

# **‘The troika is dead, long live the domestic troikas?’: The diffusion of national fiscal councils in the**

## **European Union**

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### **INTRODUCTION**

The euro area crisis triggered a reform effort tailored towards fixing dysfunctional fiscal institutions with a focus on addressing the compliance gap that plagued the Stability and Growth Pact (SGP). But how could EMU’s fiscal architecture regain its credibility given that the European Commission had proven to be too lenient as a fiscal watchdog? Decentralization of fiscal surveillance by creating expert fiscal councils at the national level was proposed as a potential remedy. The International Monetary Fund (IMF) defines a fiscal council as ‘a permanent agency with a statutory or executive mandate to assess publicly and independently from partisan influence government’s fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short-medium-term macroeconomic stability, and other official objectives.’ (Debrun et al. 2013, 8) If these new technocratic bodies could build up a reputation for ‘unbiased’ analysis and disseminate their reports to the public, they could govern fiscal discipline indirectly through enabling intermediaries (i.e. voters, media, credit rating agencies or parliamentarians) to adequately judge the government’s fiscal competence (Beetsma and Debrun 2017). As a result, the compliance gap would be narrowed and negative externalities for the whole eurozone contained because existing informational asymmetries would be evened out leading to a more prudent fiscal policy.

The first fiscal council in Europe was established in 1945 in the fiscally-hawkish Netherlands, followed by others in Denmark (1962), Austria (1970), Belgium (1989) and Sweden (2007). It was, however, not until the 2008 financial crisis that the number of fiscal councils rose in the European Union (EU) (see Beetsma et al. 2018, 6-7; Debrun et al. 2013, 11). The sovereign debt crisis subsequently accelerated the spread of

fiscal councils even more. The diffusion of fiscal councils constitutes the second wave of delegation to technocratic non-majoritarian institutions after the rise of independent central banks and regulatory agencies in the 1990s (McNamara 2002). But in contrast to the previous wave, it did not result in the spreading of a one-size-fits-all governance model. What explains this variance in the design features of fiscal councils in the EU? An explanation based on coercive pressures exerted by powerful member states attempting to impose constraining institutions on fiscally profligate governments through EU-wide regulations would lead us to find such a one-size-fits-all fiscal council. Yet, this is not what we observe empirically. Fiscally hawkish Germany has set up a fiscal council that leaves too much space for political meddling and lacks the financial resources to build up sufficient analytical capacity (Fromage 2017). In contrast, the repeated SGP-violator Portugal has exceeded the minimum legislative requirements and created an effective vanguard fiscal council (von Trapp, Lienert, and Wehner 2016; Horvath 2018). This article contends that by focusing on the influence of different international organizations (IOs) in the diffusion of fiscal councils this puzzle can be solved. Broome and Seabrooke (2012) have shown that IOs use ‘analytic institutions’ to make their member states ‘legible’, which in turn allows them to construct cognitive authority in certain policy areas. Thus, IOs have the capacity to instigate domestic institutional change indirectly. As this article will show, this task becomes harder as different IOs compete in the same policy area to assert their cognitive authority over others. In the case of fiscal councils, IOs have relied on indices to interpret their member states’ experience with them and to promote a certain conceptual model that is in line with their own institutional self-interest and policy goals. This type of persuasion through *entrepreneurial benchmarking* constitutes the key mechanism by which member states were nudged to adopt a specific conceptual model. The troika institutions - the European Commission, the European Central Bank (ECB) and the IMF - formed a technocratic consensus about the desirability of establishing a fiscal council to improve fiscal policy-making in the long-term. Their consensus was based on the shared understanding that the status quo of the fiscal governance framework was untenable and that fiscal policy had an important role to play in macroeconomic stabilization despite being subject to the principle of long-

term sustainable public financing. Nevertheless, considerable disagreement existed about the desirable fiscal council design features that would promote the particular IO's institutional self-interest. As a result, the respective benchmarking indices proposed by IOs do not focus on the same characteristics or tasks of national fiscal councils and differ markedly with regards to the rankings. The three troika members ultimately undermined each other's persuasion efforts and, thereby, prevented the emergence of a one-size-fits-all fiscal council model.

This article will derive three conceptual models of fiscal councils from the literature and categorize them according to a specific mode of indirect governance (i.e. delegation, trusteeship and orchestration). Subsequently, the main transmission mechanism of each model to foster fiscal discipline will be elucidated. The following section shows why each troika institution supported a distinct mode of indirect governance, which ultimately undermined the emergence of a one-size-fits-all conceptual model of a fiscal council. Finally, the article concludes with a summary of the main findings.

