

The European Union as a Trigger of Discursive Change:

The Impact of the Structural Deficit Rule on Fiscal Policy-Making

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Abstract: This paper explores both theoretically and empirically what kind of impacts a rule prescribed by the European Union has on policy discourse in a member state. Drawing on the literature of discursive institutionalism and Europeanization, the theoretical discussion developed in the paper provides an outline of factors that influence the discursive shifts triggered by an externally imposed rule. The empirical part examines the discursive impacts of the introduction of the structural budget deficit rule, prescribed by the Fiscal Compact, in Estonia and Latvia. The paper shows that the externally imposed rule has led to discursive shifts in fiscal policy-making in both countries. It demonstrates that such shifts are influenced by the nature of the imposed rule, existing policy legacies, experience of the crisis, institutional features of the polity and the strategic interests of policy actors.

Key words: discursive institutionalism, Europeanization, fiscal policy, fiscal rules, crisis

1. Introduction

There is a growing understanding in governance research that in order to understand and to explain institutional development and policy change, we need to pay attention to the role of *ideas* and *discourse*. Discursive institutionalism (e.g. Schmidt 2008, 2010, 2011) and related ideational research streams (e.g. Campbell 1998; 2004; Beland and Cox 2011; Carstensen 2011) have contributed significantly to giving ideas and discourse a more prominent position. Indeed, discursive institutionalism (DI) – a framework for analysis that focuses on the substantive content of ideas and the interactive processes of discourse in institutional context (Schmidt 2008, 2010) – has been considered to be more fruitful in exploring and explaining policy *change* than the other three institutionalisms (rational choice, historical and sociological) which have more static orientations (Carstensen 2011; Crespy and Schmidt 2014; Schmidt 2009, 2011; Schmidt and Radaelli 2004).

With the increasing role played by the European Union (EU) in the policy-making arenas of the European countries, understanding the kinds of *ideational* and *discursive* impacts that EU-imposed rules can have has become more important than ever. Most of the studies on Europeanization, however, tend to focus on shifts in member states' policies themselves (Cowles et al. 2001; Börzel and Risse 2003), rather than on the ideational and discursive mechanisms that may act as drivers of change.¹ As Schmidt and Radaelli (2004, p. 184) have emphasized, however, without examining the impact of the EU on the policy discourses of its member states, our understanding of Europeanization remains incomplete.² Indeed, given that shifts in discourse can play a role in bringing about longer-term policy change (e.g. Campbell 2004; Schmidt 2002; Schmidt and Radaelli 2004; Radaelli 2003), it would be useful to synthesize further the perspectives of DI and Europeanization research and explore more systematically what kind of discursive shifts are triggered in member states by EU-imposed rules.

Thus, the focus of our paper is to continue the endeavour of blending insights from the DI and Europeanization literatures, initiated by Schmidt and Radaelli (2004), and to explore – both theoretically and empirically – what kind of impacts a rule prescribed by the EU can have on policy discourse in a member state. While Schmidt and Radaelli (2004) pointed to discourse as a factor that *mediates* the impacts of EU rules on member states' policies, our paper focuses on a somewhat different issue: namely, when do EU rules lead to *discursive changes* in a member state? As a first step – drawing on the existing literature on DI, related streams of ideational

¹ For exceptions, see Busch (2004), Capano and Piattoni (2011), and Thatcher (2004).

² In our paper, “Europeanization” refers to “domestic adaptation to the pressures emanating directly or indirectly from EU membership” (Featherstone 2003, p. 7).

research and Europeanization studies – we provide a theoretical discussion exploring this question. As a second step, in order to examine the plausibility of the conjectures developed in the theoretical part, we undertake an empirical analysis of the ideational and discursive impacts of the introduction of the structural budget deficit rule in two EU member states: Estonia and Latvia. The Fiscal Compact (or the Treaty on Stability, Coordination and Governance) signed in March 2012 and enacted in 2013 required the members of the eurozone to stipulate a structural deficit rule in their domestic legislation (Jaonnou et al. 2015). Hence, the research questions addressed in our empirical analysis are: What kind of ideational and discursive impacts did the introduction of the structural budget deficit rule have on the fiscal policy-making arenas of these two countries? Did the incorporation of this new – and externally imposed – rule change the fiscal policy discourse? If yes, then how? And what kind of factors contributed to these shifts?

The case selection for the empirical study was based on the following considerations. The Fiscal Compact requires the members of the euro-zone to establish a structural deficit rule, which prescribes a focus on the *cyclical* stance of the budget and entails a *counter-cyclical* role for fiscal policy. Thus, it would be insightful to examine the impacts of the structural deficit rule on polities where fiscal policy-making has hitherto focused on the *nominal* stance of the budget and been *pro-cyclical*. Since the regaining of independence in the 1990s, fiscal policy-making in both Estonia and Latvia has focused on nominal balance and has tended to be pro-cyclical (Kattel and Raudla 2013). Hence, for our purposes, they could be regarded as revelatory cases. Furthermore, because of their similar historical legacies, Estonia and Latvia can be regarded as “the most similar” cases. This allows us to examine the impacts of their small differences on the changes in fiscal policy discourse and tease out the effects of various mediating factors on the discursive shifts.³ As sources of data for the two cases, we used semi-structured interviews with civil servants working in the finance ministries, policy documents, verbatim records of the legislative debates and media articles from 2013 to 2015. The paper is structured as follows. Section 2 outlines the theoretical arguments, followed by empirical analysis in section 3. Section 4 discusses the findings and provides conclusions.

