary Plans (the National Semester)

By Mid-October	Eurozone Member States submit their Draft Budgetary Plans (DBPs) to the Commission and to the Eurogroup.
By the End of October	If within one week after the submission of DBPs the Commission detects a particularly serious non-compliance with the fiscal policy obligations of the SGP, the Commission consults with the relevant Member State. Within two weeks after the DBP submission, the Commission adopts an Opinion requesting the submission of a Revised Draft Budgetary Plan.
By 21 November	Within three weeks of the Commission’s Opinion, the relevant Member State submits a Revised DBP.
By the End of November	The Commission adopts an Opinion on each DBP. Additionally, the Commission proceeds to an Overall Assessment of the budgetary situation in the Eurozone as a whole based on the content and the interaction of the national DBPs. This assessment is one of the Reports that trigger the European Semester cycle.
By Mid-December	Within three weeks from the submission of the Revised DBP, the Commission adopts a new Opinion.

Source: Own construction based on Union secondary law (Regulation No. 473/2013; Regulation No. 1175/2011).

The assessment of the Draft Budgetary Plans is an unequivocal manifestation of the institutions-based belief. The so-called “National Semester” represents an outright intervention in national budgetary preparations. The assessment of DBPs establishes hierarchical procedures during the national budgetary negotiations by assigning strategic powers and prerogatives to certain actors. At the initial “executive planning” stage of the budgetary preparation, Regulation No 473/2013 delegates special authority to a fiscal entrepreneur: the Commission is given veto power over the draft budgetary plans of Eurozone member states.

The purpose of this centralisation element is to ensure “the consistent setting of targets at the outset of the process” creating constraints for subsequent decisions (von Hagen, 2002: 271). Being detached from national political settings, the Commission is not bound by particular national interests and can protect the collective Eurozone interest during national budgetary negotiations as it can take into account potential negative spillover effects to other member states or the Eurozone as a whole.

Additionally, the Regulation intervenes in the second “legislative approval” stage of national budgetary negotiations by strengthening the agenda-setting power of the executive over the parliament. As the Commission issues its Opinion on the DBPs before the finalisation of decisions in national parliaments, it can shape the relevant parliamentary debates and limit the scope of amendments to the executive’s budget proposal tabled by the members of parliament (von Hagen, 2002: 273). The link between the timeline of the DBP assessment and the structuring of the national parliamentary debate is underlined in the EFC Guidelines on the implementation of the Two Pack:

the timing of the DBP submission should allow the Eurogroup to discuss the DBP and the national parliaments to take this discussion into account before the adoption of the budget.

(Council of the European Union, 2016b: 8)

The presentation of the Commission’s Opinion to the relevant national parliament (after the latter’s request) and to the Eurogroup serve the purpose of increasing the visibility of the Commission’s Opinion. In this way, parliamentarians have to face significant reputational costs for tabling amendments to the executive’s budget, especially when the EU institutions have pointed out an increased risk of non-compliance with the SGP. Defying the Commission’s Opinion can prove very costly both for governments and for the members of national legislatures. According to Article 12 of Regulation No 473/2013, the Commission’s Opinion on the budgetary plans affects the Commission’s Report on the existence of an excessive deficit and the lodgement of a non-interest bearing deposit under the EDP. Given the introduction of RQMV in every stage of the EDP after the Fiscal Compact, ignoring the Commission’s assessment can swiftly lead to financial sanctions.

The fact that the vetoing of DBPs and the timing of DBP assessments fit well with the institutions-based approach to discipline can be further demonstrated by the fact that both

provisions were included in the “Sustainability Council” proposal of Fatás et al. in 2003. The replacement of “dead rules” with “living institutions” promoted by the authors of the proposal required the use of economic judgement in the analysis of national budgetary plans. According to the proposal:

The Sustainability Council would veto a government’s fiscal plans if it came to the conclusion that they were not compatible with sustainability. In this case, it would demand adjustments from a national government

(Fatás et al., 2003: 70)

The proposal made particular reference to the setting of an *appropriate* deadline so that

national parliaments would be informed of the Sustainability Council’s assessment when they vote on the annual budgets of governments

(Fatás et al., 2003: 70)

Economic Partnership Programmes: Introducing Structural Reform Requirements to the Excessive Deficit Procedure

Regulation No 473/2013 further amended the EDP by adding structural reform requirements to the requested budgetary measures to correct the excessive deficit. By devising Economic Partnerships Programmes (EPPs) describing structural reform priorities, Eurozone member states that are subject to the EDP commit to achieve an “effective and lasting” correction of the excessive deficit by increasing the competitiveness of their economies and tackling their structural weaknesses. The relevant member state presents its EPP at the same time as the Report on action taken (Step 7 of the EDP, Table 7.3). Based on a Commission proposal, the Council adopts an Opinion on the EPP. The Regulation provides that the EPP can be replaced by a Corrective Action Plan (CAP), thereby establishing a direct link with the Excessive Imbalance Procedure (Step 9 of the EIP, Table 7.4). At this point, it should be recalled that the EIP can ultimately lead to the imposition of fines and that relevant decision are taken under RQMV.

The creation of the EPPs follows the logic of the institutions-based discipline. The EU institutions enjoy wide discretion to assess the appropriateness of the structural reform priorities outlined by the member state with the use of economic judgement. A further indication of the institutions-based approach is the link of the EPP with the CAP as the

Excessive Imbalance Procedure creates a hierarchical relationship between the Commission and the member states given the Commission's strong agenda-setting role due to the RQMV.

Enhanced Surveillance: Creating a Parallel Surveillance Process for Eurozone Members Encountering Difficulties with their Financial Stability

Regulation No 472/2013 set up a more intensive surveillance procedure for Eurozone member states facing serious difficulties with their financial stability. Enhanced Surveillance complements the European Semester framework by providing a more expeditious process of providing EU-level guidance aimed at preventing adverse spillover effects to other Eurozone members. A member state subject to Enhanced Surveillance adopts measures to address financial difficulties after consulting with the Commission, the ECB and, where appropriate, the International Monetary Fund (IMF). These bodies conduct regular Review Missions in the relevant member state to verify its progress with the implementation of measures. The Commission informs the EFC about its assessment and examines whether further measures are required. If the Commission concludes that more needs to be done, it proposes the adoption of precautionary corrective measures or the drafting of a macroeconomic adjustment programme (see below). The Council adopts a Recommendation based on the Commission's proposal.

The underlying economic policy belief of Enhanced Surveillance is institutions-based discipline. Independent institutions, namely the Commission, the ECB and the IMF, are entrusted with the provision of guidance to member states with financial difficulties. What is more important is that the triggering of the Enhanced Surveillance process relies primarily on the assessment of the EU institutions. In particular, the Commission can unilaterally decide to subject a member state to Enhanced Surveillance if it assesses that the member state experiences or is threatened with serious financial difficulties that can cause adverse spillover effects to other member states. The Commission's evaluation is based on a "comprehensive assessment" of a number of rather vague factors like the robustness of the budgetary framework, the importance of the debt burden and the borrowing conditions in the financial markets. The Commission is obliged to subject a member state to Enhanced Surveillance only if the latter requests and receives financial assistance on a precautionary basis.

In contrast to the rest of the economic governance framework the ultimate aim of Enhanced Surveillance is not limited to achieving constrained discretion, namely the combination of short-term discretion with long-term discipline, but includes the very significant goal of ensuring financial stability. As it was noted in Chapter 5, after the outbreak of the financial

crisis financial stability became an equally important priority as price stability and economic stability within EMU. The emergence of the financial stability belief led to a further strengthening of institutions-based discipline within the system of European Economic Governance by securing a prominent role for independent bodies with particular expertise in financial affairs, such as the ECB or the IMF. The Regulation creates a parallel structure to the European and National Semester surveillance framework to ensure the swift adoption of measures promoting financial stability within EMU. The proposed measures can have a fiscal or a structural nature, but what makes them part of the Enhanced Surveillance procedure is the need to implement them urgently to avoid contagion due to the interconnectedness of the financial systems in the Eurozone. The Review Missions and the regular assessments prove that the parallel surveillance system is much more intrusive than the surveillance system established by the European Semester.