### **THREE CONCEPTUAL MODELS OF FISCAL COUNCILS**

The three troika institutions formed a technocratic consensus that propagated fiscal councils as an effective institutional innovation to tackle fiscal profligacy (European Commission 2006; European Central Bank 2010; Debrun and Kumar 2007; Debrun, Hauner, and Kumar 2009; Debrun 2010; Debrun et al. 2013). Their alignment resulted from a shared long-term goal to achieve sound fiscal policies and sustainable public finances. Yet, diverse medium-term objectives also motivated their promotion of fiscal councils: (1) the Commission wanted to improve compliance with the SGP and increase local ownership of the fiscal rules but without endangering its monopoly power as the 'fiscal rule interpreter of last resort' (European Commission 2006, 2014); (2) the ECB wanted to anchor monetary dominance (i.e. a regime in which the central bank's monetary policy stance acts as an effective constraint on fiscal policy) more firmly in EMU's governance architecture and prevent negative spillover-effects from fiscal profligacy (cf. Henning 2016);

and (3) the IMF wanted to maintain global financial stability and ensure repayment of their financial assistance by reinforcing EMU's fiscal discipline.

But which fiscal council design would best achieve these diverse policy goals? After all, eurozone member states were in charge of implementing EU legislation that mandated the creation of a 'functionally autonomous' fiscal council (Jankovics and Sherwood 2017, 10; Fromage 2017, 111)<sup>1</sup>. Especially the ECB and the IMF favored a more independent fiscal council because they had less leverage over member states but were also less constrained by European politics than the Commission. Thus, a fiscal council managed in a non-hierarchical fashion and insulated from governmental pressures would be more likely to achieve their policy goals. However, the Commission was adamant that a fiscal council's mandate should be limited to the monitoring of compliance with the fiscal rules and the assessment of macroeconomic forecasts tightly controlled by the government (agent model). The Commission's pivotal role in the legislative process requires its proposals to be adopted towards the preferences of the member states as expressed in the Council of the EU. The ECB argued in favor of a highly independent fiscal council that would possess the competence to set a certain budgetary target (trustee model). Such a fiscal council would act as an active constraint on discretionary spending but would fall short of a complete delegation of fiscal policy like handing over the direct control over fiscal instruments to set specific taxation levels. Like the ECB, the IMF favored a highly independent fiscal council. The IMF argued that fiscal councils should indirectly govern fiscal policy by providing ideational support to intermediaries (voters, media, rating agencies or parliament) that would then be empowered to adequately judge the fiscal competence of the government (orchestrator model). These heterogeneous views on fiscal councils rendered it more difficult for any of the troika institutions to impose its preferred model.

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<sup>1</sup> In the intergovernmental Treaty on Stability, Coordination and Governance in the EMU (TSCG), which entails the so-called Fiscal Compact, it was the amendment to the preventive arm of the SGP (EU Regulation 1466/97), the 'Six-pack' (EU Directive 2011/85) and the 'Two-pack' (EU Regulation 473/2013) that instructed eurozone members to create a fiscal council (Fromage 2017, 111).

In each case the policy goal of the respective IO determines the preferred institutional design of the fiscal council. A principal initiating a new indirect governance relationship has to make two fundamental choices. First, she has to decide whether to grant authority to a new institution or to enlist a pre-existing one. Second, she has to decide whether to manage this relationship through hierarchical or non-hierarchical controls (Abbott et al. forthcoming). As a result, Abbott et al. (forthcoming) distinguish four modes of indirect governance<sup>2</sup>.

#### **[FIGURE1]**

Delegation constitutes the dominant mode of indirect governance. It describes a situation in which a principal grants authority to an agent that is subject to ex ante and ex post controls (Hawkins et al. 2006). The principal can write a detailed delegation contract and assign certain tasks to the agent. If the agent acts outside of his mandate, he will be sanctioned under the ultimate threat of revoking the granted authority. A fiscal council that is supposed to give an impartial assessment of the government's fiscal policy might find it hard to build up a reputation if it is obvious that any confrontation with the government would trigger immediate sanctioning. This hierarchical type of ex post control stands in marked contrast to a non-hierarchical relationship. The latter gives the agent more degrees of freedom and, thus, reaps the benefits of relative policy autonomy. In a trusteeship, a trustor (principal) grants authority to a trustee (agent) who has considerable discretion in interpreting its mandate (Abbott et al. forthcoming; Majone 2001). As a consequence, the initial authority relationship might be inverted ex post (Abbott et al. forthcoming; Thatcher and Stone Sweet 2002). A government that creates a trustee fiscal council might find that it will gradually lose its ability to conduct fiscal policy. Finally, orchestration describes 'the mobilization of an intermediary by an orchestrator on a voluntary basis in pursuit of a joint governance

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<sup>2</sup> Co-optation refers to the co-optor (principal) enlisting a co-optee (agent) with the goal to reverse pre-existing authority relationships (Abbott et al. forthcoming). The Orbán government's co-optation of its fiscal council is a good example (Kopits and Romhányi 2013). Beyond the Hungarian case no empirical evidence exists, which is why this mode of indirect governance will not be further explored here.

goal' (Abbott et al. 2015, 722). Orchestrating fiscal councils rely on intermediaries to disseminate their assessments about the true state of the government's public finances to govern fiscal policy choices (target). It is important to note that one rarely observes any of the three models in their pure form. Rather, national fiscal councils (like the Dutch CPB) often exhibit mixed features that combine various aspects of the three models. The OECD's principles for independent fiscal institutions reconcile design features of all three models (von Trapp, Lienert, and Wehner 2016). For the sake of clarity, this section presents the key features of the three ideal types of fiscal councils.