2. Theoretical discussion

Before zooming in on the theoretical discussion of how EU-imposed rules can influence policy-making discourse in a polity, it would be useful to clarify what we mean by “discourse” and why it is important to study it. Drawing on Schmidt and Radaelli (2004, p. 184), “discourse” in our paper is defined “in terms of its content, as a set of policy ideas and values, and in terms of its usage, as a process of interaction focused on policy formulation and communication”. With regard to the *interactive* dimension of discourse, Schmidt (2008) distinguishes between two broad types of political discourse: *coordinative* and *communicative*. While coordinative discourse takes place between policy-makers and is aimed at policy construction and elaboration, communicative discourse is directed from policy-makers to the electorate and aims to persuade the public that a chosen policy is necessary and desirable (Schmidt 2008, 2011).

The central argument of DI is that in order to understand and explain policy change, it may not be sufficient to look at the interests, political institutions, and existing norms, as suggested by the three older institutionalisms (rational choice, historical and sociological, respectively). In addition, we should pay attention to discourse since it can play a significant role in shaping

³ For example, while Estonia has been praised as the poster-child of fiscal conservatism in Europe (e.g. Raudla and Kattel 2011), Latvian fiscal policy has been somewhat more “lax” (at least compared to Estonia). Estonia came through the crisis of 2008-2009 “on its own”, whereas Latvia needed financial assistance from the EU and the IMF.

policy-making, policies and institutional development. (Schmidt 2002, 2008, 2010) First, discourse can alter perceptions of policy problems, break the existing “cognitive locks”, influence the preferences and goals of policy-makers, shape political identities, and reconceptualize interests (Beland and Cox 2001; Menahem 2008; Schmidt and Radaelli 2004; Schmidt 2002). Second, discourse can contribute to policy-learning (Schmidt and Radaelli 2004) since it is in the policy discourse that lessons learnt from previous failures, potential new solutions and references to other countries’ experiences become articulated. Third, it can help policy actors to assess policy legacies and to interpret whether a new policy fits with the existing traditions (Schmidt 2002; Schmidt and Radaelli 2004). Fourth, policy actors can also use discourse to legitimize chosen policies to the public, by deliberately packaging and framing policy ideas in a way that show that certain proposals constitute acceptable solutions to pressing problems (Beland 2005; Campbell 1998; Kurzer 2013; Menahem 2008). Thus, discourse can be utilized to build ideational coalitions that can overcome retrenched interests and to receive a mandate via electoral approval or public acquiescence (Crespy and Schmidt 2014; Kurzer 2013; Schmidt 2002, 2009). Finally, discourse can be used after the adoption of a policy to consolidate the decision and to institutionalize it (Schmidt and Radaelli 2004). In the context of Europeanization, all these mechanisms can play a role in whether a policy change prescribed by the EU translates into an *actual* policy change in a member state.

As mentioned in the introductory section, Europeanization studies have usually focussed on changes in institutions and policies of the member states undertaken in response to the pressures emanating from the EU (Cowles et al. 2001; Börzel and Risse 2003), but have paid less attention to *discursive* shifts brought about by externally imposed requirements. However, by just focusing on the former, we may miss more nuanced changes that can be triggered by EU-imposed rules (Schmidt and Radaelli 2004). Given the important role discursive shifts can play in bringing about actual and longer-lasting policy changes (Schmidt 2008, 2010), it is relevant to further our understanding of when and how EU-rules can lead to discursive shifts in the first place. Thus, the core theoretical question of our paper is the following: when is it likely that an externally imposed EU-rule triggers ideational and discursive changes in a particular field of policy-making of a member state and which factors influence such shifts? Synthesizing the insights from recent research in DI (and related ideational research) and studies on Europeanization the following conjectures can be put forth.

Based on existing studies on Europeanization, we would expect that the effects of an externally prescribed rule on policy discourse depend on the “goodness of fit” between the mandated rule and the existing national *policy legacies* (Cowles et al. 2001; Börzel and Risse 2003; Radaelli 2003; Risse et al. 2001). If there is a complete “fit”, it is likely that the imposed rule is simply “absorbed”, without any significant effects on prevailing policy discourse. If, however, there are discrepancies between the long-standing legacies and the prescribed rule, the adoption of the new rule can bring about ideational and discursive shifts – when the national level policy actors attempt to deal with the “adaptational pressure” (Cowles et al. 2001; Risse et al. 2001; Börzel and Risse 2003) by “localizing” the idea via discursively increasing its congruence (Skogstad and Schmidt 2011). On the other hand, if the gap between the new rule and existing policies is construed as “too large” in the coordinative policy discourse, the policy actors may prefer “inertia” (or even “retrenchment”) in dealing with the new rule (Börzel and Risse 2003, 2009; Featherstone and Radaelli 2003; Radaelli 2003), in which case they may prefer not drawing attention to the issue in their communicative discourse.

The traditional argument of institutionalist research is that a *crisis* is likely to provide a “critical juncture” or “a window of opportunity” for change (e.g. Hall 1993; Hogan and Doyle 2007). Thus, if the externally imposed rule is viewed as offering potential solutions to problems or

vulnerabilities connected to a perceived crisis, it is likely to have a stronger impact on policy discourse than it would have in times of normalcy (e.g. Bakir 2009; Blyth 2002, 2007; Busch 2004; Crespy and Schmidt 2014; Campbell 2004; Culpepper 2008).

