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Political Aversion To a Multilateral Fiscal Rule: The Dynamic Commitment Problem in European Fiscal Governance

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Abstract

From a retrospective perspective, effective future fiscal cooperation in Europe is not likely to stand a chance. Focusing on the Stability and Growth Pact (SGP, the Pact), this paper studies the determinants of national policymakers' changing commitment to a multilateral fiscal rule, referred to as the "dynamic commitment problem". The empirical analysis sheds light on the economic and political economy factors that contribute to national policymakers' aversion to a multilateral fiscal rule in a monetary union that is not a political union. The underlying analysis is based on an event study including 147 statements of EU heads of government (the European Council) and members of the Economic and Financial Affairs Council (the EcoFin) over the period 2001 to 2008. All statements are either related to flexible interpretations of the SGP or calls for changing the rules of the framework, thus being an indicator of political non-commitment to the Pact. Standard political-economy theory is considered to derive a number of testable hypotheses. The unique dataset is linked to econometric analysis in order to estimate the effects of national economic and national political economy determinants on the strength of political aversion to the SGP. The empirical findings show that political aversion to the SGP is positively correlated to the national budgetary deficit, negatively correlated to domestic economic growth and negatively correlated to the costs of government borrowing. In addition, the results indicate that economic and political power, government fragmentation and rising non-commitment amongst other member countries' politicians systematically influence national political aversion to the SGP. The findings cast serious doubts on future EU/EMU policymakers' full commitment to the recently revised SGP and the recently adopted European Fiscal Compact, both of which are discussed in the final part of the paper.

JEL Classifiaction: E62; F55; C22; C58

Key words: fiscal rules, monetary union, political economy

I Introduction

Over the past decade, credibility of the European Union's (EU) legislation of fiscal cooperation has been seriously damaged. The emergence as well as the persistence of the European sovereign debt crisis, which is by many recognised as a crisis of the euro, and the recent political struggle for stronger fiscal policy coordination makes evident that the monetarily united part of the EU, the European Monetary

Union (EMU), still is subject to contradictory political visions about the conduct of national fiscal policy.

Before strong capital market pressure emerged for the governments of Ireland, Greece, Portugal, Italy, Spain, and more recently for Cyprus, pressure on EMU governments against the conduct of loose fiscal policies was mainly based on poor peer pressure under the preventive arm of the Stability and Growth Pact (SGP, the Pact). Right from the beginning of EMU some governments more intensively than others tried to flexibly interpret or even to modify the SGP's original set of rules. The Pact never gained ownership by the majority of national political elites. As a result, disagreement among EMU members over the practice of denouncing and sanctioning countries that failed to respect budgetary limits (under both the preventive and the corrective arm) seriously undermined the initial objectives of the Pact. Due to the political haggling over the SGP's rules, the Pact very early lost its credibility.

Therefore, the SGP provides a suitable framework for studying the role of both national economic conditions and national political institutions in determining national policymakers' commitment to a multilateral fiscal rule in a monetary union that is not a political union. This is the underlying matter of this paper and this subject is crucial since the EMU's underlying new legal framework, reformed for the second time now, as well as the new European Fiscal Compact (Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, TSCG) aims to strengthen national public finances of EMU members. Since both institutional frameworks still lack effective judicial enforcement they are likely to be permanently prone to non-compliance.

Theoretical and empirical research suggest that economic variables do not suffice to explain divergent fiscal policy decisions. Rather partisan preferences and political institutions can play a crucial role in explaining fiscal policy outcomes (see, e.g., Price, 2010; Pamp, 2008; Golinelli and Momigliano, 2006; Alesina et al., 2006; Mulas-Granados, 2003; Alesina and Perotti, 1999; Roubini and Sachs, 1989). In contrast to most of these papers, this study analyses the determinants of political rhetoric that serves as a proxy for political aversion to a multilateral fiscal rule. Put differently, a country's unwillingness to stick to the SGP is measured by the rhetoric of its ruling policymakers: EU heads of government and members of the EcoFin. Based on data of 12 EMU member states over the period 2001 to 2008 time series cross section models (TSCS) are applied in order to test the economic and political determinants of what is called "strength of national political aversion" to the SGP.

The paper is organised as follows. Section II presents political-economy considerations related to multilateral fiscal cooperation under EMU and the dynamic commitment problem. In addition, nine testable working hypotheses are derived from standard political economy theory. Section III presents data and variable definitions and describes the applied econometric framework. The empirical results are presented in section IV. Section V evaluates the results of the empirical analysis and provides policy implications with respect to the EMU's reformed fiscal governance legislation. Section VI concludes.

II Theoretical Background and Hypotheses

II.1 Soft Fiscal Policy Coordination under the SGP

Although theoretical and empirical economic literature offers abundant advice on how taxes and public expenditures should be applied over the business cycle[1], history shows that policymakers appear to be driven by other incentives rather than the objective to pursue sound public finances. The public choice and political economy literature provides various explanations of the government's bias to run persistent deficits. The motivation behind fiscal policy choices can be explained by opportunistic policymakers, partisan interests, and the common pool problem of resources, which is related to distributional conflicts and the influence of pressure groups (for an overview see, e.g., Wyplosz, 2012 and Eslava, 2011). For a monetary union that is not a political union, these insights are of particular relevance.

Theory of optimal currency areas suggests that a monetary union needs a system of fiscal transfers. As an instrument of intra-EU/EMU fiscal policy coordination, the SGP has been introduced to make member countries take into account the externalities they impose to their neighbours due to excessive deficits and (continuing) debt accumulation. In this context, the SGP can be considered as a federal institution aiming to restrict fiscal leeway among the member states of a monetary union (Mckay, 2006). With the benefit of hindsight, however, it is generally acknowledged that the SGP has been a rather weak substitute for a system of fiscal transfers governed by a central fiscal authority. Enforcement of the rules was ineffective in the past and countries frequently breaching the rules have never been fined. These facts give reason to think about why this framework of soft policy coordination, though recently renewed, is still alive.

Peer pressure under the preventive arm and ultimate financial fines under the corrective arm of the Pact failed to create appropriate incentives for member countries to cooperate. In this context, Eichengreen (2005) argues that the lack of political integration in Europe forms an obstacle to effective enforcement mechanisms. Similarly, Larch et al. (2010) refer to the need of deeper fiscal integration due to the ongoing political constrains for effective enforcement of the SGP's legal provisions.

Nevertheless, the problems associated with the implementation of the "first" Pact have led a substantial number of economists to work on proposals for improvement and reform (for an overview of 101 reform proposals see EU Commission, 2006). In addition, although the "flexibility" reform of the SGP in March 2005 clearly demonstrates that most European governments do not wish to comply with a hard

[1] See, e.g., Barro (1979) for a seminal contribution.

multilateral fiscal rule, the SGP is still presented by scholars and European institutions to be an instrument that ensures fiscal discipline. The European Commission still views the 2005 reform as "a positive step forward, as it enhanced the economic rationale of the SGP. It [the reform] introduced provisions on how to deal with special circumstances and country-specific problems, above all linked to macroeconomic downturns" (EU Commission, 2012, pg. 66).[2]

More recently, under the pressure of the European sovereign debt crisis a number of new suggestions on how to organise multilateral fiscal cooperation emerged, most of them claiming for stricter enforcement of sanctions (Sachverständigenrat, 2010; EU Commission, 2010; Schuknecht et al., 2011). However, though aiming for more effective fiscal policy coordination, all of these new suggestions are again based on peer pressure (essentially naming and shaming) among individual EU/EMU governments only.