### **Fiscal councils as agents: fiscal rule monitoring and forecast assessment**

A stripped-down version of a fiscal council acting as an agent on behalf of a principal would limit its role to the monitoring of the fiscal rules and/or assessing macroeconomic and budgetary forecasts. Such a minimalist version would have several benefits for the principal. First, an agent would operate hierarchically under the control of elected representatives. Second, it would not be in direct control of any fiscal instruments which would increase its democratic legitimacy. Third, the principal would have the right to sanction the agent if it overstretched its mandate (hard control). Herein lies a major risk for the credibility of a fiscal council acting on behalf of a political principal. Even though agents can pursue strategies to enhance their autonomy, it is harder when the costs of revoking delegated competences are low for the principal (Hawkins et al. 2006, 199-228). A hawkish fiscal rule monitor that does not shy away from publicly criticizing a government's fiscal policy stance could face fiscal starvation. Fiscal councils require relatively little financial resources to operate but are still susceptible to budget cuts. If the financial and operational independence is not sufficiently guaranteed, a credible monitoring of the fiscal rules is not achievable. It would also make it harder to reduce the forecasting error in the government's macroeconomic and budgetary projections. Furthermore, the increased complexity of the fiscal rules has turned monitoring them into a discretionary task. Regulating this discretion in a P-A contract is neither feasible nor desirable. The credibility and reputation of the fiscal council would suffer. In sum, an agent

fiscal council is likely to be characterized by the following observable implications: a low level of independence, a mandate limited to fiscal rule-monitoring and forecast assessment excluding the possibility to make binding fiscal policy choices, and low public awareness. An agent fiscal council usually has only weak ties to other actors like the parliament because it interacts predominantly with the government. In practice, the German fiscal council – the Advisory Board to the Stability Council – follows the agent model. It performs only a narrow range of tasks and is subordinated to the Stability Council which is a joint political body of the federal level and its constituent parts monitoring the budgets of all levels of government (Fromage 2017, 125).

### **The independent trustee model: conducting fiscal policy**

The trustee fiscal council is inspired by the independent central bank model (Wyplosz 2005; European Central Bank 2010; Coeuré 2016). It suggests that an independent fiscal council should mimic the success of inflation-targeting central banks (Wyplosz 2005; Blinder 1997). Importantly, it puts a premium on political insulation over reputation building to enhance the credible commitment of the government to fiscal prudence. Accordingly, fiscal policy like monetary policy needs to be insulated from political pressures to overcome the time-inconsistency problem. Politicians facing short-term incentives will deviate from the optimal fiscal policy path (Alesina and Tabellini 1990; Persson and Svensson 1989; Wyplosz 2008). To address the inherent deficit bias, politicians can credibly commit to fiscal prudence by delegating authority in the realm of fiscal policy to independent technocrats (Majone 2001). The trustee could then set the overall long-term objectives - for example, debt targets - and determine the short-term fiscal balance that is compatible with them (von Hagen and Harden 1995; Eichengreen, Hausmann, and Von Hagen 1999; Calmfors 2003). In an extreme case, a trustee fiscal council could even make binding fiscal policy choices like setting the level of taxation and expenditures to achieve long-term debt sustainability. Existing proposals regarding a mandate differ with respect to the optimal combination of

control over targets and policy instruments (see Debrun, Hauner, and Kumar 2009). According to Wyplosz (2005, 72):

the proposal's main advantage in comparison with budget rules is to replace mechanical limits with judgement, exactly as inflation targeting does in comparison with monetary aggregate rules. The demonstrated success of MPCs [Monetary Policy Committees] to balance their *long-term* objective against shorter-run output stabilization can be replicated in the case of FPCs [Fiscal Policy Committees]. What seems to be squaring the circle, combining short-run flexibility with long-run discipline, can be achieved in the area of fiscal policy in the same way as it has been achieved in the area of monetary policy.

A trustee fiscal council would exhibit the following observable characteristics: a high level of political, financial and personal independence, and a mandate that goes beyond merely fiscal rule-monitoring and forecasting explicitly allowing for the possibility to make binding fiscal policy choices with high distributive consequences, thus raising the level of public awareness (European Central Bank 2014, 96; Coeuré 2016). However, the trustee model would need to overcome serious obstacles to be implemented in practice (Wyplosz 2008, 186-90). First, time-inconsistency as the sole origin of the deficit bias in fiscal policy might be misleading. The political economy literature on the deficit bias points to a panoply of potential origins (Debrun et al. 2013, 43; Larch and Braendle 2018) but no straightforward methodology exists to correctly identify them. Second, the trustee model leaves the control of certain fiscal policy instruments in the hands of un-elected technocrats. The right to tax and spend is a sovereign prerogative of elected representatives and cannot be easily delegated without constitutional amendments ('no taxation without representation') (Wren-Lewis 2013). The fine distinction between the budget balance and the broader role of fiscal policy can be deliberately blurred by opponents of the trustee model (Wyplosz 2008, 190). Third, there is no proven track record of a fiscal council conducting fiscal policy instead of the government (Wren-Lewis 2013). This is not surprising given the lack of consensus regarding the goals of fiscal policy (Ódor 2014, 7;