The *nature* of the mandated rule plays a role as well in shaping its impacts. On the one hand, the clearer and simpler the rule, the more extensive its impact on political discussions is likely to be, given the cognitive ease of absorbing it (Campbell 1998). If the rule is too technical and complex, it may not exceed the “boredom threshold” and could hence fail to gain traction in discursive interactions (especially in the communicative domain) (Busch 2004). On the other hand, the more complex the rule and the more ambiguous or malleable its meaning (Jabko 2006), the more likely it is to generate political discussions when political actors attempt to flesh out its meaning.

Drawing on Streeck and Thelen (2005) and related institutionalist studies which discuss evolutionary and incremental institutional change, it can be conjectured that an externally imposed rule can lead to ideational and discursive changes in the adopter jurisdiction if the political actors can plausibly “layer” it on existing institutions (see also Schmidt 2009). In other words, when policy actors are faced with a new rule, they can accommodate it by “hooking” it on their existing beliefs and explaining how it fits with the prevalent traditions (Bevir and Rhodes 2003). The more successful such “bricolage” of the old and new rules (Carstensen 2011; Schmidt 2014), the stronger the ideational and discursive impacts of the externally imposed rule are likely to be.

An important observation emerging from ideational and institutional research is that we should pay careful attention to the possible *interactions* between *ideas* and *interests* (see, e.g. Beland and Cox 2001; Blyth 2002; Campbell 1998, 2004; Jabko 2006; Kurzer 2013; Schmidt and Radaelli 2004; Schmidt 2009; Thatcher 2004). Policy actors can use the new rule to legitimize their interest-based decisions. When (at least some) political actors can utilize the externally prescribed policy rule for gaining strategic advantage, we can expect the emergence of discursive confrontations. If the new rule can provide ammunition for political actors vis-a-vis their opponents, the more likely it is that it would be brought up in the discursive interactions.

Another relevant insight that has come out from the existing studies is that in order to understand political change, we need to examine the interactions between *discourse* and existing political *institutions* (Beland and Cox 2011; Campbell 1998, 2004; Hall 1993; Schmidt 2008, 2010; Schmidt and Radaelli 2004). Political institutions can play an important role by constraining or enabling access to policy-making arenas, shaping the modes of interaction in policy-making arenas and influencing “who talks to whom” (Schmidt and Radaelli 2004, p. 197). The existing political institutional setting is likely to influence the types of discursive interactions policy-makers predominantly engage in. When the policy arena is characterized by multiple (veto) actors and centres of authority, more energies are likely to be channelled into *coordinative* policy discourse, whereas in more “simple” constellations of actors, the *communicative* discourse is likely to dominate (Schmidt 2008, 2009, 2010). Thus, we can expect that the more potential actors there are who can (feasibly) take part in discussions over the policy area the externally imposed rule pertains to, the more likely it is that the rule triggers discursive battles and gives rise to thicker coordinative discourse. In policy arenas with fewer actors, the discussions over the new rule would primarily take the form of communicative discourse.

Besides elected officials, *civil servants* may play an important role in whether the new rule brings about ideational and discursive shifts. A policy idea is likely to have more traction if the

bureaucracy of the country is open to it and have the capacities and resources to embrace it (e.g. Bakir 2009; Hall 1989; Campbell 2004). The more the civil servants from the national governments have been immersed in the policy-making processes of the EU, the more likely that such “elite networking” acts as a socialization mechanism (Busch 2004; Börzel and Risse 2003; Radaelli 2003). As a result, the more likely it is they can act as carriers of the policy ideas originating from the EU (Trondal 2001) and contribute to the coordinative discourse unfolding in the national arena. The stronger the position of the civil servants in the policy-making process, the more extensive their influence on the discursive shifts are likely to be (Barnett and Finnemore 2004). In particular, civil servants can play an important role in offering the localized translations and (re-)interpretations of the external idea – especially if their policy area is highly complex and technical (Gutierrez 2010; Irvine 2011). Thus, even if the policy idea originates from the outside and is imposed on the polity, the civil servants can play an important role “translating” it (Campbell 2004; Gutierrez 2010), by offering specific interpretations of a more general idea, “attaching” desirable connotations to the idea and drawing out its implications for policy action.

3. The empirical study

Following the methodological recommendations of the existing studies on DI (e.g., Busch 2004; Schmidt and Radaelli 2004; Schmidt 2014; Crespy and Schmidt 2014) we used the following sources of data for our study: semi-structured interviews with civil servants working in the finance ministries, policy documents, verbatim records of the legislative debates and media articles from 2013 to 2015. The interviews and policy documents were used for gaining insights about the changes in coordinative policy discourse, spurred by the adoption of the structural deficit (or balance) rule. In particular, we were interested in whether the civil servants observed (and whether policy documents also reflected) more elaborate coordinative discourse on fiscal policy after the adoption of the rule, a shift from pro-cyclical towards counter-cyclically oriented fiscal policy discussions or any other discursive changes. The analysis of the content of legislative debates and media articles was conducted with the view to identifying any shifts in the national governments’ communicative discourse directed towards the local electorate regarding fiscal policy. We were particularly interested in whether the notion of structural balance was brought up in communicative discourse and how the political actors utilized it. The semi-structured interviews (6 from Estonia and 5 from Latvia) were conducted between August 2014 and October 2015. The interviews, usually lasting 1-3 hours, were recorded and transcribed. For the media articles, the main daily newspapers in Estonia and Latvia were searched, using key words “structural balance” and “structural deficit”. The same search words were used for screening the verbatim records of the parliaments in Estonia and Latvia between 2013 and 2015.