Regarding the role of peer pressure, the early contribution of Meyer (2004) deals with the effectiveness of soft fiscal policy coordination in the EU. In this early analysis of the effectiveness of proposals and recommendations made under the SGP and the Broad Economic Policy guidelines (BEPG), Meyer asks whether public peer pressure (naming and shaming) has had an impact on national policymaking. The author draws on the power of peer review in affecting policy learning and policy change at national level. It is tested whether the public discourse that is covered by various media can influence national policymakers' response to proposals and recommendations of supranational institutions, particularly made by the European Commission and the EcoFin. The conclusion of this study is, that there is no substantial evidence that any publicized discourse has had an impact on policymakers, although negative news frequently produced a number headline stories. As a consequence, Meyer remains sceptical whether policy coordination can have a positive impact on policy learning and cross-national dialogue in the field of fiscal policy. This finding is of particular relevance because national political ownership is a crucial precondition for a fiscal rule to work effectively at multilateral level.

II.2 The Dynamic Commitment Problem

Though the Pact's numerical rules were simple (and also transparent), adherence to the rules proved not to be self-enforcing. Most importantly, neither peer pressure arriving from EU/EMU member states contributed to national compliance nor an external agent (the European Commission) has had the power to continuously enforce the Pact's rules.

[2]On the other hand, the Council clearly acknowledged the problems linked to political non-ownership of the previous legislation: "Experience gained and mistakes made during the first decade of the economic and monetary union show a need for improved economic governance in the Union, which should be built on stronger national ownership of commonly agreed rules and policies and on a more robust framework at the level of the Union for the surveillance of national economic policies." See recital (4) of Council Regulation (EU) No 1177/2011 of 8 November 2011.

While academics were worrying mainly about the missing strength of enforcement under the established regime, ruling politicians successively claimed for a less restricted SGP at all - a political straitjacket that was initially set up by EU/EMU policymakers ruling in the late 1990s. Put differently, politicians' commitment to the established multilateral fiscal framework has changed over time, presumably owing not only to changing economic conditions, but also to changing political actors. From a theoretical perspective, the policymakers' dynamic attitudes to the Pact, which are expressed by observable political behaviour, can be explained by political economy considerations of intergovernmental cooperation.

Based on the clarification of Schuknecht (2005), decision-making on intergovernmental cooperation exists at two levels: 1) the constitutional stage and 2) the post-constitutional stage including the implementation and enforcement of the rules that previously came to agreement. Policymakers' incentives might differ at the stage of the initial setting of certain rules compared to a later point in time at which policymakers are required to choose how to play within a given legal framework. In a post-constitutional decision of reform, such as made in March 2005, voting for strict enforcement has apparently become less attractive since policymakers did not face substantial public pressure to do so and strong warning signals from financial markets, e.g. a gradual dry up of refinancing channels which might end up in a liquidity or even a solvency crisis, did not emerge.

The the data analysed below illustrate that the post-constitutional debate on increasing the flexibility of the initial SGP was characterised by controversial contributions from political players of almost all European countries, all political colors and almost all European institutions. National politicians frequently claimed either for a more flexible interpretation of the rules or even for a reform of the overall framework. Put differently, policymakers frequently expressed their "aversion to the restrictions of the SGP", thereby seriously undermining its credibility.[3] After the 2005 reform, however, voices against the new Pact appear to have faded away.

Evidently, the initial set up of the SGP did not improve fiscal performance of most EMU members. Policymakers' attitudes to national fiscal policymaking did not change under the boundaries set up by the Pact. It follows from these insights that the SGP being a multilateral fiscal rule did not have the power to permanently suppress fiscal discretion at national level: initial political commitment to fiscal behaviour in line with the rules turned to substantial non-commitment. In this paper, this development is referred to as the "dynamic commitment problem".[4]

[3]For a comprehensive analysis of national politicians' preferences determining the creation and the reform of the initial SGP framework see Schwarzer (2007).

[4]Having a more general discussion about the effectiveness of fiscal rules per se, Wyplosz (2005) refers to the analogies to monetary policy theory stating that the time consistency problem also prevails in fiscal policy due to policymakers' temptation to apply discretionary fiscal policies whenever preferable to adhere to given a rule. The term "dynamic commitment problem" is more suitable for the purpose of this paper since it refers to policymakers' changing attitudes to a certain fiscal framework over time.

The economic and political determinants of the strength of political aversion to the SGP are studied in the empirical section below. Before starting this exercise, standard political economy considerations are briefly introduced. In order to develop testable hypotheses, models of policy oriented preferences of politicians as well as economic and institutional constraints are discussed in the next section.

II.3 Modelling the Determinants of Political Aversion To a Multilateral Fiscal Rule

Conceptionally, this paper is related to the work of Ehrmann and Fratzscher (2011) who study politicians' preferences on EMU monetary policy over the period 1999 to 2007. In their paper, various statements of EU politicians are classified depending on whether each comment indicates a preference for certain interest rates.[5]

The theoretical underpinnings of the hypotheses about the determinants of political aversion to the SGP are presented below. The hypotheses derived in this section are tested in the subsequent empirical analysis.

II.3.1 Economic Determinants

The Structural Balance

The SGP's 3 per cent limitation on national fiscal policy is critical because the budget responds to the economic cycle. On the expenditure side, automatic stabilisers like unemployment schemes inherently affect the budget. On the revenue side, the budget responds to shortfalls in tax receipts. Empirical research indicates that fiscal policy is more persistent than responsive to economic conditions. Following Afonso et al. (2010, pg. 528) this implies that " [...] apart from the fact that there is also less room for discretion, it may be more difficult for policy makers to implement temporary fiscal activism, and, more importantly, successfully to reverse it quickly when no longer needed." Empirical findings also indicate that policymakers frequently fall back to discretionary interventions in order to provide for economic stimulus, rather than to fuel an economic crisis any further with contractionary policies (Maravalle and Claeys, 2012; Turrini, 2008; Wyplosz, 2005). There is also ample evidence for procyclical fiscal behaviour whereby most of the empirical literature refers to hysteresis in government expenditure. As was shown in IMF (2004), also EU fiscal policies have been rather procyclical since the early 1980s. Related to these findings, Debrun et al. (2008) find that the cyclically-adjusted primary balance in the EU is highly positively correlated to that of the previous year.