Leeper 2010). While monetary policy theory has steadily evolved, a trend towards the ‘scientization’ of fiscal policy has emerged only recently. Fourth, politicians prefer not to fully lose control over fiscal policy because redistribution allows them to build winning coalitions of voters to boost their reelection prospects (Alesina and Tabellini 2007). Fifth, a trustee fiscal council that constraints the government too tightly runs the risk of being dissolved completely (Wyplosz 2008, 188). Thus far, these hurdles have prohibited the implementation of the trustee model in its pure form. Nevertheless, one can observe fiscal councils with trustee-like features. The UK’s Office for Budget Responsibility (OBR), for instance, is tasked with producing the bi-annual five-year economic and fiscal forecasts that are used by the government (Chote and Wren-Lewis 2013; von Trapp, Lienert, and Wehner 2016, 241-56). This bestows a degree of budgetary authority upon the OBR at an early stage of the budgetary process and distinguishes it from other fiscal councils that merely assess the government’s forecasts.

### **Fiscal councils as orchestrators: pushing governments towards fiscal discipline**

Orchestration perfectly illustrates the transmission mechanism of a fiscal council. First, orchestrating fiscal councils lack hard control over the targets they want to govern (Abbott et al. 2015, 720). They neither possess decision-making authority nor do they have legally-binding enforcement powers (Kopits 2011; Hemming and Joyce 2013). A fiscal council might want to reduce the budget deficit to meet the Maastricht criteria but has no direct control over the fiscal instruments to achieve this goal. This allows other actors to easily dismiss the orchestrator’s recommendations unless it is politically costly to do so because the latter possesses a high reputation and a degree of focality in budgetary politics. Second, an orchestrator enlists a voluntary intermediary whose goals are aligned (Abbott et al. 2015, 722). Fiscal councils (orchestrator) can enlist voters, the media, credit rating agencies or parliamentarians with a strong preference for fiscal discipline (intermediaries) by providing ideational support, such as nonpartisan budgetary forecasts, normative assessments and recommendations or costing of specific fiscal policy measures (soft inducements) to influence the fiscal policy choices of the government indirectly (target).

Informational asymmetry often hinders voters and opposition parties from fulfilling their role in a system based on checks and balances. The average voter struggles to verify whether a fiscal policy measure will be budgetary neutral (Calmfors and Wren-Lewis 2011). Thus, the electorate may not be able to observe the ‘true’ fiscal position of the government. In the absence of a sufficient understanding of the intertemporal budget constraint (‘fiscal illusion’), voters might be prone to succumb to over-optimism regarding the ‘true’ state of public finances (Calmfors 2010, 2015). If governments exploit this informational asymmetry for electoral gain, the well-known political business cycle will ensue and create persistently high budget deficits (‘deficit bias’). Fiscal councils can break this vicious circle by sending a credible signal to voters about the ‘true’ fiscal stance of a government. The credibility of the signal will be stronger if the fiscal council enjoys a reputation for non-partisanship. Like the trustee model, the orchestrator model therefore presupposes strong institutional independence. The main difference between the two is then that the trustee can make binding fiscal policy decisions, whereas the orchestrator cannot. Third, by enhancing fiscal transparency, better informed citizens will make better decisions when judging the government’s fiscal competence (Beetsma and Debrun 2017). Governments target individual groups through increased spending to reward the loyalty of their constituency (Weingast, Shepsle, and Johnsen 1981; Calmfors 2010; Calmfors and Wren-Lewis 2011; von Hagen 2013). ‘Unbiased’ information might reinforce the *ex-ante* and *ex-post* public scrutiny on budgetary matters and, thereby, influence fiscal policy indirectly. In sum, an orchestrating fiscal council is characterized by the following observable implications: high public awareness due to a well-developed network of intermediaries and an effective communication strategy, sufficient access to information and a high level of independence. The Portuguese fiscal council, the *Conselho das Finanças Públicas* (CFP), closely adheres to the orchestration model. The CFP is not merely in charge of conducting assessments of the compliance with the fiscal rules but, crucially, assesses the government’s overall fiscal strategy (von Trapp, Lienert, and Wehner 2016, 189-203). The use of various media channels ensures that the CFP sends credible signals to the public. In doing so, it multiplies its impact and lives up to its full orchestration potential.

## THE DIFFUSION OF HETEROGENEOUS MODELS OF FISCAL COUNCILS IN THE EU

IOs can play an important role in domestic institutional change. They can rely on ‘analytic institutions’ to interpret the experience of their member states, which allows them to construct cognitive authority in a wide array of policy fields (Broome and Seabrooke 2012). However, IOs are not neutral observers but self-interested players that try to advocate institutional change in line with their own agenda. They often use their ‘analytic institutions’, such as different indices, to promote their preferred conceptual model. This *entrepreneurial benchmarking* is defined here as the indexing of institutional models according to selected criteria to persuade actors of the benefits of a specific conceptual model preferred by the respective organization. The IMF often makes use of ‘associational templates’ that compares the experiences of a regional peer group like the EU to make its advice to member states more palatable (Broome and Seabrooke 2007). If different IOs simultaneously promote heterogeneous conceptual models, member states have more wiggle room to ‘pick and choose’ from the available menu options.