3.1. Background information on Estonia and Latvia

Despite common policy legacies and similar trajectories of economic development since regaining independence in 1991, the fiscal indicators of Estonia and Latvia show somewhat different dynamics over the past 15 years. While Estonia has recorded a nominal budget deficit in 4 out of the 15, the Latvian budget has been in deficit in all 15 years (see Table 1). Also, the Estonian government debt has been significantly lower than that of Latvia; the significant jump in the Latvian debt in 2008-2010 was caused by the bail-out of the Parex Bank by the Latvian government (Kattel and Raudla 2013). It is noteworthy that the nominal budget deficit in Estonia remained below 3% of GDP even in 2009, when the real GDP fell by 14.7% (see Table 1). As pointed out by Raudla and Kattel (2011), the fiscal policy discourse in Estonia since the early 1990s – and which continued during the crisis of 2008-2009 – has been characterized by

extreme fiscal conservatism and commitment of all political parties to avoiding (nominal) budget deficits. As Raudla and Kattel (2011) explain, this has been driven by the underlying belief of the political actors that balanced budgets and low debt help to guarantee macroeconomic stability and encourage economic development. While the Latvian government's deficit has remained under the Maastricht criterion of 3% of GDP in all but crisis years, it has not aspired to maintain the nominal balance or even achieve surplus like the Estonian government. Given the *pro*-cyclical nature of the fiscal policy in both countries since the early 1990s, it would be particularly insightful to examine what happened to the fiscal policy discussion after the adoption of a fiscal rule requiring a *counter*-cyclical focus for fiscal policy.

Table 1: Fiscal and economic indicators for Estonia and Latvia 2000-2015.

Year	Budget deficit in Estonia (% of GDP)*	Budget deficit in Latvia (% of GDP)	Public debt in Estonia (% of GDP)	Public debt in Latvia (% of GDP)	Real GDP growth in Estonia	Real GDP growth in Latvia
2000	0.0	-2.8	5.1	12.2	6.4	6.4
2001	0.1	-2.0	4.8	14.0	6.8	8.5
2002	0.4	-2.2	5.7	13.2	6.8	8.5
2003	1.8	-1.6	5.6	13.9	7.5	8.6
2004	2.4	-1.0	5.1	14.2	6.5	8.9
2005	1.1	-0.4	4.5	11.7	9.5	10.2
2006	2.9	-0.6	4.4	9.9	10.4	11.6
2007	2.5	-0.6	3.7	8.4	7.9	9.8
2008	-2.7	-4.0	4.5	18.6	-5.3	-3.2
2009	-2.2	-9.0	7.0	36.4	-14.7	-14.2
2010	0.2	-8.1	6.5	46.8	2.5	-2.9
2011	1.2	-3.3	6.0	42.7	8.3	5.0
2012	-0.2	-0.8	9.7	40.9	4.7	4.8
2013	-0.2	-0.7	10.0	38.2	1.6	4.2
2014	0.6	-1.4	10.6	40.0	2.1	2.4

*Net lending (+) /net borrowing (-)

Source: Eurostat

3.2. The adoption of structural balance/deficit rule

Before the enactment of the Fiscal Compact neither Estonia nor Latvia had a fiscal rule stipulating budget balance or deficit target in their domestic legislation. The Fiscal Compact (enacted in 2013) required the members of the eurozone to introduce a structural deficit ceiling in their domestic legislation. The structural position of the budget is calculated on the basis of a cyclically adjusted position, which is adjusted for one-off and temporary transactions. The cyclically adjusted budget position, in turn, is found by subtracting the cyclical component (or the output gap) from the nominal budget position (for a more detailed discussion, see, for example, Mourre et al. 2014).

Following this obligation, Latvia's new Fiscal Responsibility Law, passed in early 2013, stipulates that the structural budget deficit of the annual budget should not exceed 0.5% of GDP. The new State Budget Act of Estonia, adopted in early 2014, however, establishes a stricter rule than prescribed by the Fiscal Compact and requires the structural budget position has to be "in balance or in surplus". As the interviewed officials from Estonia explained, the drafters of the law hoped that the structural *balance* – rather than deficit – requirement would provide a

“buffer”, just in case calculations by the Ministry of Finance (MoF) deviate from those of the European Commission.

Several interviewees from both Estonia and Latvia stated that the introduction of structural balance/deficit rule can be considered to be one of the biggest reforms in the fiscal policy arena during the recent years. At the same time, the interviewed officials noted that *without* the Fiscal Compact, the structural deficit (or balance) target would *not* have been written into domestic legislation. The reasons for that, however, were different in the two countries. In Estonia, the interviewed civil servants felt that there was actually no need for such a rule, given the political culture of fiscal conservatism. They also noted that if a fiscal rule had to be established at all, the local preference would have been for one with a *nominal* – rather than structural – target. Although in Latvia, the discussions over the draft fiscal discipline law, which started in 2011, included the possibility of establishing a deficit target (first a nominal and then a cyclical one), it was the Fiscal Compact that ensured that the structural deficit requirement was actually written into the law.