[5]The authors find that politicians' preferences for monetary policy are asymmetric. On average, politicians favour lower interest rates in favour of economic growth. More specifically, politicians' preferences for monetary policy are determined not only by general domestic economic conditions but also on national political economy factors such as political orientation, partisan politics and, to some extend, elections. More generally, political aversion to the monetary policy of the ECB is determined by economic and political factors. For this reason, Ehrmann and Fratzscher stress the importance of central bank independence.

Generally, expenditures rise during booms, but are not driven down in busts (see, e.g., Hauptmeier et al., 2011; Hercowitz and Strawczynski, 2004).

Given that national policymakers have an inherent tendency to generate budgetary deficits, political rhetoric regarding the SGP should reflect both the state of the economy and the government budget. Since the SGP limits policymakers' freedom in the implementation of fiscal policies, the first hypothesis is:

Hypothesis I: Structural Deficit

The higher the structural deficit, the higher the political aversion to the SGP.

The Economic Growth Differential

In a similar vein, national economic growth might affect political political commitment to the SGP. Alesina and Cukierman (1990) argue that individuals vote retrospectively. In other words, the incumbent is judged according to actual economic outcomes achieved over the term of office. Following this argument, forward looking voters take into account economic growth considerations. In turn, by anticipating retrospective voters, national policymakers have an incentive to blame EU/EMU institutions for the fact of poor national performance. In this context, for instance, Ehrmann and Fratzscher (2011) argue that ruling politicians have an incentive to blame monetary policy for poor economic growth.

Since the SGP restricts the implementation of economic stimulus packages and expansionary fiscal policies in order to stimulate economic growth, policymakers' aversion to this restraint might be determined by the relative macroeconomic performance of their country's economy. According to this view, policymakers will stress the need to foster economic growth when domestic economic growth is relatively low compared to other members of the currency club. It follows as a second hypothesis:

Hypothesis II: National Economic Growth Considerations

The higher the negative growth differential compared to the euro area average, the higher the political aversion to the SGP.

Market Discipline

Capital markets process various types of information concerning the creditworthiness of governments. Empirical evidence suggests that hard fiscal indicators predominantly determine a sovereign's credit risk (see, e.g., Alexopoulou et al., 2009; Barrios et al., 2009; Balassone et al., 2004; Lemmen and Goodhart, 1999; Bayoumi et al., 1995; Alesina et al., 1992). Since bond markets set the conditions for further lending, market participants should also react on a political rhetoric which indicates fiscal leeway in the future (Goldbach and Fahrholz, 2011).

For market discipline to work effectively, policymakers should respond adequately to market signals in order to prevent rising interest rates and higher costs of borrowing, respectively (Lane, 1993). Given that financial market participants fulfil their disciplining role and given that policymakers respond adequately to market signals, political rhetoric undermining the SGP should diminish in presence of high borrowing costs. Thus as a third working hypothesis follows:

Hypothesis III: Market Discipline

The higher the costs of borrowing, the lower the aversion to the SGP.

II.3.2 Political Economy Determinants

Peer Pressure and Political Power in European Politics

From a political economy perspective, the SGP is perceived as weak law, ie law that is argued by many to be ineffective as regards enforcement. Yet, as Padoan (2002) points out, at the beginning of EMU member countries had various incentives to adhere to the Pact. The argument is as follows: since poor fiscal policies and weak economic performance negatively affect the overall reputation of a currency club, increasing peer pressure exerted by good performers (and the European Commission) should drive poor performers to adjust fiscal policies. As a consequence, the loss of reputation resulting from poor fiscal policies in an individual EMU member state would end up in a loss of "political capital", which in turn would reduce a country's political leverage in shaping EU politics in general.

Above considerations are taken up by the game-theoretical framework developend in the work of De Haan et al. (2003) and Berger et al. (2004). It links political commitment to a multilateral fiscal rule to a member state's size, and to the potential for self-enforcing behaviour among other members of the currency union. The two main messages of this coordination game are as follows: 1) Based on the economic power in the EU and on the political power of a country in EU politics, large members (countries) of a monetary union have an incentive to argue against a given set of multilateral fiscal rules while small members might not adopt political rhetoric of this type. 2) A country might choose to break the rules of the Pact if other countries successively breach it, too. Thus it is likely that this outcome of the coordination game is self-enforcing. Expectations about fiscal misbehaviour in other countries in the future, e.g. breaching the 3 per cent deficit ceiling, might encourage a country's ruling policymakers to choose to breach the ceiling, too.

Accordingly, the data should support the following hypotheses:

Hypothesis IV: Political Power

The larger the political capital of a country, the higher is a country's political aversion to the SGP.

Hypothesis V: Negative Peer Pressure

The higher other members' political aversion to the Pact, the higher is a country's political aversion to the SGP.

Institutional Veto Players

Following the theoretical work of Tsebelis (2002) certain individuals or groups have constitutional power to veto over proposals for reform in the legislative process. Tsebelis distinguishes between partisan veto players (e.g. different parties in the house of representatives) and institutional veto players (e.g. the president, different chambers in parliament). All players, regardless of whether individually or collectively, have the power to veto in the legislative process. In addition, there might be interest groups whose veto power is restricted to informal influence on political processes.

The basic idea of the Tsebelis' veto player approach is that policy change depends on both the size of the "win set" and the size of the "core". The win set is a set of policies that can overcome a certain status quo. The core is a set of points where no outcome is feasible under a certain decision-making rule due to veto players' differing preferences. Accordingly, the bigger the win set, the more likely is policy change. On the contrary, the bigger the core, the less likely is policy change. The difficulty to achieve a significant change of the status quo is defined as policy stability, which is positively correlated with the number of veto players Tsebelis (2002, pp 19). In the context of fiscal policy, this theory explains why veto players particularly retard adjustment of certain policies (Franzese, 2002).

Early studies dealing with government fragmentation confirm that there is a positive correlation between coalition cabinets and fiscal policy outcomes. The findings of Roubini and Sachs (1989) suggest a positive correlation between fiscal deficits and the number of parties in cabinet. The findings of Grilli et al. (1991) indicate that accumulation of large public debt is positively correlated with government fragmentation. Similarly, Volkerink and De Haan (2001) find that political fragmentation, including the number of parties in cabinet, contributes to higher deficits. For advanced industrial countries Tsebelis and Chang (2004) find that change in the budgetary structure is explained by veto players' different ideologies and changing governments. A fundamental insight of this study is that there is some hysteresis in composition of the budget when ideological distance among veto players exists. On the contrary, the budgetary structure is more flexible in political systems where veto players' ideology is similar. Schaltegger and Feld (2009) argue that the number of veto players is particularly high under fiscal federalism. Thus there might be a bias to keep the status quo, ie the delay of fiscal stabilisation.

Since measuring party ideology is a difficult undertaking, the methodology applied in this paper follows that of Pamp (2008). The author studies the number of institutional veto players because this variable is readily observable.[6] Because the number of veto players is generally found to be positively correlated with fiscal

[6] Cusack (1999), for example, uses a measure to calculate the political center of gravity for governments. This approach is based on the work of Gross and Sigelman (1984) and combines relative strength and ideology of a party in government.

deficits, the number of veto players might also affect political rhetoric about external constraints of national fiscal policymaking. As a consequence, the following hypothesis should hold:

Hypothesis VI: Veto Players

The higher the number of institutional veto players, the higher the country's political aversion to the SGP.