Other factors contributing to the heterogeneity of fiscal councils include: the timing of their creation, historical path dependencies, party preferences, the political system and economic and financial crisis. First, fiscal councils created after 2004 are more likely to harness their full orchestration potential through regular hearings in parliament (Debrun et al. 2013, 17). Second, country-specific historical path dependencies can condition the institutional adaptation. In France and Finland the fiscal councils are located within their country’s court of audit (Debrun et al. 2013, 24), whereas in other countries an institutional clean slate made it necessary to build new fiscal institutions from scratch. Third, the preferences of political parties matter for the creation of fiscal councils but their advocates do not stem from a particular corner of the political spectrum. In Sweden, the liberal-conservative government established a fiscal council but later formed a cross-party consensus with the left-leaning opposition (Calmfors 2013). Fourth, in presidential systems with a powerful executive, fiscal councils are often attached to the parliament. The US Congressional Budget Office was formed in 1974 in an attempt to

regain congressional control over the federal budget by counterbalancing President Nixon (Steuerle and Rennane 2013). In parliamentary systems with strict party discipline, on the other hand, a fiscal council should ideally be a stand-alone body separated from both branches of government (Kopits 2013, 9). Finally, the origins of fiscal councils can often be traced back to economic and financial crises (Kopits 2013, 3).

Before the 2008 global financial crisis only five fiscal councils existed in the EU. When Hungary became the first country to ask for financial assistance in November 2008 it provided a window of opportunity for the Commission and the IMF to put pressure on the Hungarian government to install a fiscal council. A loan agreement with the IMF allowed the country to tap the EU's balance-of-payment facility for non-euro area countries, which gave the IMF and the Commission additional leverage to enforce its conditionality. However, even under maximum external pressure it was not clear which conceptual model of a fiscal council should be adopted (Kopits and Romhanyi 2013, 216). Ultimately, the Hungarian parliament passed the Fiscal Responsibility Law that foresaw the creation of an orchestrating fiscal council that would have sufficient 'dissuasive authority' to put pressure on the government in case of fiscal profligacy (Kopits and Romhanyi 2013). During the Romanian bailout programme in 2010, the IMF also explicitly demanded the creation of a fiscal council and staged a public intervention in support of the latter when the Romanian government was about to co-opt the new fiscal watchdog's authority (Ban 2016, 224-5). Thus, early adopters were small open economies like Romania, Hungary, Ireland, Greece and Portugal that were particularly vulnerable after the financial crisis and depended on external financial assistance. Especially for the latter three countries the creation of a fiscal council was an iron-clad provision of the memoranda of understanding negotiated by the troika (Fromage 2017, 121).

A power-based explanation of the diffusion of fiscal councils in the EU would emphasize external coercion as the main independent variable. Member states experiencing fiscal stress turned to the troika for financial assistance which imposed a fiscal council on them as part of its conditionality. While the troika

format provided an important enforcement vehicle to create fiscal councils in the first place, it fails to explain the variance in the design features. Some member states without a troika presence imposed a fiscal council on themselves overshooting the EU's legislative requirements, whereas other countries with a troika programme reluctantly implemented the minimum requirements. A functional rational choice institutionalist (RCI) explanation would argue that fiscally stressed member states were eager to credibly commit to fiscal prudence to avoid having to implement the politically costly conditionality of a financial assistance programme. Fiscally profligate countries with clientelistic regimes could promote fiscal transparency through setting up fiscal councils (Wyplosz 2008). When the troika comes knocking on your door and confronts you with the prospect of having to implement tough austerity measures, political parties face strong incentives to quickly form a cross-party consensus to create an independent fiscal council to reaffirm their commitment to fiscal discipline. Under these circumstances, it might be politically expedient to delegate some fiscal policy tasks to technocrats for future blame avoidance. Even if these watchdogs would turn out to be mere smokescreens, it would be worth to set them up to receive a short-term boost in fiscal credibility until financial markets would call the bluff. A constructivist explanation would explain the fiscal council variance with the role of ideas. Especially, ordo-liberal ideas have constituted an important driver behind the new EMU fiscal architecture (Nedergaard and Snaith 2015). However, this explanation would lead us to expect the German fiscal council to be particularly hawkish which doesn't hold. In sum, the above listed explanations shed light on contributing factors to the rise of heterogeneous fiscal councils. The following section will elaborate on the rationale behind the support for a particular fiscal council model by the respective troika member and will show how each member promoted its preferred model.