Macroeconomic Adjustment Programmes: Replacing Surveillance and Incorporating Conditionality for the Receipt of Financial Assistance

Regulation No 472/2013 created a new surveillance procedure for member states requesting financial assistance from other member states, third countries, the European Stability Mechanism (ESM) or the IMF. In that case, the Macroeconomic Adjustment Programme (MAP) replaces every other surveillance instrument within the framework of European Economic Governance. In particular, a member state subject to a MAP is exempt from: i) submitting Reports on action taken under the EDP, ii) monitoring under the In-Depth Reviews of the Macroeconomic Imbalance Procedure, iii) submitting a Corrective Action Plan under the Excessive Imbalance Procedure, iv) monitoring in the context of the European Semester, v) submitting Draft Budgetary Plans, vi) submitting Economic Partnership Programmes. A draft Macroeconomic Adjustment Programme is prepared by the relevant member state in collaboration with the Commission, the ECB and, where relevant, the IMF. On the basis of a Commission proposal, the Council approves the MAP. The programme is accompanied by a Memorandum of Understanding (MoU) detailing the conditions attached to the financial assistance. The MoU is signed by the Commission on behalf of the ESM and the member state receiving the financial assistance. The format of the monitoring process resembles that of the Enhanced Surveillance: every three months the “troika” of the institutions, namely the Commission, the ECB and the IMF, monitor the progress of the member state with the implementation of the programme via the conduct of Review Missions. The Commission

informs the EFC on the outcome of the monitoring missions. However, the MAP features a much stronger compliance mechanism than Enhanced Surveillance: loan disbursement is linked to the accomplishment of the MAP's "prior actions".

The underlying logic of the MAP is very different from the other surveillance instruments included in the European Economic Governance. The suspension of the multilateral surveillance framework does not reflect a turn to a more lenient approach to monitoring -quite the contrary- but denotes the "comprehensive nature" of the Macroeconomic Adjustment Programme (Regulation No 472/2013, Recital 7). The latter constitutes a long-established practice of the IMF that also became applicable to the Eurozone member states that received financial assistance after the outbreak of the sovereign debt crisis (Greece, Ireland, Portugal). According to the Commission,

The Regulation was established in order to align current practice used in implementing financial assistance programmes in euro-area Member States with the Treaty institutional framework

(European Commission, 2014: 2)

In reality, the Regulation incorporates the logic of the IMF conditionality in the European legal framework. A thorough investigation of the underlying concepts behind the conditionality of IMF financial assistance is beyond the scope of this thesis. A branch of the relevant academic literature has linked conditionality with loan repayment (see, for example, Dreher, 2009). Other scholars point to a variety of objectives (Stone, 2008). The IMF admits that loan repayment has equal footing to other policy goals in the conditionality of its programmes:

Conditionality covers the design of IMF-supported programs—that is, macroeconomic and structural policies—and the specific tools used to monitor progress toward goals outlined by the country in cooperation with the IMF. Conditionality helps countries solve balance-of-payments problems without resorting to measures that are harmful to national or international prosperity. At the same time, the measures are meant to *safeguard IMF resources* by ensuring that the country's balance of payments will be strong enough to permit it *to repay the loan*.

(International Monetary Fund, 2019a, my emphasis)

The European Semester's surveillance processes are anchored to distinct logics, such as the long-term sustainability of public finances or the protection of economic stability, and can point to obligations that are substantially different from the protection of the repayment of loans. Therefore, the existence of a MAP within EMU justifies the suspension of every other surveillance instrument to avoid inconsistencies within the monitoring framework.

Post-Programme Surveillance: Reestablishing Surveillance after the Receipt of Financial Assistance

Regulation No 472/2013 established a special surveillance procedure for member states that have received financial assistance and are no longer in a programme (MAP). The Post-Programme Surveillance procedure is a hybrid transitional instrument: its form is similar to the Enhanced Surveillance process but its triggering and length are linked to the receipt of financial assistance, which resemble the Macroeconomic Adjustment Programme. In this context, Review Missions under this special procedure begin after the conclusion of a MAP and continue to take place until 75% of the loans are repaid. In contrast to the MAP surveillance, the member state is allowed to return to the normal surveillance framework of the European Semester. In reality, the Post-Programme Surveillance procedure mirrors another IMF-type surveillance instrument: the so-called Post-Program Monitoring (Anonymous Interviewee 17). According to the IMF,

A country's return to economic and financial health during the program and in the medium term ensures that IMF funds are repaid, and can be made available to other member countries. Post-program monitoring helps support this process.

(International Monetary Fund, 2019b)

The underlying logic of the Post-Programme Surveillance is the restoration of institutions-based discipline (ergo the return of the member state to the Semester framework) but the goal of loan repayment is not abandoned. The continuation of Regular Review Missions incentivises member states that have received financial assistance to meet the medium-term loan repayment requirements.

Conclusion

In this chapter I explored the effect of the adjusted Sound Money paradigm on the organisational structure of the EMU. My argument was that the enhancement of the institutions-based discipline belief rewarded policy arrangements that were compatible with the cognitive scripts that had been established by the EFC: the integration of economic surveillance, the emphasis on prevention and the centralisation of budgetary procedures. I showed that EMU's underlying social consensus shaped the content of the formal negotiations and their final outcome.

The Six-Pack emerged as a process of alignment of European Economic Governance with the post-crisis social legitimacy of the EMU. The prioritisation of prevention was promoted through the upgrading of the Stability and Convergence Programmes and the amendment of the EDP to allow the pursuit of multiannual consolidation paths. The integration of economic surveillance would proceed via the establishment of the Macroeconomic Imbalance Procedure and the accompanying sanctioning mechanism of the Excessive Imbalance Procedure. The centralisation of budgetary procedures required the establishment of hierarchical structures in national fiscal policymaking justifying the creation of a system of EU-level guidance of national fiscal policies, namely the European Semester. The introduction of the RQMV in the sanctioning mechanisms (SDP, EDP, EIP) provides further evidence of the Eurozone policymakers' intention to increase the independence of the EU institutions in line with the institutions-based discipline belief. Deviations from the underlying consensus occurring during the formal negotiation process due to the strategic concerns of some actors were remedied by the decisive intervention of other actors adhering to the social appropriateness. The government of Luxembourg, the ECB and the European Parliament proved very influential at different stages of the negotiation by promoting or defending the social legitimacy.

The idea behind the creation of the Fiscal Compact originated from a distinct social environment: the German political system. The unfolding sovereign debt crisis and the concomitant need to create permanent financial assistance instruments made the EMU resource dependent. For a brief period in 2011-2012 the National Parliaments became significant actors within the Eurozone system of governance. In this context, the German Bundestag tried to impose domestic legitimisation schemas on the EMU by linking financial assistance to the creation of decentralised fiscal discipline mechanisms. The Balanced Budget Rule and the Correction Mechanism emulated the German Golden Rule and the German Debt Brake. In the

course of negotiations, however, the EMU's social legitimacy led EU institutions and Eurozone governments to amend the German proposals so that the Fiscal Compact would be compatible with the centralisation of fiscal coordination. The realignment of the German proposals to the underlying consensus included concrete policy provisions: the Balanced Budget Rule became linked to the MTO, the measurement of which embodies significant discretion from the part of the EU institutions, the (national) Correction Mechanisms would follow common principles issued by the Commission and the RQMV would be extended to every part of the EDP thereby increasing the independence of EU institutions.

The Two-Pack was a process of consolidation of the centralisation of fiscal coordination. The reform initiative followed the presentation of the Fiscal Compact proposals constituting the EU institutions' reaction to the decentralised surveillance promoted by the German Parliament. The protection of the social legitimacy justified the addition of a National Semester to the European Semester in an attempt to complete the system of EU-level guidance of national budgetary policies. The assessment of Draft Budgetary Plans established hierarchical procedures within the national budgetary preparation process and strengthened the role of the executive in full compliance with the institutions-based logic. The fortification of the system of meaning involved the incorporation of ad hoc surveillance arrangements for members receiving financial assistance and Fiscal Compact provisions into the Union legal framework to guarantee their compatibility with the framework of centralised fiscal surveillance. The underlying consensus enabled the Commission to reach a quick agreement with the Council and the European Parliament on the above policy areas. The Parliament's attempt to exploit the reform initiative to impose debt mutualisation proved fruitless as the relevant policy provisions did not comply with the Eurozone's adjusted social legitimacy.

In the next chapter, I summarise the results of this thesis and compare the sociological institutionalist explanation of the European Economic Governance reform to the explanations advanced by alternative approaches. Also, I discuss the implications of my argument for the analysis of the political economy of the EMU and explore future research trajectories.

¹ The participant number is removed to protect the institutional affiliation of the interviewee.

² Ibid.

³ Chapter 6 explores the link between ex ante coordination and institutions-based discipline in detail.

⁴ A redacted version of the Minutes was obtained after an official application to the Secretariat of the EFC.

⁵ The members of the Task Force were national finance ministers, while the President of the European Council chaired the meetings.