3.3. The impact of the structural balance/deficit rule on fiscal policy discussions

3.3.1. Estonia

When the drafts of the new organic budget law were debated in the Estonian parliament in 2013-2014, the deliberations on the structural balance rule focused on the technical complexities involved in calculating it and how the real time estimations may differ from the ex post assessments (e.g. Verbatim record 14 January 2014; 19 February 2014). There was also some discussion over whether a structural balance requirement should be preferred over a nominal balance rule and how it is also important to pay attention to the nominal balance (Verbatim record 6 November 2013; 19 February 2014). Generally, however, there was very little discussion about it; the elected officials simply accepted that since the Fiscal Compact required such a rule, it had to be incorporated into the domestic legislation.

After the enactment of the new organic budget law, the structural balance rule triggered shifts in both coordinative and communicative discourse on fiscal policy. Most of the interviewed Estonian officials noted that *after* the adoption of the structural budget balance rule, the *main focus* of fiscal policy-making has switched from the nominal balance to the *structural* position. As one of the interviewees from Estonia put it, “In fiscal policy, we used to focus on the nominal balance but now we strive to focus on the structural balance. ... At the moment, in our decisions, the structural balance has more weight than the nominal one.” (Interview E3).

The interviews indicate that the adoption of the structural balance rule has led to more elaborate *coordinative* discourse on fiscal policy. While in the years before 2014, the cyclical position of the budget and the potential role of the state budget in smoothing the economic cycle were hardly considered and discussed, the adoption of the structural balance rule has led to the inclusion of such issues into fiscal policy discourse. Furthermore, in the past, even if the relationship between the annual budget and the economic cycle was discussed (e.g. during the crisis in 2008-2009), the policymakers had been sceptical or even expressly negative of using the public budget for stabilizing the economy (see Raudla and Kattel 2011). After the inclusion of the structural balance rule in the organic budget law, however, we can observe a significant shift in fiscal policy discourse, both in the coordinative and communicative domains: for the first time since independence, policy actors have started to consider the use of the budget in a *counter-cyclical* way.

The shift in communicative discourse – directed towards the Estonian public – can be most starkly observed when we compare the public statements of Jürgen Ligi (the minister of finance) in 2009 and 2014. The same finance minister who in 2009 claimed that “If we do not have money, we cannot spend it” (see Raudla and Kattel 2011), said in 2014: “We shouldn’t just look at whether we have money or not.” He stated further that “Structural balance is not just a euphemism. ... This is what Europe follows in fiscal policy-making. ... It means that during bad times it is natural to have a nominal deficit. ... Having a nominal deficit during recession means that we do not exaggerate the economic cycle.” (Press conference of the Government of the Republic, 10 April 2014). The same minister, who in 2009 advocated severe austerity measures, claimed in 2014 that “If the economic forecast worsens, it does not mean we should immediately start cutting expenditures.” (Nael 2014).

In a similar vein, the officials of the MoF, who in 2008-2009 supported austerity measures in the midst of a deep economic crisis, stated in our interviews in 2014-2015: “If a crisis hit again, we would be able to let the automatic stabilizers work and we could afford not cutting expenditures.” (Interview E2) “If a recession were to hit, we would fall below the potential GDP and automatic stabilizers would kick in. Nominally we would get into deficit but structurally we would remain in balance. ... If we then have nominal deficit but structural balance, this would be the right economic policy.” (Interview E1) Most of the interviewed civil servants considered the focus on structural balance to be a *better* guideline for fiscal policy than just looking at the nominal balance. While they noted that calculating the structural balance is much more complicated than the nominal balance, they concurred that as a guide for fiscal policy-making, structural balance is more informative. As one of the interviewees noted, “Fiscal policy should smooth the economic cycle. If we just follow the nominal balance, we are acting pro-cyclically and aggravate the cycle.” (Interview E6)

Still, the idea of the structural balance as the primary focus in fiscal policy-making has not been uniformly received by all political actors in Estonia, as witnessed by extensive discussions over the rule in the media.⁴ The Pro Patria and Res Publica Union, which has been traditionally the most fiscally conservative party, has vocally criticized the use of structural balance as a yardstick in fiscal policy and argued that nominal balance should be taken more seriously (e.g. Sester 2014a). Its representatives also admonished the government in 2014 for giving up the goal of nominal balance and relaxing the fiscal stance by allowing nominal deficit for years 2014-2017 (Sester 2014b).

In sum, the introduction of the structural balance rule in the organic budget law has allowed policy-makers in Estonia to take a somewhat more “relaxed” stance in fiscal policy discussions. The predominant goal of fiscal policy since the early 1990s had been a nominally *balanced* budget; however, the insertion of the idea of structural balance into the fiscal policy-making arena has forced the policy-maker to think more in cyclical terms. While the nominal budget balance was viewed almost as a political “holy cow” throughout the 1990s and 2000s (see Raudla and Kattel 2011), the new focus on structural balance has allowed political actors to move away from the notion that the budget has to be *always* nominally balanced (no matter the cyclical position of the economy). Thus, the emergence of discussions over the cyclical position of the economy and its relationship to fiscal policy marks a significant shift in the fiscal policy discourse. At the same time, as the dissenting opinions demonstrate, the idea of observing structural balance into has not yet amounted to a complete paradigm shift. Also, how much the discursive shifts described above will actually influence fiscal policy itself in the future still remains to be seen.