## **THE ACTORS AND THEIR INTERESTS BEHIND THE CREATION OF FISCAL COUNCILS**

### **The European Commission: closing the compliance gap and increasing local ownership**

The European Commission had been an advocate of fiscal councils ever since member states started to dilute the SGP (European Commission 2006, 2014). First, it wanted to improve the compliance record with the fiscal rules. Second, many member states concluded that a ‘political’ Commission lacked the credibility to fulfil its role as the ‘guardian of the treaties’. Partially outsourcing a task that had become too politicized was the attempt to reestablish its own credibility. But it also meant creating potential challengers to the Commission’s monopoly power as the ‘fiscal rule interpreter of last resort’. Competing compliance assessments by the national fiscal councils and the Commission could lead to conflicting interpretations of the rules (Jankovics and Sherwood 2017, 29). To avoid such conflicts the Commission would have ideally preferred to set up a ‘European System of Fiscal Councils’ in which the supranational European Fiscal Board (EFB) as its agent would have coordinated the work of independent national fiscal councils (Asatryan and Heinemann 2018). However, member states and their national fiscal councils opposed such a system. The Commission’s second-best solution was then to advocate for a narrow mandate for national fiscal councils so that its discretion in interpreting the various flexibility clauses under the SGP would not be endangered. To persuade member states of the benefits of the agent model of a fiscal council the Commission constructed its SIFI Index (Figure 2), which puts a disproportionate weight on the monitoring of the fiscal rules under the SGP and macroeconomic/budgetary forecast assessment. This *entrepreneurial benchmarking* leads to a considerably different ranking of fiscal councils compared to the IMF’s ranking (Figure 3). It rewards those fiscal councils that have adopted the agent model, whereas it punishes orchestrating fiscal councils. An index can provide a soft incentive for member states to undertake institutional change in order to avoid being labeled as the laggard. The political costs of this public shaming can be minimized by adopting the model that would catapult the national fiscal council to the upper ranks.

## **[FIGURE2]**

The eurozone crisis has demonstrated that negative fiscal spill-over effects can bring a monetary union to the brink of collapse. Strengthening the fiscal governance framework was a core task to make EMU more

sustainable. This would require a higher degree of local ownership of the fiscal rules, which would in turn make the fiscal measures appear more nationally rooted. It explains why the Commission provided enough leeway in its legislative proposal to account for national idiosyncrasies. In its 2017 report on the implementation of their obligations contained in the Fiscal Compact, the Commission found that all euro area member states were compliant with the TSCG and the common principles (European Commission 2017b). In its stock-taking exercise it pointed out that:

‘The framework set by the TSCG and the accompanying common principles is one of relatively broad requirements that are principles-based, reflecting compromises needed when negotiating the TSCG and the common principles. In addition, to raise national ownership, margin was given to customise national provisions to the specific institutional budgetary setting.’ (European Commission 2017a, 3)

The Commission’s pivotal role in the legislative process renders it sensitive to EU member states’ preferences as expressed in the Council of the EU. This political interplay might have tipped the balance towards the Commission’s support for a leaner (advisory) fiscal council mandate.

### **The ECB: ensuring monetary dominance**

In light of the repeated SGP violations the ECB had been struggling to ensure monetary dominance (Henning 2016). Fiscal profligacy in one member state could put pressure on the ECB to soften its monetary policy stance and in a worst-case scenario lead to monetary financing. If local ownership of the fiscal rules could be increased, it would allow the ECB to step back from the politicized role as ‘policeman and judge’ of the SGP (Howarth and Loedel 2004). Fiscal councils acting as a permanent ‘domestic troika’ would provide an additional prevention mechanism against negative externalities arising from low compliance with the fiscal rules. Thus, they indirectly help to maintain the quality of the ECB’s sovereign bond portfolio. The ECB’s preference for the creation of trustee fiscal councils is most evident in the central

bank's comprehensive blueprint for a deepened EMU entitled 'Reinforcing Economic Governance in the Euro Area' (European Central Bank 2010). The report did not only call for an independent EU fiscal agency acting as a watchdog for the fiscal surveillance framework but also strongly encouraged the creation of 'independent fiscal monitoring institutions' (European Central Bank 2010, 8). In its legal opinion on economic governance reform in the EU, the ECB proposes 'introducing a top-down approach, meaning a prior agreement on the total spending level that is then allocated in spending allotments for different ministries or government agencies.' (European Central Bank 2011, 6) While this proposal falls short of the full-fledged trustee model, it would constitute a first step towards 'institutions-based fiscal decision-making' (Coeuré 2016). While the ECB expressed concerns about the limited leverage to force the government to pay attention to fiscal councils' policy recommendations (European Central Bank 2014, 99), it contends that:

the effectiveness of fiscal councils will largely depend on whether they are independent from political interference and whether they have functional autonomy. A fully independent and credible fiscal council increases the political cost for the government to deviate from its commitments. It is thus important that political interference is legally prohibited and that the council members are appointed based on competence and experience rather than political preference. (European Central Bank 2014, 99)

The ECB's view on a fiscal council's design features is strongly affected by its own experience with the time-inconsistency problem, which provided the rationale for its high level of independence. Thus, it does not come as a surprise that the ECB tries to promote its own institutional design as a template for other technocratic institutions. While the ECB tried to persuade member states of the benefits of the trustee model, the main reason for the ECB's unsuccessful persuasion attempt was the relative unattractiveness of the trustee model to elected politicians. The ECB only engaged half-heartedly in *entrepreneurial benchmarking* because it shied away from ranking countries. Instead, the ECB chose to rely predominantly



on the persuasive power of its legal opinion, conferences and its Economic Bulletin in which it published a qualitative fiscal council index (see European Central Bank 2014, 97).