⁶ Corien Wortmann-Kool (Netherlands) and Diogo Feio (Portugal) belonged to the centre-right European People's Party (EPP). Sylvie Goulard (France) and Carl Haglund (Finland) were part of the Alliance of Liberals and

Democrats for Europe (ALDE). Elisa Ferreira (Portugal) participated in the Progressive Alliance of Socialists and Democrats (S&D), while Vicky Ford (United Kingdom) belonged to the European Conservatives and Reformists (ECR).

⁷ The six Rapporteurs represented the Parliament, the Council Presidency participated on behalf of the Council, while the Commission was represented by Commissioner Rehn.

⁸ As a result of the integrated nature of the CSRs, the legal basis of the Recommendations is found in a combination of different legal texts. In 2014 the Council was noting that “[t]hese recommendations combine economic and employment recommendations, based on Articles 121(2) and 148(4) of the Treaty on the Functioning of the European Union (TFEU), with Council opinions on stability and convergence programmes, based on Articles 121(2) and 148(4) of the Treaty on the Functioning of the European Union (TFEU) and Articles 5(2) and 9(2) of Regulation 1466/97, as well as with a recommendation on the implementation of the broad guidelines for the economic policies of the Member States whose currency is the euro, based on Articles 136 and 121(2) TFEU, and, in certain cases, with recommendations on the preventive part of the macroeconomic imbalances procedure under Article 6(1) of Regulation 1176/2011” (Council of the European Union, 2014: 2).

⁹ The proposed “Sustainability Council” of Fatás et al. (2003) is fully in line with the institutions-based approach (see Chapter 6).

¹⁰ Article 3(2), Council Regulation No 1466/97 as amended by Regulation No 1175/2011. The reform included similar provisions for the Convergence Programmes.

¹¹ The reform included similar provisions for the Convergence Programmes. See Articles 7-10, Council Regulation No 1466/97 as amended by Regulation No 1175/2011.

¹² The escape clause was used for the first time in March 2020 as the Commission and the Council used economic judgement to evaluate the anticipated economic effects of the pandemic (see Chapter 8).

¹³ It is indicative that when the Commission presented its views on the strengthening of national fiscal frameworks to the EFC in April 2010, “[t]he ensuing discussion touched in particular on the concept of independent institutions” (Economic and Financial Committee, 2010b: 3). A redacted version of the minutes was obtained after an official application to the EFC Secretariat.

¹⁴ Articles 3(5) and 5(2), Council Regulation No 1467/97 as amended by Council Regulation No 1177/2011.

¹⁵ Article 2(3), Council Regulation No 1467/97 as amended by Council Regulation No 1177/2011.

¹⁶ Admittedly, the examination of compliance on the basis of the deficit criterion remains more automatic as the “relevant factors” can be taken into account only if the deficit remains close to the reference value and the excess is temporary (Article 2(4), Council Regulation No 1467/97 as amended by Council Regulation No 1177/2011).

¹⁷ Hungary, the Czech Republic, Sweden and the United Kingdom opted out from the Pact.

¹⁸ Anonymous Interviewee 14 underlined the political nature of the Pact and its limited consequences for Eurozone governance. He noted that “France promoted the Competitiveness Pact but that was nothing. It was just for President Sarkozy to say that he achieved something”.

¹⁹ The participant number is removed to protect the institutional affiliation of the interviewee.

²⁰ Leaked draft of the Treaty on Stability, Coordination and Governance of 19 January 2012.

²¹ The participant number is removed in order to protect the institutional affiliation of the interviewee.

²² This is different from the “Golden Rule” that had been implemented by the UK government during Gordon Brown’s tenure as Chancellor of the Exchequer (Lee, 2009). According to that rule, the government would borrow over the economic cycle only to finance public investment and not to fund current spending.

CHAPTER 8

GENERAL CONCLUSION

The financial crisis of 2007-2009 marked the beginning of the first serious crisis of the Eurozone since the circulation of the euro in 2002. The turmoil in the subprime mortgage market in the United States unleashed economic dynamics that have severely stressed the institutional framework of the EMU. The increased economic interdependence of the European states that had spurred the great integrative steps of the 1980s and the 1990s, namely the Single Market and the Single Currency, was suddenly creating pressures that threatened the cohesion of the Eurozone. Faced with unprecedented circumstances, Eurozone policymakers decided to revise the institutional foundations of the currency union promoting significant changes to the direction of the economic and monetary policies.

This thesis has asked why the Eurozone member states advanced the centralisation of European economic coordination after the financial crisis. The negotiation and adoption of the Six-Pack, the Two-Pack and the Fiscal Compact between 2010 and 2013 marked the abandonment of the asymmetric architecture of the EMU that had been established at Maastricht. The decision to strengthen the “E” of the EMU resulted in the extensive reform of the Stability and Growth Pact and the replacement of the Open Method of Coordination with a more robust framework of structural surveillance. Existing academic explanations focus on various causes: power imbalances and hegemonic relations within the Eurozone, historical European integration drivers, constraining effects of formal institutions, actor ideas and discursive interactions. These contributions offer valuable insights on important aspects of the EMU but provide answers that are either too broad or too narrow. This is because the theoretical underpinnings of these explanations lead the relevant scholars to focus on wider social contexts and historical processes or concentrate on the ideas and discourse of particular agents. A different way to approach the above question is to examine the Eurozone’s distinct social environment. By exploring the evolution of the Eurozone’s underlying economic policy beliefs, this thesis advances an explanation based on an endogenous account of actor preferences.

I have argued that the post-crisis reform of European Economic Governance is the result of a significant adjustment of the Eurozone’s social legitimacy. In line with Sociological

Institutionalism, it is argued that the Eurozone's system of meaning, namely the Sound Money paradigm comprising ten underlying economic policy beliefs, has constitutive effects on the preferences of Eurozone decision-makers. The post-crisis replacement of rules-based discipline with institutions-based discipline led Eurozone policymakers to strengthen the European economic coordination.

This chapter is divided in four parts. In the first part, I summarise the main findings of this thesis starting with the developments in Eurozone social legitimacy and moving to the review of organisational changes. The second part is devoted to the contribution of this thesis to the existing literature. The third part looks at the implications of this thesis outcome for the political economy of the EMU. Finally, in the last part of the chapter I present the limitations of this thesis and indicate possible future research trajectories.

8.1 Summary of the Findings

The Sociological Institutional approach of this thesis acknowledges that organisational developments, such as the legislative reforms of the Six-Pack, the Two-Pack and the Fiscal Compact, are not detached from developments in the social legitimacy of the Eurozone. Therefore, the thesis traces the evolution of the Eurozone's social legitimacy before turning to the analysis of organisational change.

8.1.1 Eurozone's Sound Money Paradigm: The Rise of Institutions-based Discipline

The thesis has confirmed the existence of a system of meaning within the Eurozone, namely the Sound Money paradigm, constituting its social legitimacy. At the launch of the EMU, the Sound Money paradigm comprised eight distinct economic policy beliefs: price stability, credibility of monetary policy, fiscal discipline, structural adjustment, deficit bias, market discipline, rules-based discipline and institutions-based discipline. It is shown that these beliefs shaped the original organisational framework of the EMU. A thorough exploration of the intellectual origins of these elements in the economic literature has unveiled their conceptual interlinkages unifying them into a single paradigm. The Sound Money paradigm was not entirely coherent, however, due to the antagonistic relationship between rules-based discipline and institutions-based discipline. The friction did not become apparent as the latter belief was rather weak at the time.

During the pre-crisis period, the Eurozone's Sound Money paradigm remained relatively stable. Some minor adaptations of the social legitimacy of the EMU, however, had detectable organisational effects. Problems with the enforceability of fiscal rules in the early years of the EMU did not result in the weakening of the rules-based belief but opened the way for the modest strengthening of institutions-based discipline and the limited decline of the fiscal discipline belief. The acknowledgement of the value of short-term discretion led Eurozone policymakers to reform the Stability and Growth Pact in 2005 to increase the flexibility of fiscal rules in line with the revised approach to fiscal discipline.

The Financial Crisis of 2007-2009 destabilised the Sound Money paradigm as the existing social legitimacy clashed with economic reality. Price stability could not prevent financial and economic instability. The Keynesian fiscal stimulus reemerged as a legitimate concept but the turn to Keynesianism was only partial. Fiscal policy could pursue seemingly incompatible Keynesian and monetarist objectives by using a differentiated approach. The economic policy belief of constrained discretion combined short-term fiscal discretion with long-term fiscal sustainability. The concept, which had emerged before the 2005 SGP reform, became consolidated replacing the fiscal discipline belief. The European Commission's European Economic Recovery Plan promoting countercyclical fiscal expansion was the organisational reflection of constrained discretion. The successful implementation of the fiscal stimulus phase of the Plan that managed to stabilise the European economies in the first half of 2009, was succeeded by a problematic fiscal consolidation phase. The preparation of the Fiscal Exit strategies in the autumn of 2009 exposed the incompatibility of rules-based discipline with the logic of constrained discretion. The rigidity of fiscal rules prevented the extension of the adjustment paths to enable a smooth consolidation of public finances. Eurozone decision-makers admitted that fiscal rules did not make sense any more.