⁴ The structural balance was extensively discussed in more than 10 media articles in 2014.

3.3.2. Latvia

Compared to the parliamentary deliberations in Estonia, where the necessity of incorporating the structural balance rule was not questioned (even by the opposition), there were more extensive debates about the desirability of such a fiscal rule in the Latvian legislature. In the discussions over incorporating the structural deficit requirement into the Fiscal Discipline Law, concerns were voiced by the opposition about it being too restrictive and limiting Latvia's possibilities to incur loans in order to promote economic development. As MP Pimenovs (Concord, centre-left party) argued, "The interest of Latvia is to develop faster, to make sure that our investment in the economy is greater. This would also mean that our wealth is growing faster than our debt. And 0.5% is just not enough in order to make this possible." (Verbatim record of the parliamentary sessions, 31 January 2013) In addition, like in Estonia, concerns were voiced about the accuracies involved in calculating the cyclical component of the structural deficit (Verbatim record, 20 December 2012). At the same time, the inclusion of the structural deficit rule in the fiscal discipline law was supported by the MoF officials and also the Prime Minister; thus, with reference to the Fiscal Compact, it was written into the domestic legislation.

According to the interviewed officials, within the MoF, the structural deficit rule has brought about a shift in the coordinative fiscal policy discourse. While the pre-crisis fiscal policy-making was oriented to following the Maastricht deficit criterion and the discussions during the crisis itself were strongly influenced by the bailout programme, the EC and the IMF, the fiscal policy-making in recent years has started to pay closer attention to the *cyclical* role of the budget and also the longer-term sustainability of public finances. As one of the officials summed it up, "We've come a long way in terms of legislation and now everything is modern and corresponds to theoretical thinking." (Interview L1). While previously, the focus of fiscal policy-making had been on observing the nominal budget position, the structural deficit requirement led to a shift of the focus to the structural position, according to the interviewed officials. Like in Estonia, the MoF officials in Latvia considered the structural position to be a better guide for fiscal-policy making than the nominal rule. In the words of one of the officials, "Even though we can criticize the indeterminacies involved in calculating it, it is the best option available for guiding fiscal policy.... It is the only rule that addresses the tendencies to spend pro-cyclically." (Interview L1).

The interviewed officials noted, however, that the MoF officials have been the ones trying to persuade the politicians that the observing structural deficit rule and being fiscally disciplined are important goals. As one of the civil servants admitted, "In the heads of politicians, it seems that the idea that there should be a strict framework with regard to fiscal policy and saving in the good years in order to spend in the bad ones is still not acceptable." (Interview L2). "We can observe now, especially in the pre-election atmosphere, that the desire of the politicians not to comply with the fiscal policy targets is high. So we in the MoF serve the role of a watchdog, who's barking all the time, saying that you have to comply with the requirements, but there is willingness to trespass." (Interview L2)

In sum, during the adoption of the deficit rule in the parliament, the debates in Latvia were more extensive than in Estonia. Like in Estonia, after the rule was enacted, it produced a shift in the coordinative domain of fiscal policy – whereby the policy actors started to consider more seriously the role of the budget in the cyclical development of the economy. However, while in Estonia, the shift was from the "obsession" with the nominal balance to a somewhat more relaxed stance towards nominal deficits (while observing the structural balance), in Latvia, the coordinative discourse shifted from just following the nominal Maastricht deficit criterion to

paying attention to the cyclical position. While in Estonia, the structural balance rule triggered extensive discussions in the communicative domain of fiscal policy discourse, in Latvia, the issues related to the structural deficit have not entered the communicative discourse. We could not find any media articles or other examples of communicative discourse where the issues related to structural deficit would be the main subject.

3.4. Factors mediating the effect of the idea of the structural balance/deficit

As emerged from the interviews with the MoF officials in both countries, an important factor that contributed to shifts in fiscal policy discussions alongside the introduction of the structural balance (or deficit) rule was the experience of the *crisis* in 2008-2010. The crisis was more dramatic in Latvia, given the need for a bailout, but was also strongly felt in Estonia because of the extensive austerity measures adopted in 2008-2009 (Kattel and Raudla 2013). Specifically, one of the important reasons why the MoF officials in both countries have come to support a counter-cyclical role for fiscal policy is that with the benefit of hindsight, the *pre-crisis* fiscal policies (especially in 2004-2007) are viewed as excessively *pro-cyclical*, meaning that they exacerbated the unsustainable boom. In the words of the interviewed officials: “In the run-up to the crisis, we stimulated the economy with additional expenditures at the time when we should have been cooling the economy down. Such fiscal policy only magnified the bubble.” (Interview L1). “Before the crisis, by following the nominal balance, the government fuelled the boom” (Interview E6). Thus, the MoF officials in both countries argued that using the structural balance (or deficit) rule in fiscal policy helps to avoid such mistakes and prevents overspending during a boom. As one of the Latvian officials admitted, “I think that the crisis has clearly proven that during the good years, if the government spends all the revenue and observes the nominal 3% (of GDP) deficit target, then during a downturn, it objectively can’t maintain it. ... Without the structural rule we wouldn’t know how much we can actually afford to spend during the good years.” (Interview L1). The interviews with the Estonian officials echoed similar concerns.