Excessive Deficit Procedure

In the period under consideration, the majority of countries was subjected to at least one excessive deficit procedure. Since this implies to be an additional constraint to national fiscal policy implementation, national policymakers may have a higher aversion to the SGP when their country is subjected to an EDP.[7] In order to control for this possibility we test the following hypothesis:

Hypothesis VII: EDP

When a country is subjected to an excessive deficit procedure, national politicians have a higher political aversion to the SGP.

Elections

Abundant theoretical and empirical political economy research deals with political processes and economic policy decisions. Beyond campaigning and voting procedures, elections are of particular interest in explaining the behaviour of strategic agents such as parties and political candidates who are seeking for or wish to remain in office (for an overview economic models of electoral politics see Dewan and Shepsle, 2011).

Assuming that, *ceteris paribus*, electorates vote for policymakers from which they expect to increase their material prosperity, these policymakers have an incentive to signal their ability to do so, e.g. to service voters' demand for redistribution of income. Generally, the incentives to do so may rise with elections approaching.

In the context of the early years of the SGP, Buti and van den Noord (2003) argue that the rules laid down in the Pact did not prevent national governments from running politically motivated fiscal policies ahead of upcoming elections. Referring to standard political economy theory, the authors further argue that national policymakers' short-term benefits outweighed the longer-term systemic costs of breaking the rules.

Based on above insights and assuming that policymakers have an inherent bias to spend more that earned from tax income in a given period (as already outlined in hypotheses I) both ruling policymakers as well as those representing the opposition

[7] Studying the institutional determinants of fiscal retrenchment, Pamp, 2008 tests for the impact of the Maastricht three per cent convergence criterion, but does not find a statistically significant impact on fiscal retrenchment.

should generally favour less external restrictions on national fiscal policy. This holds even more in the case of upcoming elections. Accordingly, in order to control for election effects, the following hypothesis is tested:

Hypothesis VIII: Elections

Forthcoming elections systematically increase political aversion to the Pact.

Partisan Politics

The value policymakers attach to sound fiscal policies might differ depending on their political orientation. Generally, incumbents can apply fiscal policies in order to serve the interests of their core constituencies thereby increasing popularity among the electoral base such as different social groups. The literature frequently claims that left-wing parties tend to serve the interests of workers and lower income individuals who are particularly affected by low growth and high unemployment, respectively. By contrast, conservative parties care more about inflation since their core constituency consists of wealthier individuals (see, e.g., Hibbs, 1977 and Swank, 1993).

Partisan models have been investigated by several authors. Though empirical evidence on the link between partisan politics and the implementation of economic policies is mixed (Ehrmann and Fratzscher, 2011; Pamp, 2008; Clark and Hallerberg, 2000), political rhetoric undermining the SGP could be determined by party ideology. Since the SGP is an external constraint to national fiscal policymaking, left-wing parties might have an aversion to strict enforcement of the Pact's rules. Assuming that left-wing parties more frequently pursue expansionary fiscal policies and have a bias for fiscal deficits, the following hypothesis should hold:

Hypothesis IX: Left-wing Government

The higher the share of left-wing parties in government, the higher the country's political aversion to the SGP.

III Empirical Analysis

III.1 Data and Variable Definitions

This section describes the data underlying the subsequent empirical analysis. In order to study the determinants of political rhetoric that is undermining the SGP, a panel of quarterly data of 12 EMU countries[8] is constructed, covering the period 2001 to 2008. This period is chosen for two reasons: 1) 2001 marks the year of Greece's accession to the Eurozone. For that reason our dataset is uniform for the

[8] Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.

overall period. 2) In 2008, national budgets of EMU countries and, as a consequence, political rhetoric about fiscal policy were not yet affected by the European sovereign debt crisis that emerged in late 2009.

In order to quantitatively catch the political process before and after the SGP's 2005 reform, we develop the political statements variable $PS_{i,t}$, which is the quarterly number of political statements of politicians of country t in quarter i. This variable can be read as "strength of national political aversion" to the SGP. Relevant commentaries are extracted from the original dataset underlying the work of Bauer and Zenker (2012a) and Bauer and Zenker (2012b). Political commentaries are systematically extracted from the FACTIVA database. The data applied in the subsequent analysis is restricted to political statements made by either national heads of government or members of the EcoFin.[9]

Following the methodology of Ehrmann and Fratzscher (2011), we consider news arriving in English language only. Since FACTIVA contains news arriving from 14.000 sources such as news-wire reports and local newspapers, this selection should be comprehensive though. Political aversion is defined as follows: 1) calls for flexible interpretation of the SGP's rules and 2) calls for changing the rules of the SGP framework.

The original data extraction was done individually by the authors and is thus based on the authors own judgements according to the previously devised definition. In the vast majority of commentaries wording is unambiguous. In order to account for possible discrepancies and to avoid double-counting (due to the fact that FACTIVA frequently contains a number of news entries that are related to one single event) the authors cross-checked coding of the data and removed decoded statements that were not unanimous. First of all, the authors evaluated all the data thereby determining whether a specific news entry contains information about statements concerning the SGP. In a next step, the news selected have been encoded in order to enable statistical computation. For that reason, each event has been decoded with discrete values ("destabilising" = 1, "neutral" = 0) according to its very content. See figure 1 in appendix 5 for an overview of the development of political rhetoric against the SGP. The figures provide prima facie evidence that eurozone members' political aversion to the SGP is positively correlated to the average EMU fiscal deficit.

Based on the theoretical considerations presented in section II, the subsequent analysis links the economic as well as the political economy factors to the data on political aversion to the SGP. For a detailed description of the underlying data view table 2 in appendix 5. In order to measure the strength of political aversion, the number of political statements is aggregated by country on a quarterly basis.

[9] Bauer and Zenker (2012a) and Bauer and Zenker (2012b) also account for political behaviour in which an infringement of the SGP is not appropriately punished, ie political decisions at EcoFin level and European Commission official statements and European Commission decisions.

The cyclically adjusted annual deficit captures the extend to which political aversion to the SGP is related to actual fiscal performance. In order to account for politicians' preferences related to economic growth, the negative GDP growth differential accounts for politicians' preferences to domestic economic conditions. The long-term interest rate on government bonds captures the extend to which political aversion to the Pact is affected by the cost of borrowing.