The thesis detected a significant adjustment of the Sound Money paradigm in the first months of 2010. The influential Economic and Financial Committee that prepared the meetings of the finance ministers created new meaning out of its practices that strengthened the institutions-based economic policy belief at the expense of rules-based discipline. Encountered with skyrocketing fiscal deficits, the EFC proceeded to three organisational innovations: the strengthening of the assessment of Stability or Convergence Programmes, the alignment of fiscal and macroeconomic surveillance and the informal ex ante consultation on Fiscal Exit strategies. The EFC then objectified its practices by creating shared definitions of policy problems and theorisations of policy solutions. The EFC formulated the lack of room for

manoeuvre in good times, the exclusive focus on fiscal imbalances and the neglect of spillovers as wider policy problems requiring particular solutions: the prominence of prevention, the integration of economic surveillance and the necessity of genuine EU-level guidance to national budgetary policies. The objectified understandings of the EFC fitted well with the institutions-based belief, which was intellectually enhanced. The transmission of the EFC's understandings to the European Parliament provided the element of exteriority that was necessary to integrate the new meaning in Eurozone's social legitimacy.

8.1.2 The Post-crisis Legislative Reform: Adapting to the Revised Sound Money Paradigm

This thesis has found that the Six-Pack reform was an alignment of the fiscal and macroeconomic framework with the revised Sound Money paradigm. The enhanced institutions-based belief established an underlying consensus among decision-makers during the negotiations. Policy proposals that were close to the underlying consensus were rewarded, while proposals that deviated from it were rejected. By putting forward proposals that complied with the revised social legitimacy of the EMU, the government of Luxembourg, the ECB and the European Parliament had a surprising and disproportionate influence on the outcome of the negotiations. Strategic considerations of the Commission and political concerns of powerful governments emerged in the negotiations, but their impact was limited due to the intervention of the above-named parties that acted as “guardians of the social appropriateness”. The policy instruments that were introduced by the Six-Pack reform corresponded to the new meaning that had been created by the EFC. The European Semester, the Macroeconomic Imbalance Procedure, the Excessive Imbalance Procedure, the revised Stability and Convergence Programmes, the Significant Deviation Procedure and the revamped Excessive Deficit Procedure were the organisational reflections of three key understandings of the EFC: the need for EU-level guidance of national budgetary policies, the primacy of prevention and the necessity of integrating fiscal and macroeconomic surveillance. Perhaps the most symbolic policy arrangement that signified the decisive turn to institutions-based discipline was RQMV. The establishment of the latter as the baseline decision-making method of the reformed framework of European Economic Governance confirmed the trust of the Eurozone policymakers in independent institutions.

The Fiscal Compact was created as a result of a different social process: coercive isomorphism. After the adoption of the Six-Pack, the German political system attempted to impose the

country's domestic social legitimacy on the rest of the member states by linking the decision on a permanent financial assistance mechanism to the enhancement of national fiscal rules. A proposed amendment of the Treaty would oblige member states to establish strict fiscal rules at the national level modelling the framework in Germany. The German proposal promoting decentralised fiscal discipline clearly deviated from the underlying consensus. In the ensuing negotiations, proposals that protected the centralisation of fiscal procedures were rewarded. The EFC members managed to amend the German proposals, substantially realigning them with the social legitimacy of the EMU. The Balanced Budget Rule became linked to the (centralised) medium-term surveillance, while the Correction Mechanisms would have to follow common principles devised by the Commission. The extension of the RQMV to every part of the EDP marked the further enhancement of the independence of the Commission. Eventually, the final form of the Fiscal Compact was shaped by the institutions-based discipline belief.

The Two-Pack consolidated the institutions-based centralisation of fiscal coordination that became challenged by the German proposals on national fiscal rules. Tabling its proposals at a time when national governments explored the possibility of amending the Treaty (primary law), the Commission sought to use secondary law to neutralise the threat to the centralised framework of coordination that had been established by the Six-Pack. The European Semester would be complemented by a National Semester to make the system of EU guidance more robust, while the ad hoc surveillance arrangements that had been devised for countries receiving financial assistance would be incorporated into the legal framework of the EU to ensure that any exceptions to the framework of surveillance would be compatible with the system of surveillance. The Eurozone's social legitimacy rewarded policy initiatives that protected the centralisation of fiscal coordination. The Council and the European Parliament quickly endorsed the Commission's proposals. The assessment of the Draft Budgetary Plans by the Commission reflected the EFC's understanding on the need for genuine EU-level guidance. The Commission's newly acquired authority to intervene in the national budgetary procedures verified the impact of the institutions-based discipline belief on the decisions of Eurozone policymakers.

8.2 Contribution of the Thesis

The first contribution of this thesis is an original cultural explanation of the post-crisis reform of the European Economic Governance based on the evolution of the Eurozone's social legitimacy. The thorough examination of cultural and cognitive processes undertaken by this thesis provides crucial insights on the endogenous dimension of the overhaul of the fiscal and the macroeconomic coordination of the EMU after the financial crisis of 2007-2009. While a few rival explanations also attempt to explore the endogenous aspect of the reform concentrating on domestic cultural frames (strategic constructivists) and the communicative discourse at the EU-level (discursive institutionalists), they are preoccupied with agency neglecting the structural impact of the Eurozone's culture on agents. In contrast, the sociological institutionalist approach of this thesis takes seriously the embeddedness of policymakers in Eurozone's social environment. The Eurozone's social legitimacy is a framework of meaning that shapes the way that individuals interpret reality and identify their preferences. The examination of taken-for-granted understandings constitutes a deeper level of analysis focusing on preconscious processes. Here agency has a minor role as actors adapt their behaviour unconsciously. Therefore, the cultural explanation advanced in this thesis sheds light upon significant aspects of the reform process that remain unexplored by the other approaches.

The thesis has unveiled the presence of an unidentified cognitive element within the Eurozone's Sound Money paradigm. I have shown that the institutions-based discipline belief led Eurozone policymakers to change their perception of interest and embrace the centralisation of fiscal and macroeconomic coordination. The examination of the belief has been thorough. Initially, I traced the origins of the belief in the economic literature and detected its impact on the pre-crisis organisational framework of the EMU. Subsequently, I analysed how the belief had been reinforced in the post-crisis period as a result of the creation of new meaning by the Eurozone elites. In turn, I showed how the belief had shaped the formal negotiations in the cases of the Six-Pack, the Fiscal Compact and the Two-Pack. Ultimately, I detected its impact on the adopted legislation. In this way, the thesis has proved that organisational change was the result of cultural adjustment.

The second contribution of this thesis is an empirical application of Sociological Institutionalism in the analysis of economic and monetary integration. While the purpose of this research is to explain a particular policy outcome, the post-crisis reform of the EEG, and not to proceed to generalisations about the theory, the thesis proves the continued relevance of

the sociological institutionalist framework for the analysis of policy development in the Eurozone. It must be recalled that the particular theory has provided significant insights on the transition from the EMS to the EMU (Dyson, 1994; McNamara, 1998; Dyson and Featherstone, 1999) and the EMU's policy framework at its launch (Dyson, 2000). As the Six-Pack, the Two-Pack and the Fiscal Compact constitute the latest reforms of the initial design of the EMU, it is evident that Sociological Institutionalism is a particularly suitable framework for the analysis of empirical developments in the field of European economic integration. Also, given that the post-crisis reform of the European Economic Governance is an inherently interesting atypical case of European public policymaking (see Chapter 4), the particular application of the theory expands the sociological institutionalist literature by adding an important case study.

In parallel, the application of Sociological Institutionalism in the case of the EEG reform addresses the criticism mounted by discursive institutionalists and strategic constructivists on the inability of policy paradigms to account for change in a time of crisis (Blyth, 2013b; Schmidt, 2014: 196-198). The thesis has shown empirically that apart from comprehensive policy shifts and radical transformations, such as the shift from Monetarism to Keynesianism in the 1980s, the sociological approach can account for less dramatic paradigmatic developments. Indeed, my research has proved that the adjustment of a paradigm in a time of crisis might be necessary for its survival. In this sense, the thesis provides an empirical illustration of ideational change *within* a paradigm (Carstensen and Matthijs, 2018). More broadly, critics of paradigms should be careful to examine the evolution of constitutive (economic) policy beliefs in detail before renouncing explanations based on paradigmatic change.