With regard to the *nature of the policy idea* entailed in the structural balance/deficit rule, all of the interviewed officials in both countries considered the use of the structural target as a yardstick for fiscal policy rather complex. They argued that the calculation of the structural position is complicated and hence it is hard for the politicians, media and ordinary citizens to understand what it actually encompasses. All the officials also agreed that there are significant indeterminacies and uncertainties involved in estimating the structural budget position because of the challenges in evaluating the cyclical position of the economy and the output gap.

Based on the interviews, we can argue that the complexities involved in calculating the structural budget position have enhanced the *role and the power of the finance ministries* in the coordinative discourse on fiscal policy in both countries. The MoFs *propose* what the structural position of the budget should be. Furthermore, the MoF officials now also have a major role in *explaining* to the elected officials what the structural budget position means and how it is calculated. The interviewed officials also felt that alongside the introduction of the structural balance rule, their impact on fiscal policy discussions was *enhanced* by the crisis experience, given that the politicians had to increasingly rely on the finance ministries for gathering information about the budgetary developments during that time. Thus, owing to the enhanced position of the MoFs after the crisis, its officials feel that their arguments about the importance of structural position in fiscal policy-making are being taken more seriously than they would be otherwise.

Also, since the crisis, the MoF officials of both countries have been more intensively involved in the policy-making processes of the EU and it appears that through the *socialization*

mechanisms that have accompanied this participation, the MoF officials have increasingly “bought into” the idea of using structural position (rather than nominal balance) as the predominant yardstick in fiscal policy.

Besides the indirect involvement of the EU through socialization processes, other reforms of fiscal governance in the EU have influenced the coordinative discourse arena – in terms of the constellation of actors who take part in fiscal policy discussions. This has contributed to making the coordinative discourse on fiscal policy more elaborate than in the past. For example, via European Semester, the European Commission (EC) has become more extensively involved in the budget preparation process of the member states (see Ioannou et al. 2015), and its assessments of the structural position of the draft budgets provide additional input to fiscal policy discussion. In Estonia and Latvia, the estimations of the EC have differed from those of the national MoFs, which, in turn, has led to discussions over why these computations diverged.

Despite the inherent complexity of the idea of the structural budget position, it has clearly exceeded the “boredom” threshold and made its way beyond coordinative discourse into *communicative* discourse in the legislative arena and media in Estonia, though not so in Latvia. In fact, one could argue that the inherent *complexity* and *ambiguity* of the concept of structural balance contributed to its becoming a prominent subject of political discussions in Estonia. As mentioned above, given that the MoF and the EC use somewhat different models for estimating the output gap, their assessments of the structural position of the budget have diverged. In the fall of 2014, for example, according to the EC calculations, the Estonian government budget was in structural deficit, whereas the MoF calculations indicated that the budget was in structural surplus. This divergence, in turn, was used by the fiscally conservative Pro Patria and Res Publica Union (when they got into opposition in spring 2014) to attack the coalition of the Reform Party and the Social Democrats and to accuse the government of violating the structural balance requirement. It also provided them with additional ammunition in claiming that the nominal balance is in fact better (and more objective) yardstick in fiscal policy.

In order to better understand the shift in the Estonian government’s fiscal policy rhetoric in the spring of 2014 (described in section 3.3.1), the *interests and strategic considerations* of the political parties have to be factored in. When a new coalition was formed between the Reform Party and the Social Democratic party in Estonia in the spring of 2014 – one year ahead of the regular elections in 2015 – additional expenditures were needed to cover the promises of the new coalition agreement. At the same time, the economic outlook worsened, due to developments in the external environment (especially the crisis in the Ukraine). Maintaining the nominal balance of the budget in such a context became challenging and hence the new coalition promised to keep the budget in *structural* balance (or even surplus) while running a nominal deficit.

In order to make the abandonment of the “holy principle” of a nominally balanced budget more palatable to the Estonian electorate, both elected officials and civil servants attempted to *layer* the idea of “structural balance” on the pre-existing notion of “a balanced budget”. This was facilitated by the fact the new organic budget law requires structural budget *balance* (rather than stipulating a structural *deficit* limit). As one of the interviewed officials put it, “Since in our society the general idea is that the state budget should be balanced, the structural *balance* also resonates well with that.” (Interview E2) Thus, it has been emphasized that the structural balance means that the budget would be balanced “over the long term”. Using the “layering” and “bricolage” described in section 2, the new coalition partners were able to emphasize that the budget is still “balanced”, although now “structurally balanced” rather than “nominally balanced”.

4. Discussion and conclusion

Given the increasing role of the EU in the political lives of its member states, it is important to explore, in greater depth, what kinds of impacts an externally imposed rule can have on policy-making *discourse* in a member state. The growing literature on DI has demonstrated that discursive shifts can contribute significantly to *actual* policy changes (Schmidt 2008, 2010, 211). Hence, by tracing discursive shifts we are able to better understand which mechanisms shape policy developments in the long term. The *theoretical* contribution of our article was to continue the discussion – initiated by Schmidt and Radaelli (2004) – geared at synthesizing the insights from the DI and Europeanization literatures and to consider more systematically the different factors that mediate the effects of an externally imposed rule on domestic policy discourse. We believe the theoretical framework we have developed provides a useful starting point for future empirical studies that make use of the DI perspective in the context of Europeanization.