The annual ratio of national GDP to total EMU-GDP is taken as a proxy for political and economic power in EU/EMU political affairs. To test whether national political aversion is a self-enforcing process, a dummy variable is constructed, that is equal to one if the total number of statements excluding statements of country i is larger than the sample mean. As an indicator of the number of institutional veto players, the Lijphart first dimension index captures the extend to which government fragmentation is related to the strength of political aversion to the SGP. The variable EDP accounts for shifts in fiscal preferences of politicians of countries that are subjected to an excessive deficit procedure. EDP is a dummy variable that is equal to one for all quarters where the national government is subjected to an excessive deficit procedure. Since fiscal preferences of politicians are affected by (re-)election considerations, we account for the event of national elections. The variable Election is a dummy variable that is equal to one in the quarter of a parliamentary election and the quarter prior to the quarter of an election. For France and Italy we also account for the event of presidential elections. Since we are also interested whether party affiliation within the cabinet affects political aversion to the SGP, we test the effect of the percentage amount of social-democrats and other left parties in the national cabinet.

III.2 Econometric Framework

For our political statements variable, the reduced form equation that is estimated can be formalised as follows:

$$
\begin{aligned}
PS_{i,t} = \alpha_t + \beta_1 \mathit{BudgetaryBalance}_{i,t} + \beta_2 \mathit{NegGrowthDiff}_{i,t} + \beta_3 \mathit{InterestRate}_{i,t} + \\
\beta_4 \mathit{PoliticalPower}_{i,t} + \beta_5 \mathit{PeerPressure}_{i,t} + \beta_6 \mathit{Veto}_{i,t} + \\
\beta_7 \mathit{EDP}_{i,t} + \beta_8 \mathit{Election}_{i,t} + \beta_9 \mathit{Left\text{-}Wing}_{i,t} + \varepsilon_{i,t}
\end{aligned} \tag{1}
$$

where i represents country $1, ..., 12$ and t indexes the period $1Q2001$ to $4Q2008$. The dependent variable $PS_{i,t}$ represents the quarterly number of country-specific political statements undermining the SGP. In order to test for robustness and differences within the two sub-groups, we provide estimates for aggregate statements of national heads of government and members of the EcoFin as well as separate estimates for either of this group of politicians (=three dependent variable series). The vector of explanatory variables includes the budgetary balance ($\mathit{BudgetaryBalance}_{i,t}$), the negative growth differential (*NegGrowthDiff*$_{i,t}$), the long-term interest rate (*InterestRate*$_{i,t}$), the national GDP to EMU-GDP ratio (*PoliticalPower*$_{i,t}$), peer pressure (*PeerPressure*$_{i,t}$), the size of government fragmentation (*Veto*$_{i,t}$), the EDP dummy variable (*EDP*$_{i,t}$), the election dummy variable (*Election*$_{i,t}$), and the share of left-wing parties in the government (*Left-Wing*$_{i,t}$). Fixed effects are represented by α_t in order to capture unobservable time-specific heterogeneity. $\varepsilon_{i,t}$ captures the residual variation of the cross-sections over time.

The dependent variable time series consist of always positive and discrete count data, where an event count is the number of political statements per quarter. Thus a count data model needs to be estimated, such as the Poisson regression model (see, e.g., Wooldridge, 2002 pp 645; Cameron and Trivedi, 1998). Model specification tests point to over-dispersion in the data thus leading us to reject the Poisson restrictions. For this reason a negative binomial regression model is applied.

The negative binomial model is derived from the Poisson distribution. Thus the starting point of the regression analysis is the log-linear Poisson regression model that ensures non-negativity. Given α_i represents the parameters for individual heterogeneity (individual fixed effects), $x^{'}_{i,t}$ is a vector of explanatory variables and β is the vector of unknown coefficients, the conditional mean equation can be formalised as

$$E\left[y_{i,t} \mid x_{i,t}, \alpha_i\right] = \mu_{i,t} = exp(\alpha_i + x^{'}_{i,t}\beta). \tag{2}$$

For the Poisson model it is assumed that the conditional variance $Var\left[y_{i,t} \mid x_{i,t}, \alpha_i\right]$ is equal to the conditional mean $E\left[y_{i,t} \mid x_{i,t}, \alpha_i\right]$. Since this assumption is relaxed in the negative binomial regression model we assume that $y_{i,t}$ follows a negative binomial distribution allowing the variance to exceed the mean. For the $NEGBIN1$ model (see Cameron and Trivedi, 1998 and Guimarães, 2008) the conditional variance can be formalised as

$$Var\left[y_{i,t} \mid x_{i,t}, \alpha_i\right] = \mu_{i,t}(1 + \theta_i), \tag{3}$$

where θ_i is a scalar parameter, also known as dispersion parameter, that is to be estimated.

IV Empirical Results

Estimates of OLS regressions can predict negative expected values of the conditional mean of the dependent count variable, though, according to simulations of Sturman (1999), OLS estimates do also perform well. In addition, although Poisson and negative binomial models theoretically match the assumptions of the data better than OLS, the OLS estimator is unbiased. Thus we provide additional OLS specifications in order to test for robustness of the results. OLS results can be found in appendix 3, tables 6, 7, 8.

We provide estimation results for the whole sample of 147 political statements. In addition, we test for differences between politicians separately, which leaves us to 82 EcoFin statements, and 65 statements of EU heads of government, respectively. The estimation results are presented in appendix 2, tables 3, 4, 5.

The impact of economic determinants on political aversion to the SGP is tested in model 1. As expected, the coefficients of the cyclically adjusted budgetary balance, the negative GDP growth differential, and the long-term interest rate on government bonds are negative and highly statistically significant. These results are highly robust across different model specifications and also robust to the split up of the dependent variable observations into two sub-groups. Although less statistically significant, these results are also robust to most OLS specifications.

Above results confirm hypothesis 1, 2, and 3. As expected, political aversion against the SGP is the higher, the smaller the national budgetary surplus is or the higher the budgetary deficit is. Similarly, the lower national GDP growth is relative to the rest of the currency club, the higher is national political aversion to the SGP. Finally, the higher the costs of borrowing, the lower is national political aversion to the SGP. Apparently, political aversion to the SGP is substantially driven by national economic conditions. On the one hand, above results indicate that political aversion to a multilateral fiscal rule increases when domestic economic growth moderates and the national budgetary balance deteriorates. On the other hand, the findings indicate that politicians' aversion to a multilateral fiscal rule decreases when costs of borrowing rise.

The impact of political economy determinants of political aversion to the SGP is tested in models 2 to 8. Looking at economic power in model 2, we observe that the coefficient for this variable is positive and highly statistically significant. This result is robust across all specifications and OLS estimations. For both EcoFin and heads of government statements the numbers of the coefficients do not differ significantly. These results lend strong support for hypothesis 4. As expected, the stronger economic power is, the stronger is political aversion to the SGP expressed by national policymakers.