The third contribution of this thesis is an empirical investigation of the impact of the Economic and Financial Committee on the reform of European Economic Governance. Despite being a central component of the decision-making structure of the system of European fiscal and economic coordination, proven by the fact that it constitutes the main preparatory body of the ECOFIN, the EFC remains a surprisingly underresearched EU body. Certainly, the contributions of Grosche and Puetter (2008), Puetter (2006: 70-77), Heipertz and Verdun (2004; 2005) provide a general understanding of the EFC's composition and function. However, there is a lack of empirical studies focusing on the Committee's effect on the direction of European public policy. The EFC's secretive nature and working method have also contributed to this outcome. By dedicating a significant part of my fieldwork to interviews with EFC participants (12 of the 21 interviewees were EFC members or EFC alternates), analysing

the discourse of the EFC in relevant EU documents and tracing the involvement of the Committee in cultural and organisational procedures, this thesis provided a substantial empirical addition to the literature on the EFC.

The thesis corroborated the centrality of the EFC in the economic governance of the Eurozone. It confirmed the EFC's role in the presentation of ECOFIN agenda items as "shared problems" (Puetter, 2006: 143; Dyson, 2000: 76). However, the thesis moved beyond that, unveiling the EFC's capacity to create new meaning out of its practices. As was shown in Chapters 6 and 7, the EFC can shape not just the agenda of the ECOFIN but the taken-for-granted understandings of the other Eurozone policymakers, including politicians in the Council and the European Parliament. By influencing the very interpretations of interest of decision-makers, the EFC was proven to be able to shape not only the day-to-day decisions of the ministers but also the structural foundations of the EMU. Consequently, this thesis points to the necessity of a reappraisal of the role of the EFC within the EMU by scholars and politicians.

A closer look at the impact of the EFC on the EMU is pertinent to the evolving discussion on the status and the function of a different decision-making body of the EMU, the Eurogroup (Braun and Hübner, 2019; Craig, 2017).¹ Attention to the latter has significantly increased after the 2015 public confrontation of the then Greek Finance Minister, Yanis Varoufakis, with his counterparts in the context of the renegotiation of the terms of the financial assistance to Greece (Hodson and Puetter, 2016: 377; Featherstone, 2016: 52-56; Henning, 2017: 201-231; European Stability Mechanism, 2019: 311-320). The efforts of Varoufakis, a Professor of Economic Theory, to negotiate with the other ministers at the Eurogroup on the substance of the arrangements were repeatedly frustrated as he failed to circumvent the level of the EFC experts (Varoufakis, 2017: 221-447). Several months after leaving office, Varoufakis pointed out that as his ministerial colleagues lacked an appropriate understanding of the economic policy issues, they relied on the work of the experts to make decisions:

Every single decision they made in there [the Eurogroup], firstly they never consulted anyone about. Secondly, they themselves were not consulted. *Their aides reached those decisions behind closed door[s] and then told the ministers.* The ministers didn't even *understand* what they were agreeing to. And thirdly, they never even announced it. It's not just that the populations were presented with a *fait accompli*.

(Varoufakis, 2016, my emphasis)

The conclusions of this thesis highlight the importance of examining the activity of the preparatory bodies of the ECOFIN and the Eurogroup to explain the course of European economic policymaking. The connotation is that research on the Eurogroup or the ECOFIN cannot rely exclusively on the analysis of ministerial public statements. A coalface approach is essential: digging into the work of the preparatory bodies can reveal a lot more about the rationale of the final decisions.

8.3 An Ordoliberal Reform?

This thesis provides some important insights on the impact of ordoliberalism on the post-crisis EMU. Mark Blyth's seminal work on austerity advanced the hypothesis of a post-crisis "ordoliberalisation" of the EU to explain the Union's turn to austerity in the aftermath of the financial crisis (2013a). Other scholars not interested in the issue of austerity adopted the ordoliberalisation hypothesis by examining the post-crisis structure of the EMU and linking the policy arrangements to specific ordoliberal concepts. The provisions of the EEG reform were also part of these analyses. Nedergaard and Snaith (2015) argued that the Six-Pack, the Two-Pack and the Fiscal Compact operationalised two particular ordoliberal principles: the predictability of economic policy and the constancy of economic policy contributing to the "incremental ordoliberalization" in the EMU framework after the crisis. Werner Bonefeld stressed that after the adoption of the new fiscal provisions, the Eurozone continued to adhere to the system of subsidiarity emanating from the economic constitution (2017: 135-154). In line with the ordoliberal doctrine, fiscal policy remained a national responsibility, while the Union's involvement in national budgets only reflected its negative fiscal powers. The Six-Pack and the Fiscal Compact were seen as a strengthening of the SGP thereby asserting the ordoliberalisation hypothesis. Additionally, as was shown in Chapter 2, a number of political economists argued that German ordoliberal ideas influenced the decisions of Eurozone policymakers shaping the structure of the post-crisis governance framework, thereby enhancing the ordoliberalisation assumption.

The post-crisis ordoliberalisation of the Eurozone has been rejected by the ordoliberal standard-bearers at the Walker Eucken Institut and the University of Freiburg, who stressed the breach of ordoliberal principles (Feld, Köhler and Nientiedt, 2015). For them, even the German stance had to be considered as an example of pragmatic adaptation rather than strict adherence to the ordoliberal doctrine. Their critique, however, was based on the analysis of the developments

in the monetary policy field, the examination of the establishment of the ESM and the rejection of Eurobonds. By focusing on the developments in the field of fiscal and structural governance, this thesis reaches a similar conclusion: the European Economic Governance reform did not comply with the ordoliberal doctrine.

This thesis has proved the emergence of a distinct economic policy belief with far-reaching implications on the Eurozone's post-crisis structure of economic governance: institutions-based discipline. This belief is fundamentally incompatible with some core assumptions of ordoliberalism. Firstly, the economic *raison d'être* of institutions-based discipline, namely the implementation of constrained discretion, directly undermines the cherished "consistency of economic policy" of the ordoliberals. The combination of short-run flexibility with long-term discipline is by definition opposite to a permanent fiscal policy. As Werner Bonefeld succinctly notes, "[d]iscretionary policy making tends thus to be at variance with the rules of the game and makes economic policy unpredictable and unprincipled. Interventionism becomes muddled to the detriment of constancy in economic policy" (2017: 72). It should be recalled that ordoliberals do not acknowledge the value of the Keynesian stabilisation policy (Eucken, 1952 [1982]: 128-130). In contrast, they perceive discretionary fiscal policy as a threat to the price mechanism and the system of the free competition due to its distortive effects on taxation and investments. An unstable fiscal policy would discourage (private) long-term investments and even lead to greater business concentration in the industry as multi-company groups would be better equipped to deal with increased uncertainty (*ibid.*). Therefore, any form of discretionary fiscal policy is anathema to ordoliberals.

Secondly, the preoccupation of institutions-based discipline with the centralisation of budgetary procedures and the delegation of fiscal policymaking to independent fiscal institutions challenges the ordoliberal concept of the self-limited state. Institutions-based discipline restricts the influence of parliaments on budgetary policymaking but at the same time empowers parts of the executive to implement the appropriate policy (which varies at different periods). This aspect of the institutions-based belief is highly problematic for ordoliberalism as the Freiburg school loathes any direct political intervention in the economy. At this point it is important to reiterate that for ordoliberals shielding the state from popular demands is not enough. The state must be able to retain its independence from powerful economic interests that seek to be granted special privileges. In contrast to *laissez-faire* liberalism, ordoliberalism acknowledges the concentration of private economic power as a fundamental problem of market economies endangering the overarching principle of complete competition (Böhm,

1947 [2017]: 121-131). According to this view, the strong state is not the state that has increased (executive) authority as this state can become a prey of powerful interests. The strong state is the self-limited state that can stand above private economic agents and act as a guardian of the competitive order (Rüstow, 1932 [2017]: 144-148). For this reason, it is imperative that the state influences the economy indirectly through the use of the legal framework (Vanberg, 2014; Bonefeld, 2017: 73-74). Ordoliberals insist that the executive must be constrained by constitutional rules and the judiciary. The centralisation of budgetary policymaking to members of the executive makes the latter a target of powerful economic interests and, in this sense, it is incompatible with ordoliberalism. Indeed, ordoliberalism opposes the use of economic judgement as a way of implementing fiscal constraints favouring the use of automatic sanctions that preclude the discretionary judgement of the executive.