Our case studies of Estonia and Latvia show that the adoption of the structural deficit rule, as required by the Fiscal Compact, *did* indeed lead to changes in the fiscal policy-making discourse of the two countries. Despite the fact that during the past decades, fiscal policy-making in the two countries has been pro-cyclical, the new rule – with its focus on the cyclical stance of the budget – has led to coordinative policy-making discourses that emphasize the counter-cyclical role of fiscal policy. The empirical findings also demonstrate the usefulness of the theoretical framework (developed in section 2) in exploring the impacts of an EU-imposed rule on policy discourse in a member state. Our study shows that in order to understand the discursive change that took place after the adoption of the new rule in Estonia and Latvia, we have to examine – in tandem – the effects of existing policy legacies, the experience of a crisis, the strategic interests of political actors, the institutional characteristics of the polity, and the role of the civil servants.

Our case studies of the two countries corroborate a number of predictions of the existing literature. First, we can see that – as hypothesized by many studies in the Europeanization literature (e.g. Börzel and Risse 2003) – the “goodness of fit” between the externally imposed rule and the existing *domestic legacies* clearly influenced the incidence and direction of discursive efforts that were triggered by the adoption of the new rule. Both in Estonia and Latvia, the shifts in coordinative fiscal policy discourse were influenced by the inherited policy legacies. In the Estonian case, the shift has been from fiscal policy discussions that concentrated on maintaining the nominal balance and avoiding deficits to deliberations where (at least) some consideration has been given to the possibility of using the budget for smoothing the economic cycle. In the Latvian case, however, where the government has recorded budget deficits in most years since 2000, the adoption of the new fiscal rule has driven home the arguments about being “fiscally responsible” and avoiding “overspending”. Thus, in Latvia, the structural deficit rule has been viewed as providing additional restrictions on fiscal policy-making, whereas in Estonia it has had a “relaxing effect” on fiscal policy discourse.

Second, our cases also corroborate the prediction by Schmidt (2008), who argued that policy arenas with *more actors* give rise to more elaborate coordinative discourse than those with fewer actors. In both countries, the increasing role of the European Commission has certainly contributed to the emergence of more extensive discourse on fiscal policy.

Third, discursive shifts in both countries have been significantly influenced by the experience of the *crisis*: the “lessons” drawn about the overly pro-cyclical pre-crisis fiscal policy have enabled the policy-makers to argue for a more counter-cyclical stance.

Going beyond the corroboration of the observations made in the existing literature, an important insight emerging from our empirical study of Estonia and Latvia is that the various factors we have outlined in the theoretical discussion – policy legacies, the nature of the imposed rule, crisis experience, institutional characteristics of the polity and interests of policy actors – can *interact* with each other in complex ways. These interactions can influence the incidence and direction of discursive efforts triggered by the adoption of a new rule.

First, our study indicates that shifts in *communicative* discourse can be influenced by the interaction of the existing policy *legacies*, the *nature* of the imposed rule, the possibilities for “layering”/“bricolage”, and partisan *interests*. If the nature of the externally imposed rule is highly complex, it appears to lead to a shift in communicative policy discourse only when the partisan actors have clear a strategic interest in bringing it up. An important difference between our two cases is that while the adoption of the structural deficit rule – which is highly complex and technical – led to shifts in *coordinative* discourse in both countries, the shift in *communicative* discourse could only be observed in Estonia. The discussions over the structural budget position found their way to communicative discourse in Estonia because of the strategic interests of the partisan actors. On the one hand, the reason why the new government started using the structural balance rule in justifying its budget plans in communicative discourse in 2014 was that they needed to legitimize additional expenditures before the elections. The ambiguity of the notion of “structural balance” allowed the government to use rhetorical layering and bricolage in legitimizing its policy choices – e.g. by arguing that a “structurally” balanced budget is still a “balanced” budget and such an approach balances the budget in the long term. On the other hand, an opposition party used the government’s shift of focus from the nominal to structural budget balance to pursue its own strategic interests via communicative discourse: it criticized the governing coalition and accused it of breaking with the established tradition of fiscal conservatism. It was additionally aided in its attacks by the complex nature of the rule: the diverging assessments of the structural position by the MoF and the EC allowed the opposition to attack the government and criticize the notion of using the structural position as a yardstick in fiscal policy-making.

Second, the dynamics of *coordinative* policy discourse can be significantly influenced by interactions between the experience of the *crisis*, the *nature* of the imposed rule and the *institutional* characteristics. In both countries, the experience of the crisis and the complex nature of the externally imposed rule enhanced the position of the finance ministries in fiscal policy-making (vis-a-vis elected officials in the cabinet and in the parliament), which allowed them to assume a stronger role in coordinative fiscal policy discourse and facilitated the emergence of more sophisticated discussions on fiscal policy.

In sum, our study shows that analyzing the discursive shifts triggered by an EU-imposed rule in a member state can be a worthwhile undertaking – because it allows us to paint a more nuanced picture of Europeanization than the traditional focus on formal policies. Our findings also suggest that in future studies of Europeanization and DI researchers should pay close attention to the complex interactions between the various factors because these interactions may influence how the discursive shifts unfold.

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Interviews with Ministry of Finance officials

Estonia

E1: 18.08.2014

E2: 09.09.2014

E3: 09.09.2014.

E4: 10.09.2014

E5: 04.05.2015

E6: 04.05.2015

Latvia

L1: 17 September 2014

L2: 17 September 2014

L3: 20 October 2014

L4: 5 June 2015

L5: 13 October 2015