As can be seen from model 3, the effect of peer pressure is positive and statistically significant for the total sample of political statements as well as for statements arriving from members of the EcoFin. These results lend support for hypothesis 5, which states that national political aversion is positively correlated to the political aversion of other members of the currency club so that opposition against the Pact becomes self-enforcing. For EU heads of government statements, however, we do not find the coefficient for peer pressure to be statistically significant. This finding reflects that most of the debate about the interpretation of the SGP took place among EU finance and economics ministers having regular meetings. Since representatives of the EcoFin frequently provide public statements after summits, their tenor generally reflects the outcome of the prior debate or, for most of the part, the consensus reached before. Thus the results indicate that self-enforcement of opposition against the Pact is more likely to exist when coordination of national fiscal policies is institutionalised. Yet, since we study a period in which the SGP framework was seriously weakened, it remains an open question whether "institutionalised" self-enforcement in favour of the rules (or in favour of stronger rules) might emerge in a different economic setting. At least in the context of the European sovereign debt crisis, recent developments show that fiscal policy coordination at European level can bring forth renewed sets of rules as the pre-constitutional debates prior to the establishment of the new European Fiscal Compact demonstrate.

Regarding government fragmentation, in model 4 we find the coefficient for institutional veto players to be positive and statistically significant across all specifications. This outcome is also robust to OLS specifications and the split-up into the political sub-groups. In addition, for both members of the EcoFin and EU heads of government the numbers of the coefficients do not differ significantly. These results support hypothesis 6. As expected, the higher government fragmentation, the higher is political aversion to the SGP.

Surprisingly, we do not find strong support for hypothesis 7, which states that political aversion to the Pact is higher for countries subjected to an excessive deficit procedure. Some support for this hypothesis arises from aggregate statements and statements arriving from EU heads of government in model 5. For both groups the coefficient of the EDP dummy is positive and statistically significant given that other political economy control variables are not included to the model. The corresponding coefficients lose statistical significance when we control for other political economy variables in model 8. Thus we cannot confirm that policymakers of countries subjected to an EDP generally have a higher aversion to the Pact.

The election dummy does not gain statistical significance in any of the specifications tested. Accordingly, we cannot confirm hypotheses 8, which states that policymakers facing national elections generally have a higher aversion to the Pact. Similarly, the coefficient for the left-wing government dummy does not gain statistical significance for most of the specifications tested. Accordingly, we do not find support for hypotheses 9. Thus the results indicate that political ideology does not explain the strength of national political aversion to the Pact.

V Policy Implications for EMU Fiscal Governance

The findings show that in the period under study political aversion to the rules and procedures of the SGP is particularly determined by national economic conditions. Moreover, political power, negative peer pressure, and national government fragmentation systematically contribute to political non-commitment to the SGP framework.

Since national political non-ownership of the rules and procedures of the Pact finally ended up in discretionary practices over its enforcement and two reforms of the overall framework, these findings have implications on the assessment of the future effectiveness of the recently reformed framework of EU/EMU fiscal cooperation.

In December 2011, five new regulations and one directive, altogether aiming for enhanced EU/EMU fiscal and economic cooperation, came into effect. The package known as "Six Pack" includes renovations of the preventive and the dissuasive arm of the SGP. For a large part, it consists of a complex (and thus intransparent) set of policies and procedures aiming to enhance the effectiveness of surveillance and correction of national fiscal policies. The key provisions of the renovated framework are presented in table 9 in appendix 4. In addition to the revised SGP, 25 EU heads of government signed the TSCG in March 2012. As part of this intergovernmental treaty, the so-called European Fiscal Compact (Title III) further aims to strengthen multilateral fiscal governance of EU/EMU member countries, mainly by empowering the role of the European Commission and the Court of Justice of the European Union. The key provisions of the TSCG are presented in table 10 in appendix 4.

At a first glance, this new legislation appears to be quite ambitious. However, the crucial question is whether national policymakers ruling in the future will meet the obligations they are subject to. In the light of above findings, the new framework leaves substantial uncertainty about member states' future compliance with the new framework, notably due to four shortcomings.

1) Formally, the preventive arm of the revised SGP has been strengthened. If a member state significantly deviates from its country-specific medium-term budgetary objective (MTO), the European Commission can issue an early warning directly to the member state concerned. In addition, the European Commission can now propose to impose financial sanctions on non-conformers, unless the Council rejects these proposals by qualified majority. Both amendments formally strengthen the power of the European Commission and increase the automatisms of the procedures under the preventive arm. However, both amendments also require the European Commission to act rigorous in the spirit of the procedures and independent from political interests. Further uncertainty remains over the EcoFin's decision to block financial sanctions proposed by the European Commission.

As was shown in the empirical part of this paper, national political aversion to the procedures of the Pact is strong in times of low economic growth and high fiscal deficits. When economic growth is low and national fiscal pressures are high, the EcoFin is likely to make use of the discretionary power over the rejection of proposals made by the European Commission. The European Council already officially announced to apply the preventive arm of the revised SGP in a growth-friendly way: "While fully respecting the Stability and Growth Pact, the possibilities offered by the EU's existing fiscal framework to balance productive public investment needs with fiscal discipline objectives can be exploited in the preventive arm of the SGP" (European Council, 2012, pg 1). Based on these insights, it is likely that the higher degree of automaticity under the preventive arm of the Pact will fall short of national political objectives.[10]

It is of further importance that political rhetoric against the SGP is not restricted to national policymakers. In the past, national political aversion spilled over to the European Commission. The political debate before the reform of the initial SGP in March 2005 clearly demonstrates that the European Commission itself contributed to the gradual undermining of the Pact. Figure 2 in appendix 5 quantitatively shows the evolution of political voices arising from European Commission officials over the period 2001 to 2010. The figure demonstrates that the European Commission also responds to national fiscal deficits (to political pressure related to national fiscal deficits) by adopting a rhetoric that undermines the SGP. This behaviour is in line with the theory of bureaucracies. Before the initial Pact's reform in March 2005 the European Commission had an interest to keep the Pact alive since no Pact would have decreased the right of initiative as well as the influence of the Commission as agenda setter in European fiscal policy coordination. Thus it started to argue in favour of a modified Pact (Schwarzer, 2007, pp. 175).

As a consequence, it is likely that the European Commission will give way to national political interests in the future again, particularly to consider exceptional circumstances in the evaluation of member countries' compliance with the provisions of the revised framework. In times of low EU/EMU wide economic growth, the European Commission might thus be politically encouraged to make use of the "severe economic downturn" clause as laid down in Regulation (EU) No 1175/2011. This is even more likely because it is still generally accepted that fiscal austerity is harmful to economic growth (see Marzinotto and Sapir, 2012 for a similar argument).

2) The EcoFin still has substantial discretionary power to decide on whether an excessive deficit exits under the dissuasive arm of the revised SGP. Particularly, the EcoFin's decision is still to be made be qualified majority voting. In addition, the European Commission has to apply the policies and regulations laid down in the revised Pact in a strict manner in order to assess whether an excessive deficit exists or not. Both provisions are likely to fall short of the political process when economic conditions turn worse. This applies to the same extent to the obligation to reduce government deficits and to reduce general government debt which is above the 60 per cent reference level.

[10]In this context, Holler and Reiss (2011) question that economically significant sanctions will be imposed on fiscal sinners in the near future. Similarly, Kullas (2011) argues that quasi-automatic sanctions will not have a deterrent effect on member countries and the revised Pact's new expenditure clause will further increase the complexity of the preventive arm. For that reason, according to Kullas, political and public acceptance of the multilateral fiscal framework should further decrease.