Thirdly, institutions-based discipline, when implemented at the EU-level, contravenes another fundamental principle of ordoliberalism: liability. According to Walter Eucken, “[t]hose who benefit from something must also be prepared to bear a loss if need be” (1952 [1982]: 126). The system of complete competition links profitability to equivalent economic performance. Passing losses to others is unacceptable for ordoliberals. Accountability in law must always be preserved, even if this means the bankruptcy of businesses. In the context of the EMU, it is natural for ordoliberals to try to prevent economic agents of one member state from passing their losses to market participants of other member states via the common fiscal framework. The national responsibility for fiscal policymaking promoted by ordoliberals seeks to contain the effects of bad fiscal decisions within the confines of national economies (Issing, 2014). Decentralised fiscal decision-making ensures that businesses enjoying the benefits of more lax fiscal policies will suffer the consequences when the relevant state is forced to consolidate its public finances. Ordoliberals insist that the decentralised system of fiscal policymaking creates the right incentives for national governments. A government realising that its economy will pay the price for its own lax behaviour is expected to act responsibly. The shared responsibility for national fiscal policymaking promoted by the institutions-based belief undermines the liability principle. Discussions on the aggregate fiscal stance of the Eurozone open up the possibility of free riding and moral hazard. The fiscal tightening of some member states might enable others to postpone difficult decisions. This means that businesses enjoying the benefits of national expansionary fiscal policies (inter alia: lower taxation, increased public investment) might avoid the downsides as the common fiscal framework concentrates on the aggregate

fiscal position of the Eurozone. The unfair treatment of economic agents in different member states impedes complete competition, the primary concern of ordoliberalism.

The clash of the institutions-based belief with the ordoliberal ideas casts doubt on the post-crisis ordoliberalisation hypothesis. At the same time, it should be stressed that the Eurozone's departure from the ordoliberal doctrine was only partial. In contrast to the centralisation of the fiscal and structural coordination, debt mutualisation was not established at the time. As was shown in Chapter 7, the Council resisted the efforts of the European Parliament to include Eurobonds in the Two-Pack. It seems that the ordoliberal concept of liability was stronger when it was linked to the assumption of debt rather than the fair contribution to the fiscal effort. Ordoliberalism remained relevant in some areas of the post-crisis EMU but became severely challenged in others. Political economists studying the structuring of power within the Eurozone are advised to pay attention to the multiplicity of policy developments before reaching conclusions.

8.4 Limitations & Future Research Trajectories

8.4.1 Limitations

This thesis has examined the strengthening of the European economic coordination after the financial crisis. As was explained in Chapter 1, such a focus on the “E” of the EMU is warranted given the asymmetrical design that had been decided at Maastricht. At the same time, this thesis has omitted the analysis of the “M” of the EMU. Indeed, after the financial crisis the ECB devised and deployed a variety of monetary policy instruments that stretched the limits of its legal authority under the Treaty framework creating important controversies (Scicluna, 2018). The Central Bank, particularly under the Presidency of Mario Draghi (2011-2019), managed to navigate the Eurozone out of the crisis but at times it had to overstep its mandate (De Grauwe and Ji, 2013; Falagiarda and Reitz, 2015; Lombardi and Moschella, 2016; Tooze, 2018: 422-446). It appeared that the Bank even encroached into the field of fiscal policy by implementing unconventional monetary instruments that gave it a “quasi-fiscal role” (Buiter and Rahbari, 2012; Sinn, 2018; Tesche, 2019). A more complete account of the EEG reform would need to engage in a parallel analysis of the organisational developments in the economic and monetary policy fields. However, this choice would have led to an exponential increase in the number of documents that had to be analysed as well as the number and the length of the interviews that

had to be conducted. To ensure the feasibility of this research, I proceeded to a judicious selection of ECB Monthly Bulletins and Reports illuminating aspects of the EEG reform, such as the role of the ECB in the Six-Pack negotiations or the post-crisis weakening of the price stability beliefs, and did not explore the innovations of the monetary policy.

A second limitation was the non-inclusion of the financial assistance mechanisms in the analysis of the European Economic Governance reform. A more complete account of the post-crisis revision of the economic coordination in the EMU would require the examination of the arrangements included in the permanent European Stability Mechanism that was created in 2012 (European Stability Mechanism, 2019). The ESM was established outside the Treaty framework (Henning, 2017:169-174). The mechanism presented a dual embeddedness: it was an international organisation embedded in the EU governance system (Howarth and Spendzharova, 2019). The dual nature of the mechanism meant that its establishment did not just rely on interinstitutional or intergovernmental negotiations within the EU but required the approval of national parliaments as well, thereby increasing the complexity of the negotiations (Moschella, 2017). Also, the mechanism drew heavily on the provisional European Financial Stability Facility (EFSF) of 2010.² The mechanism provided for the full participation of the International Monetary Fund (IMF) in the assistance and organised the economic coordination of the countries receiving support in a similar way to the IMF's long-established practice of macroeconomic conditionality for the disbursement of its loans (Hodson, 2015). The ESM retained the bespoke trilateral monitoring process of the EFSF that included the Fund, the Commission and the ECB, the so-called "Troika", by adding the ESM as a fourth part (the Troika was renamed "the Institutions"). It is evident then that the decision-making process leading to the establishment of the ESM provisions deviated significantly from those of Eurozone governance examined in this thesis. Consequently, an inclusion of the analysis of the financial assistance arrangements would require a large-scale research on the monitoring practices of the IMF and the troika as well as assessing the role of national parliaments in the creation of the mechanisms. The addition of a large number of documents in the analytical process and extra themes in the interviews would entail a loss of focus derailing my research. For this, I selectively concentrated on the aspect of the ESM negotiation that was directly related to the EEG reform: Germany's attempt to make the adoption of the Fiscal Compact a prerequisite for its support for establishing the ESM (see Chapter 7).

A third limitation was the level of secrecy of the EFC. Important documents presented and discussed in the Committee were not publicly available. To alleviate this problem, I expanded

my research for relevant publicly available documents and increased the number of conducted interviews. In total, I conducted 21 interviews.

8.4.2 Future Research Agenda

The organisational developments in the field of European economic coordination after the conclusion of the legislative reform of European Economic Governance in 2013 offer promising research avenues. The Eurozone's organisational framework of fiscal and economic coordination did not remain static. In January 2015, the Commission issued an "interpretative Communication" that further increased its discretion in the application of the fiscal framework (European Commission, 2015c). A few months later, the President of the Commission in close collaboration with the Presidents of the European Council, the Eurogroup, the ECB and the European Parliament issued a Report on the completion of the EMU (the so-called Five Presidents' Report) advocating transition to a Fiscal Union (Juncker et al., 2015). The Report was followed by a Reflection Paper on the Deepening of EMU (European Commission, 2017g). In line with the recommendations of the Report, the Commission established an independent advisory European Fiscal Board (Commission Decision 2015/1937), discussed the creation of the post of a "European Minister of Economy and Finance" (European Commission, 2017c) and promoted the idea of setting new financial instruments supporting the stabilisation of national economies and assisting with the delivery of structural reforms (European Commission, 2017b). In June 2019 the leaders of the Eurozone endorsed the idea of a Budgetary Instrument for Convergence and Competitiveness (BICC) mandating the Commission and the Eurogroup to work on detailed arrangements (Euro Summit, 2019). Scholars have quickly acknowledged that the discussed proposals about the reorganisation of fiscal governance deviated significantly from the Maastricht model of decentralised fiscal policymaking (Wickens, 2016; Herzog and Choi, 2017; Patrin and Schlosser, 2019).

Future research could explain the emergence of the proposals on Fiscal Union through the lens of Eurozone's underlying economic policy beliefs.³ The evolution of the Eurozone's Sound Money paradigm in 2008-2010 can provide important insights on the willingness of the Eurozone's policymakers to move further away from the Maastricht model after 2015 and contemplate alternative organisational forms. Indeed, the centralisation of fiscal governance via hierarchical structures (a European Finance Minister) and the interaction between fiscal and structural policies (a *Budgetary* Instrument for the support of *structural* reforms) are closely

linked to the strengthening of institutions-based discipline and the emergence of constrained discretion in the aftermath of the financial crisis of 2007-2009. Additionally, the institutions-based discipline belief could help scholars understand a different development in the EMU after 2013: the Commission's increased flexibility in the application of the fiscal and macroeconomic framework (European Court of Auditors, 2018: 65-66). Similarly, it can shed light upon the reasons for the increasing bilateralism of the surveillance process. The latter became noticed as a distinctive trend of Eurozone governance by three interviewees (Anonymous Interviewees 11, 16, 17). The increasing politicisation of the Commission is a closely related trend that can be explained by the emergence of constrained discretion (Moscovici, 2019). Indeed, the use of judgement by the Commission in the application of the fiscal framework intensified the political character of EU-level decisions raising the profile of the relevant European Commissioner. It is interesting to explore whether political appointments to the European Commission affected the level of leniency of the fiscal framework and its uniform application.