### **The IMF: creating a sustainable EMU and ensuring loan repayment**

The IMF sees the transferal of knowledge and diffusion of best practices as a core part of its technical assistance missions. The eurozone crisis opened a window of opportunity for the IMF to persuade the EU member states of the benefits of the orchestration model of a fiscal council. In the post global financial crisis period the EU has increasingly relied on the IMF with regards to loan provisioning and economic surveillance turning it into a *de facto* EU institution (Hodson 2015). As a result of the diminished confidence in the Commission, the IMF gained access to various indirect channels of influencing EU policy-making (Henning 2017) and became almost indistinguishable from the traditional ‘engines’ of deeper integration (Hodson 2015, 586-9). Former IMF Managing Director Strauss-Kahn pushed the idea of establishing a ‘more credible judge of fiscal behavior in the euro area’ in Brussels (Strauss-Kahn 2010). An IMF Staff report explicitly called for establishing fiscal councils in the euro area (Allard et al. 2013, 17). As a bail-out monitor and as a creditor the IMF had a stake in enforcing fiscal discipline in the EMU. Permanently institutionalizing fiscal discipline at the national level would increase the chances that the IMF loans would be repaid. The beneficial side effect would be that the IMF could claim credit for its research directly contributing to sound fiscal policies. The IMF had set up a fiscal council dataset to demonstrate the benefits of its preferred model and also published a comprehensive study on the global population of fiscal councils (see Debrun et al. 2013). Four design features were key to orchestrating fiscal councils: (1) a high level of operational independence, (2) the independent assessment of budgetary forecasts, (3) a high media profile (i.e. presence in the public debate), and (4) the monitoring of fiscal rules. According to the IMF’s orchestration model, a fiscal council ‘should be equipped to ensure that public information about the budget sends a clear signal of politicians’ genuine intent and actions.’ (Beetsma and Debrun 2016) Thus, the IMF’s SEC Index strongly emphasizes the ability to communicate with the public. Countries that have

adopted the orchestration model of a fiscal council will therefore be ranked higher in the IMF's evaluation (Figure 3). This soft incentive has been very successful in promoting the IMF's orchestration model. It reflects the IMF's deep knowledge of their member states' experience with their domestic institutions. To interpret and to distil lessons from this that can be used to persuade others of the superiority of a certain conceptual model is a skill that the IMF has also used in other issue areas. The frequent exchange with its member states through Article IV Consultations is indispensable in this regard. Even though the IMF has no formal rule-making powers in the EU as such, it was able to act as a major driver of institutional change.

### **[FIGURE3]**

## **CONCLUSION**

This article has shown that the conceptual models developed by the troika institutions were heterogeneous and provided enough wiggle room for member states to make their fiscal councils compatible with their domestic institutions. The empirical evidence shows that the orchestrator and the agent model make up the largest part of the population, whereas only a few EU member states like the Netherlands and the UK have created fiscal councils with trustee-like features (Horvath 2018). In the latter cases the government has entrusted them with the production of the official forecasts which bestows a degree of budgetary authority upon them. IOs employed tailor-made indices to persuade others of the superiority of their preferred conceptual model. Persuasion through *entrepreneurial benchmarking* constitutes an important mechanism by which IOs construct their cognitive authority over member states (cf. Broome and Seabrooke 2012). Yet, when different IOs propose different indices this task becomes considerably harder because they undermine each other's persuasive power. While this does not explain the entire observed variance in the design features of fiscal councils, it certainly is a condition which has hindered the development of a one-size-fits-all model.

As the euro area crisis' overshooting effects recede, fragile 'regime complexes' like the troika that were born out of necessity (Henning 2017) are being gradually substituted by more permanent institutions. When compared to the diffusion of central bank independence, it becomes clear that 'institutional isomorphism' – i.e. the spread of a uniform institutional design across different settings of social interaction (McNamara 2002, 62) – is rather exceptional as it requires all actors to converge around a single conceptual model and then collectively enforce its implementation. At the current juncture, fiscal councils resemble 'neglected siblings of independent central banks' (Larch and Braendle 2018) but definitely not twins given their institutional heterogeneity. However, convergence towards a more homogeneous fiscal council model might ensue after an initial stage of institutional experimentation. A network of EU independent fiscal institutions has already formed with the goal to 'exchange views, expertise and pool resources in areas of common concern'. But the absence of a one-size-fits-all model doesn't have to be detrimental because a degree of heterogeneity enables institutional learning and allows national fiscal councils to be embedded in the overarching domestic economic framework. If national fiscal councils and the supranational EFB would gradually intensify their cooperation, it could lay the foundation for an emerging 'technocratic federalism' in fiscal policy (Sánchez-Cuenca 2017). This would facilitate a timelier transfer of best practices, while leaving the door open for institutional innovation.