As for the deficit criterion, the new TSCG particularly strengthens the excessive deficit procedure by requiring contracting Parties whose currency is the euro to adopt European Commission proposals or recommendations, unless qualified majority blocks these decisions. Though this formal requirement aims to strengthen political commitment to the corrective arm of the revised Pact, the debt criterion is not affected. Apparently, euro area policymakers voted against a too tight straitjacket for national fiscal policies.

3) Under the new TSCG, euro area heads of state and heads of government are encouraged to meet twice a year in informal summits to discuss EMU governance together with representatives of other European institutions. Following the argument of the ECB (2012), these meetings at highest political level may strengthen political ownership, transparency and democratic accountability of Europe's fiscal framework. Since not only finance ministers enter the debate, the discussion of a more comprehensive set of policy areas (e.g. competition and employment policy) can help to improve EMU fiscal governance. However, although policymakers can shape and coordinate national fiscal policies at these summits, they are not obliged to. In addition, we can draw from the empirical analysis above, that self-enforcement of opposition against the procedures laid down in the Pact or against the TSCG is more likely to prevail when coordination of national fiscal policies is institutionalised.

Being aware of this substantial weakness, the European Central Bank (ECB) already reminds policymakers that "at the national level, broad ownership is needed, ie parliaments, governments and monitoring institutions must live up to the spirit of the TSCG and ensure full compliance with the balanced budget rule. This is vital to anchor fiscal discipline and market expectations of the sustainability of public finances in Europe, which in turn will foster medium-term growth" (ECB, 2012, pg. 94). Political ownership of a fiscal stability rule, however, depends on a political stability culture that can hardly be changed by legislators (see, e.g., Josselin et al., 2012; Heinemann et al., 2011). Insofar it remains an open question whether these summits will enhance or further undermine fiscal governance in the euro area.[11]

4) Under the new TSCG, contracting parties shall ensure a balanced budget as part of their MTO. As for the effective enforcement of this provision, the European Commission is encouraged to ensure that contracting parties converge towards their country-specific MTO in case of deviation from the balanced budget rule. If a country fails to comply with this provision, one or more contracting parties may ask the Court of Justice of the European Union to rule over compliance with the rules and the imposition of financial sanctions.

Formally, this new provision empowers the Court to veto on national budgets. However, judicial enforcement of the Court's decision is subject to considerable

[11]Needless to say, the author does not object these summits per se. These summits are important fora where ideas can be exchanged, deficient concepts can be questioned and more adequate policies be launched.

uncertainties, mainly for three reasons: First, past experience has shown that political peer pressure on fiscal sinners was weak. On the contrary, as was shown in the empirical part of this paper, peer pressure to reject the SGP's fiscal rules frequently entered the political disputes among national politicians as well as the clashes with the European Commission. Political behaviour is unlikely to change in this matter. It thus remains an open question which countries will be the first to bring matters to the Court. Second, the European Commission is not allowed to take matters to court. Instead the European Commission is restricted to assess the measures applied by the countries concerned. As already discussed above, by performing this task, the European Commission might capitulate to national political interests. Third, even if the Court finds that there has been a violation of the treaty's provision, realisation of the judgement is rather unlikely due to the national sovereignty of each contracting party. Contracting parties are likely to accept the ruling of the Court, but unlikely to rapidly change national fiscal policies, or even to pay financial sanctions. Following the empirical results above, compliance with the Court's ruling will be even more unlikely in times of poor domestic economic performance and budgetary pressures.

The provision to anchor the elements of the balanced budget rule in national constitutions or national budgetary procedures as well as the requirement that these provisions should be subject to Court of Justice of the European Union might strengthen national policymakers' commitment to comply. The more binding character of the provisions and potential pressure by national electorates may contribute to more compliance at national level. However, at the same time this provision already indicates that signatories of the TSCG do not give much trust in the future effectiveness of the revised SGP. All of these objections give argument to raise doubts that the new EU/EMU framework of fiscal governance will be resistant to the dynamic commitment problem, causing it to become another soft budget constraint.[12]

Although external enforcement of the new provisions and financial sanctions are unlikely, the higher degree of transparency might improve financial market discipline which in turn contributes to commitment to the rules. As demonstrated by the empirical results of this paper, the higher interest rates on government borrowing are the lower is the strength of political aversion to the provisions of a multilateral fiscal rule. This does not necessarily mean that national policymakers will stick to the concrete provisions of the new treaties, but rising costs of borrowing increase the likelihood of national fiscal policy decisions in the spirit of the new treaties.

Whether market discipline will be effective remains an open question. As a nec-

[12] In the context of planned economies and state-owned enterprises, the term "soft budget constraint" has been introduced by Kornai (1979). The argument is that policymakers are unable to impose hard economic budget constraints on state-owned enterprises. In turn these enterprises form bail-out expectations which is a precondition for moral hazard.

essary condition for market discipline to work more effective than in the previous regime (see, e.g., Bauer and Zenker, 2012a), EU/EMU policymakers are advised to fully comply with the fiscal surveillance (transparency) provisions under the revised SGP in order to increase public awareness of undesirable fiscal developments. In addition, good performers should abstain from signalling to grant excessive emergency bailout packages to bad performers.

VI Conclusion

Focusing on the Stability and Growth Pact (SGP, the Pact), this paper studies the determinants of national policymakers changing commitment to a multilateral fiscal rule, referred to as the "dynamic commitment problem". The economic and political economy factors that determine national politicians' aversion to an externally imposed fiscal rule are studied in the empirical part of this paper. The empirical analysis is based on an event study including 147 statements of EU heads of government (the European Council) and members of the Economic and Financial Affairs Council (EcoFin, the Council). The underlying political rhetoric is either related to flexible interpretations of the SGP or calls for changing the rules of the overall framework over the period 2001 to 2008. In order to estimate the determinants of national political ownership, these statements are used as an indicator of political non-commitment to the SGP.

Based on standard theoretical political-economy considerations, a number of testable hypotheses is derived. The empirical findings show that in the past national political aversion to the rules and procedures of the SGP was particularly determined by national economic conditions. The size of the national budgetary deficit, the level of domestic economic growth, and the costs of government borrowing systematically determine the strength of political aversion to the Pact. In addition, political and economic power, negative peer pressure, and national government fragmentation are found to systematically contribute to political non-commitment to the SGP framework. Partisan effects and elections are found to be less relevant.

In the past, national political non-ownership of the provisions of the SGP finally ended up in discretionary practices over its enforcement and two reforms of the overall framework. For these reasons, the empirical findings of this paper have implications on the assessment of the future effectiveness of the recently reformed framework of EU/EMU fiscal cooperation. The findings give strong argument to cast doubts on national policymakers' future commitment to the revised SGP and the recently adopted European Fiscal Compact.