A second area of future research could be the impact of the reformed framework of economic governance on national democratic policymaking in budgetary and structural policies. Admittedly, some scholars have shown increased interest in this particular issue over the past few years. Brigid Laffan (2014) was one of the first to underline the decline of the democratic responsiveness at the national level as a result of the "politics of the constrained choice" brought about by the new framework. Vivienne Schmidt (2015) advanced similar arguments. Others have focused on the effects of the EEG reform on the role of national parliaments in (national) economic policymaking highlighting the emerging problems of parliamentary scrutiny and control (Dawson, 2015; Maatsch, 2017; Lord, 2017; Crum, 2018; Hallerberg, Marzinotto and Wolff, 2018). Davor Jančić (2016) has even concentrated on the adaptation of the Parliaments to the restrictions of the framework by tracing their efforts to mitigate the centralisation of fiscal coordination. However, the above literature is missing an important dimension of the revised framework: the purposeful intervention in domestic budgetary procedures to limit the influence of spending ministries and parliaments on the formation of budgets. The restriction of parliamentary scrutiny and the decreasing responsiveness of the national budgetary processes are not simply side effects or unintended consequences of the revised framework but constitute the primary objectives of the 2010-2013 legislative reform. For Eurozone elites, democracy in fiscal policymaking *is* the problem, not the solution as democratic bodies are seen to be prone to deficits. It follows that by paying attention to the

institutions-based nature of the EEG prospective research can provide a more in-depth understanding of the structural restrictions placed to democratic policymaking by the revised organisational framework and incorporate a more critical approach to the analysis.

Future research could also focus on the growing tension between the Court of Justice of the European Union (CJEU) and the German Federal Constitutional Court (FCC) over the transformation of Eurozone's economic constitution. Over the past decade the European Court issued judgements that interpreted the legal framework of the EU in such a way that allowed the other EU institutions to overcome the restrictions of the Treaty framework and establish various crisis management mechanisms, such as the ESM and the extraordinary monetary policy instruments of the ECB. On 5 May 2020, the FCC found that the Quantitative Easing programme (QE) exceeded the monetary policy mandate of the ECB and obliged the Bundesbank to terminate its participation in the programme within three months unless the ECB Governing Council adopted a new decision demonstrating the proportionality of the QE (Federal Constitutional Court, 2020). Most importantly, the FCC ruled that an earlier judgement of the CJEU on the issue (*Weiss* case) had no binding force in Germany because the interpretation of EU law by the European Court exceeded its judicial mandate. The judgement of the Federal Court represented a serious challenge to the European legal order creating the prospect of a constitutional crisis within the EU (Arnold and Stubbington, 2020; Chazan, Fleming, and Arnold, 2020; von der Burchard, 2020). The quick response of the Bundesbank in tandem with the German government and the Bundestag took the steam out of the particular case but the underlying tensions between the two powerful courts is not likely to go away (Arnold and Chazan, 2020; Marsh, 2020).

An analytical turn to the evolution of the Eurozone's Sound Money beliefs can shed light upon the extraordinary constitutional conflict. For instance, in its landmark *Pringle* case, the CJEU distinguished "price stability" from "the stability of the euro area as a whole":

As regards, first, the objective pursued by that mechanism [the ESM], which is to safeguard the stability of the euro area as a whole, that is clearly distinct from the objective of maintaining price stability, which is the primary objective of the Union's monetary policy. Even though the stability of the euro area may have repercussions on the stability of the currency used within that area, *an economic policy measure cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have indirect effects on the stability of the euro.*

(Court of Justice of the European Union, 2012: par. 56, my emphasis)

By so doing, the CJEU confirmed the decline of the primacy of price stability belief within the EMU turning the Maastricht model on its head. Price stability, the monetarist touchstone, was no longer the yardstick against which all other policy objectives had to be measured. The CJEU accepted that other economic policy objectives were equally important. In contrast, in its judgement of 5 May 2020 the FCC seemed to defend the monetarist doctrine of the Maastricht model according to which monetary policy could not be used to fine tune the economy. The FCC noted that

The ESCB [the European System of Central Banks] is to merely *support* the general economic policies *in* the European Union (...) it is not, however, authorised to pursue its own economic policy agenda.

(Federal Constitutional Court, 2020: par. 163, emphasis in the original)

Tracing divergences in the taken-for-granted understandings of the two courts regarding economic and monetary policy can provide significant insights on the reasons behind their constitutional conflict.

The function of the framework of European Economic Governance during the unprecedented COVID-19 pandemic is another promising research area. The “Great Lockdown” triggered “a crisis like no other” marked by a synchronised global shock in supply and demand (International Monetary Fund, 2020a; 2020b; Wolf, 2020).⁴ The Eurozone was not immune to the economic effects of the shutdown. The ECB reacted swiftly by announcing a new monetary policy instrument on 18 March 2020, namely the Pandemic Emergency Purchase Programme (PEPP), designed to support the increased borrowing needs of the member states and the financing of corporate debt (Arnold, 2020; Decision 2020/440). A few days later, the Commission issued a communication on the activation of the general escape clause of the reformed fiscal framework that became endorsed by the ECOFIN (European Commission, 2020a; Council of the European Union, 2020). Practically, this meant that governments could deviate from the prescribed fiscal adjustment paths and use discretionary fiscal policy to stabilise their economies. Recourse to the Eurozone’s evolved Sound Money beliefs can explain the above developments. The substitution of the primacy of price stability with the balanced concern about monetary, economic and financial stability in the Eurozone led the ECB to create a new policy instrument to accommodate increased public and private spending.

Constrained discretion mandated the use of discretionary fiscal policy to stabilise the economy. In line with the institutions-based discipline belief, the Commission used economic judgement to enable governments to run deficits after assessing the economic situation at the national *and* the aggregate level.

An even more interesting dimension has to do with the limitations of the institutions-based discipline. As the economic crisis caused by the pandemic continued to unfold, member states made use of the fiscal framework's available flexibility announcing a series of measures to support the economy. The Commission's decision to effectively suspend the EU framework on state aid gave member states even more discretion. However, Eurozone policymakers soon realised that while COVID-19 represented a symmetric economic shock, the economic policy response of the Eurozone was asymmetric: member states with stronger fiscal positions could provide a much higher level of support to their economies (European Commission, 2020b: 5-8).⁵ In turn, this tendency jeopardised the Single Market. Indeed, the Commission Services warned about "a permanent distortion of the level playing field of the Single Market and increased divergence of living standards" (European Commission, 2020b: 6). Future research could explore the linkage between the promotion of fiscal transfers among the member states and the inadequacies of the institutions-based approach in the coordination of the COVID-19 response. The limited fiscal headroom in certain member states signaled the need for a centralised fiscal instrument to supplement EU-level guidance. The surprising endorsement of the Spanish proposal for the establishment of a Recovery Fund based on grants by a majority of member states, including Germany and France, and the EU institutions should be seen in the light of the growing divergences within the EMU (Dombey, 2020; Hall and Arnold, 2020; Fleming, Mallet and Chazan, 2020).⁶

8.4.3 Final Note

The sustainability of the Eurozone's Sound Money paradigm remains an open question. This thesis has shown how the evolution of the economic policy beliefs of Eurozone policymakers on the issues of stability and discipline averted a full-scale return of Keynesianism within the member states of the EMU in the aftermath of the financial crisis. However, the new ideas were met with increasing uneasiness by those German elites that remain deeply entrenched in the ordoliberal doctrine. In parallel, the evolved beliefs have disturbed the relationship between the national executives and the European executive as well as that between national executives

and national legislatures further exacerbating the democratic deficit of the EU and the crisis of representation within the member states. Most importantly, the adjusted Sound Money paradigm is now faced with the destabilisation of the global economic order and the return of (economic) nationalism, accelerated by the pandemic (Financial Times, 2020; Rachman, 2020). Whether this tendency will persist and develop into a countermovement against globalisation à la Polanyi (1944 [2001]) leading to the protection of societies from the perils of the market through increased regulation is currently unknown. It is highly probable that the EMU and the reformed framework of European Economic Governance will be subject to considerable pressures over the next decade.

John Maynard Keynes in the last lines of his *General Theory* stressed that “[p]ractical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist” (1936 [2008]: 239). This thesis has shown that the EMU relies heavily not only on the past work of deceased economists but also on the confidential discussions of living economic policy experts participating in the EFC. The questions that these people will ask and the answers that they will provide will be key for the resilience of the EMU in the future.

¹ The Eurogroup is a subgroup of the ECOFIN. Its preparatory body is a subgroup of the EFC called the Eurogroup Working Group (EWG). See Chapter 3 (section 3.5.3).