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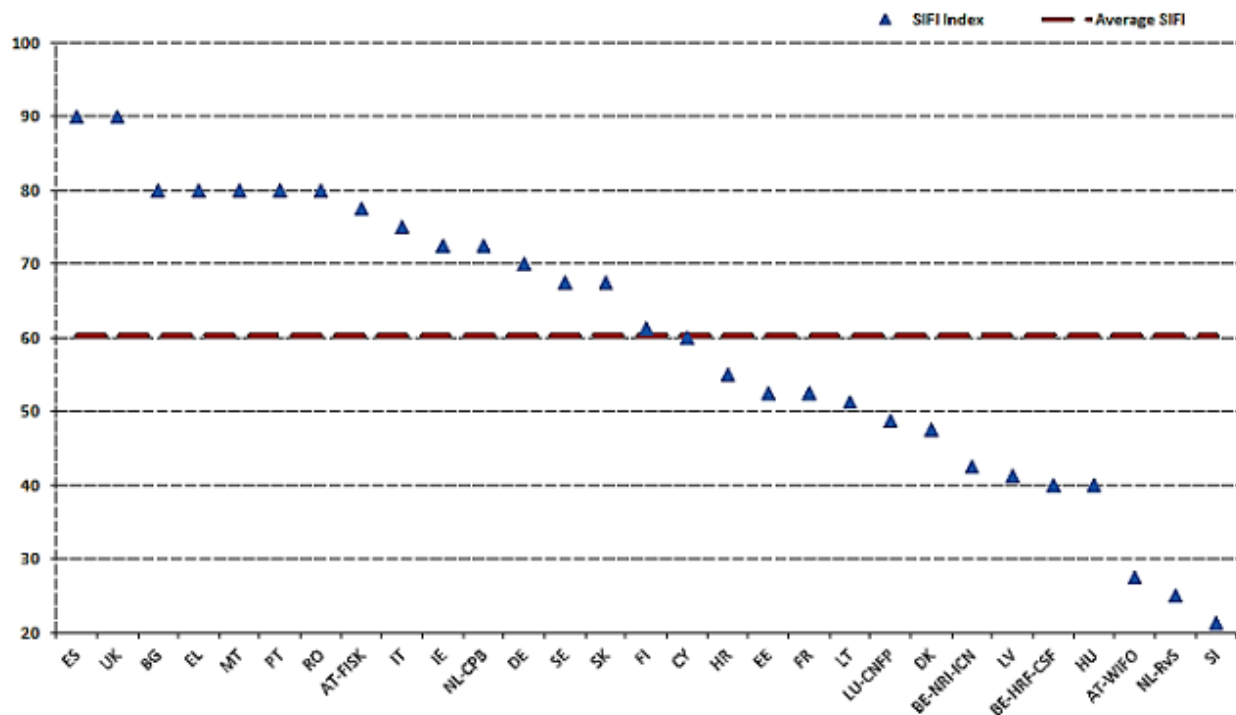
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Figure 1: Modes of Indirect Governance

INITIATION (EX ANTE)	MANAGEMENT (EX POST)	
	Hierarchical	Non-hierarchical
Granting authority	<i>Delegation</i>	<i>Trusteeship</i>
Enlisting authority	<i>Cooptation</i>	<i>Orchestration</i>

Source: Abbott et al. (forthcoming)

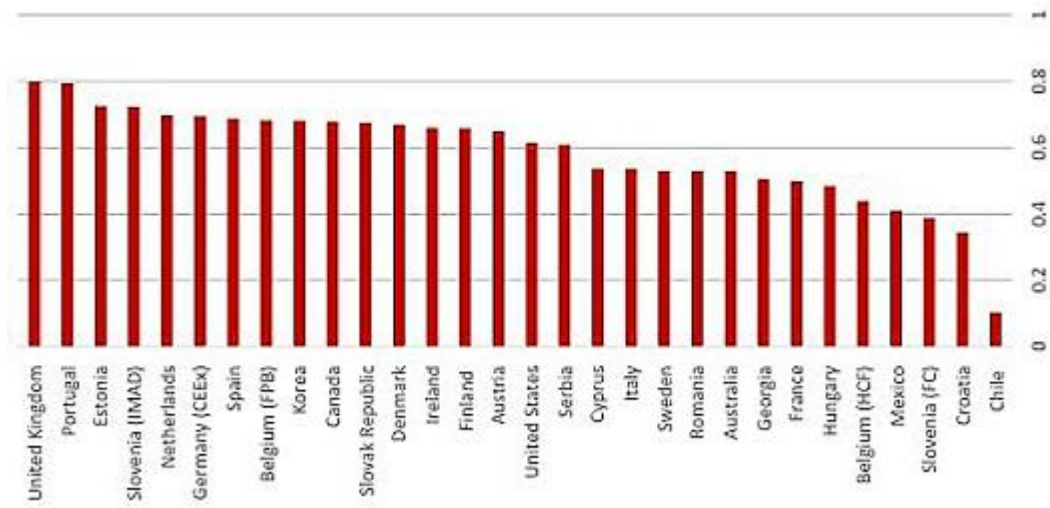
Figure 2: Scope Index of Fiscal Institutions (SIFI)



Source: European Commission Fiscal Institutions Database 2015; [https://ec.europa.eu/info/publications/fiscal-institutions-database\\_en](https://ec.europa.eu/info/publications/fiscal-institutions-database_en)



**Figure 3: Signal-Enhancing Capacity Index (SEC)**



**Source: Beetsma and Debrun (2016)**