² Formally the EFSF was a Special Purpose Vehicle incorporated under Luxembourg law. Another financial assistance instrument was the European Financial Stabilisation Mechanism (EFSM) created under EU law. The latter’s small lending capacity in comparison to the EFSF made it largely irrelevant.

³ The discussion on the Fiscal Union was an important development. As one interviewee put it: “[P]articipation in a Fiscal Union is massive. More massive than joining the EMU, even more massive than joining EU itself” (Anonymous Interviewee 01).

⁴ The outbreak of the corona virus in China in January 2020 forced the country to impose a regional lockdown that resulted in a severe contraction of industrial and economic output (Weinland and Liu, 2020). As the virus spread rapidly worldwide, one country after the other imposed nation-wide lockdowns and social distancing measures (Safi, 2020; Taylor, 2020).

⁵ The Commission Services noted that on May 1, 2020 52% of all state aid provided by EU member states came from Germany (European Commission, 2020b: 6).

⁶ The Commission tabled a formal proposal on a Recovery Instrument on 28 May 2020 (European Commission, 2020c). Four countries, namely Austria, Denmark, the Netherlands and Sweden, resisted the provision of grants and promoted the provision of loans under strict conditionality (Khan, 2020). At the time of writing the Commission’s proposal was still under discussion.

ANNEX I. PARTICIPANT CONSENT FORM

Title of Research Project:

“ECOFIN and the Post-crisis Institutionalisation of European Economic Governance: A Sociological Institutional Approach”

Name of Researcher: Dimitrios Argyroulis

Participant Identification Number for this project:

Please initial box

1. I confirm that I have read and understand the information letter dated explaining the above research project and I have had the opportunity to ask questions about the project.
2. I understand that my participation is voluntary and that I am free to withdraw at any time without giving any reason and without there being any negative consequences. In addition, should I not wish to answer any particular question or questions, I am free to decline.
Contact number: +44-----
3. I understand that my responses will be kept strictly confidential. I give permission for members of the research team to have access to my anonymised responses. I understand that my name will not be linked with the research materials, and I will not be identified or identifiable in the report or reports that result from the research.
4. I consent to the recording of my responses through the use of voice recording equipment. I understand that any recorded audio files will be securely stored on the Lead Researcher’s personal space on the University server and labelled with an appropriate code to link them to the original participant and consent form. If they need to be stored on a personal computer or laptop then they will be stored in an encrypted folder and each file password protected. Original audio files will be destroyed following the successful completion of the project or in any case within five years after their production. Transcription and analysis will be done by the Lead Researcher at the University.
5. I agree for the data collected from me to be used in future research
6. I agree to take part in the above research project.

Name of Participant

Date

Signature

Dimitrios Argyroulis
Lead Researcher

Date

Signature

Copies:

ANNEX II. INDICATIVE LIST OF INTERVIEW QUESTIONS

1. EFC discussions in the aftermath of the financial crisis (2008-2009)

1.1 Were EFC members concerned about the ability of the financial markets to discipline public finances?

-When did these concerns emerge?

-Did you share these concerns?

1.2 Member States adopted various stimuli packages in 2008 – 2009 to boost demand and consumer confidence.

-What was the role of the EFC in the adoption and the implementation of those packages?

-Were there any worries within the EFC that this turn to demand management was against the core policy ideas of the EMU?

2. Introduction of European Economic Governance reform in EFC discussions (2009-2010)

2.1 During the last months of 2009 and early 2010 there was an ongoing discussion about ‘fiscal exit strategies’ and the restoration of the sustainability of public finance. The European Commission had issued a relevant Communication in October 2009 calling for the fast reduction of the debt ratio.

-Why did the new plan come in sharp contrast to the Commission’s European Economic Recovery Plan of 2008?

-What was the rationale behind the endorsement of the necessity for substantial fiscal consolidation?

-Was this discussion on fiscal exit strategies linked to the reform of the SGP? If so, who proposed such a link?

2.2 The Stability and Growth Pact preceded the recent reforms of European fiscal governance. Indeed, it had been reformed in 2005.

-Did the previous arrangement (SGP 2005) present any weaknesses or signs of policy failure? If so, in which areas?

-Did you lose your trust in this framework? If so, when did this happen?

-Did everybody agree with the definition of the problem?

2.3 One of your colleagues told me that there was a significant mistrust towards politicians within the EFC; that the politicians could not be trusted with the implementation of the old framework and that a new approach was required.

-Would you agree with this?

-Did you feel that there was a consensus on this issue among EFC members?

2.4 At some point the EFC started debating the prospect of an SGP reform.

-When did this happen?

- Who brought the issue of an economic governance reform to the table?
- Which were your initial reactions? Did you welcome it or did you raise any concerns?
- How much time did it take to build consensus on the necessity of the reform?

2.5 The Greek sovereign debt crisis was unfolding in parallel to the discussions on the fiscal framework.

- Did the evolving sovereign debt crisis in Greece play any role in convincing you about the necessity of the reform of fiscal governance?

3. Early discussions on the direction of the economic governance reform (2010)

3.1 At some point the EFC started discussing about the shift to ex ante coordination of fiscal and macroeconomic policies.

- When did this happen?
- What was the logic behind the proposed strengthening of ex ante coordination?
- Was any other national or international setting used as a model for ex ante coordination?
- What was your own rationale on the issue?
- Who were the main proponent of ex ante coordination?

3.2 One of the EFC members told me that the logic of the old SGP was based on outcomes whereas with the reform “countries are more or less directly told what to do”.

- How do you respond to this? Would you agree that the new framework incorporates a new logic?

3.3 Was the alignment of the SGP and Europe 2020 governance via the European Semester unanimously supported by members or did this idea raise any doubts?

- Did you support the synchronisation?

4. Formal negotiations on the legislative proposals (2010 - 2013)

4.1 The European Semester was the first item of the proposed reforms that became institutionalised through the revision of the code of conduct in September 2010.

- Why was this item prioritised? Does this indicate a primacy of importance compared to the other elements of the legislative package?

-The Semester was not included in the Commission’s initial legislative proposals and was incorporated in the dossier at a later stage at the request of the Parliament. Why did the members opt to avoid its inclusion in secondary legislation?

4.2 A significant part of the legislation concerns the focus on macroeconomic imbalances. Surpluses constitute imbalances as much as deficits. The legislation, however, adopts an asymmetric approach for these two.

-Were there any calls for a more symmetric approach and potentially the imposition of sanctions for excessive surpluses?

-Did you endorse a more symmetric approach?

4.3 A persistent issue during the negotiation on the legislative proposals seems to be the adoption of the scoreboard.

-Why were the members so sensitive about the so-called inflation of the scoreboard pursued by the Parliament?

4.4 What was the necessity of the Fiscal Compact given that the Six Pack had already been adopted in 2011?

4.5 What was the necessity of the Two pack and especially the adoption of the provisions on Draft Budgetary Plans?

4.6 What changed since 2010 when there was no initial inclusion of the Semester in the proposed legislation?

-What happened to the “light approach” to the Semester?

ANNEX III. LIST OF INTERVIEWS

Participant	Date of Interview	Place of Interview
Anonymous Interviewee 01	17 July 2017	Member State A
Anonymous Interviewee 02	15 November 2016	Member State B
Anonymous Interviewee 03	07 December 2016	Member State A
Anonymous Interviewee 04	07 December 2016	Member State A
Anonymous Interviewee 05	21 December 2016	Conducted via <i>Skype</i>
Anonymous Interviewee 06	19 December 2016	Member State C
Anonymous Interviewee 07	20 December 2016	Member State C
Anonymous Interviewee 08	20 June 2017	Member State A
Anonymous Interviewee 09	14 June 2017	Member State D
Anonymous Interviewee 10	19 June 2017	Member State E
Anonymous Interviewee 11	18 July 2017	Member State A
Anonymous Interviewee 12	08 September 2017	Member State F
Anonymous Interviewee 13	19 October 2017	Member State G
Anonymous Interviewee 14	11 October 2017	Member State C
Anonymous Interviewee 15	16 October 2017	Member State A
Anonymous Interviewee 16	19 October 2017	Member State G
Anonymous Interviewee 17	24 October 2017	Member State H
Anonymous Interviewee 18	24 October 2017	Member State H
Anonymous Interviewee 19	31 October 2017	Member State B
Anonymous Interviewee 20	11 October 2018	Conducted via <i>Webex</i>
Anonymous Interviewee 21	29 October 2018	Member State G

Note: Anonymous Interviewees 01, 02, 03, 05, 06, 08, 09, 10, 14, 15, 17, 19 were EFC participants.

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