Under the new regime, external enforcement of concrete preventive and corrective measures is still unlikely, as is the imposition financial sanctions. The discretionary power left to national policymakers is still high under the revised SGP. The number of exceptional events and conditions that may be taken into account are likely to be exploited. The European Commission is a key player, but is likely to fall short of national policymakers' interests. As for the European Fiscal Compact, the limited power of the Court of Justice of the European Union is likely to fall short of national sovereignty thus preventing compliance with the rules and the imposition of financial sanctions, respectively.

Although effective external enforcement of the new provisions and financial sanctions is unlikely, the higher degree of transparency (if thoroughly adopted by EU/EMU members) might improve financial market discipline which in turn contributes to commitment to the rules. Increased market discipline does not necessarily mean that national policymakers will stick to the concrete provisions of the new treaties, but rising costs of borrowing increase the likelihood of national fiscal policy decisions in the spirit of the new treaties.

The main message of this paper is that the dynamic commitment problem is likely to continue to exist under the new regime of EU/EMU fiscal governance. Domestic economic conditions mainly determine policymakers' aversion to multilateral enforcement of fiscal cooperation. A mainly externally imposed soft budget constraint is ill-suited to ensure fiscal sustainability in a monetary union that is not a political union.

Given that national policymakers fully comply with the fiscal surveillance provisions under the revised SGP, the new framework might improve market discipline thus imposing a hard economic budgetary constraint on national fiscal policymaking. As a contribution to attaining these goals, good fiscal performers should abstain from signalling to grant excessive emergency bailout packages to bad performers.

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Appendix 1

Table 1: Correlation Across Variables

	All Statements	Statements EcoFin	Statements Heads of Government	Budgetary Balance	GDP Growth Differential	Long-term Interest Rate	Economic Power	Peer Pressure	Institutional Veto Players	EDP	Elections	Left-wing Government
All Statements	1.00											
Statements Ecofin	0.90	1.00										
Statements Heads of Government	0.88	0.58	1.00									
Budgetary Balance	- 0.11	- 0.13	- 0.07	1.00								
GDP Growth Differential	- 0.07	- 0.04	- 0.08	0.06	1.00							
Long Term Interest Rate	- 0.01	0.02	- 0.04	0.09	- 0.03	1.00						
Economic Power	0.27	0.27	0.21	- 0.05	- 0.13	- 0.06	1.00					
Peer Pressure	0.33	0.36	0.22	- 0.02	0.08	0.14	- 0.01	1.00				
Institutional Veto Players	- 0.04	- 0.05	- 0.01	0.41	- 0.09	0.03	- 0.05	0.03	1.00			
EDP	0.11	0.08	0.11	- 0.12	- 0.11	- 0.19	0.33	- 0.04	- 0.19	1.00		
Elections	0.02	0.07	- 0.04	- 0.08	0.01	0.04	0.01	0.09	- 0.02	- 0.02	1.00	
Left-wing Government	0.05	0.04	0.04	0.11	- 0.01	0.06	0.25	- 0.08	- 0.11	0.01	0.01	1.00

The table shows the correlation coefficients across the dependent and independent variables. A detailed description of the data is given in table XX.

Table 2: Variable Description

Variable	Description	Source	Obs.	Mean	Median	Std.-Dev.	Min	Max
Political Rhetoric								
All Statements	Statements of members of the EcoFin and statements of heads of government indicating flexible interpretation of the Pact or calls for reform.	FACTIVA	147	0.36	0.00	0.98	0.00	8.00
Statements Ecofin	Statements of members of the EcoFin indicating flexible interpretation of the Pact or calls for reform.	FACTIVA	82	0.21	0.00	0.57	0.00	4.00
Statements Heads of Government	Statements of heads of government indicating flexible interpretation of the Pact or calls for reform.	FACTIVA	65	0.16	0.00	0.53	0.00	5.00
Economic Variables								
Budgetary Balance	Cyclically adjusted annual deficit (government primary balance) as a percentage of potential GDP.	OECD Economic Outlook	432	0.51	0.86	2.84	-12.42	6.43
GDP Growth Differential	Growth of real GDP, percentage change from previous year.	Eurostat	432	0.12	0.08	0.92	-4.29	5.10
Long Term Interest Rate	Long-term interest rate on government bonds (10Y).	OECD Economic Outlook: Statistics and Projections (database)	432	4.23	4.21	0.61	2.21	5.72
Political Economy Variables								
Economic Power	National GDP divided by EU-EGP.	Eurostat	432	6.09	2.50	6.44	0.20	21.90
Peer Pressure	Dummy variable equal to 1 if the number of statements undermining the SGP excluding the statements of country i is larger than the sample mean.	FACTIVA, calculation based on own survey data.	432	0.32	0.00	0.47	0.00	1.00
Institutional Veto Players	Lijphart first dimension. Proxy variable institutions.	Comparative Political Data Set I (23 OECD Countries) Klaus Armingeon, David Weisstanner, Sarah Engler, Panajotis Potolidis, Marlène Gerber, Philipp Leimgruber	432	-0.04	-0.37	0.77	-1.38	1.84
EDP	Dummy variable equal to 1 for all quarters where the national government is subjected to an excessive deficit procedure.	European Commission	432	0.20	0.00	0.40	0.00	1.00
Elections	Dummy variable equal to 1 in the quarter of election and the quarter prior to the quarter of election.	ElectionGuide, provided by the International Foundation for Electoral Systems (IFES)	432	0.16	0.00	0.36	0.00	1.00
Left-wing Government	Cabinet composition: social-democratic and other left parties in percentage of total cabinet posts, weighted by days.	Comparative Political Data Set I (23 OECD Countries) Klaus Armingeon, David Weisstanner, Sarah Engler, Panajotis Potolidis, Marlène Gerber, Philipp Leimgruber	432	33.24	27.15	33.87	0.00	100.00

Appendix 2

Table 3: Regression Results: All Statements, NB Regression

		Negative Binomial Estimates							
All Statements	Hypothesis	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Economic Variables									
Budgetary Balance	b1 < 0	-0.169***	-0.077	-0.175***	-0.302***	-0.122**	-0.173***	-0.157***	-0.227***
		(0.051)	(0.058)	(0.052)	(0.073)	(0.054)	(0.053)	(0.049)	(0.073)
GDP Growth Differential	b2 < 0	-0.570***	-0.423***	-0.548***	-0.519***	-0.533***	-0.566***	-0.553***	-0.331**
		(0.149)	(0.132)	(0.149)	(0.143)	(0.156)	(0.148)	(0.146)	(0.141)
Long-term Interest Rate	b3 < 0	-0.883***	-1.143***	-0.955***	-0.923***	-1.058***	-0.884***	-0.898***	-1.410***
		(0.210)	(0.248)	(0.249)	(0.224)	(0.269)	(0.213)	(0.201)	(0.321)
Political Economic Variables									
Economic Power	b4 > 0		0.080***						0.074***
			(0.014)						(0.016)
Peer Pressure	b5 > 0			1.226*					1.424*
				(0.725)					(0.808)
Institutional Veto Players	b6 > 0				0.498***				0.604**
					(0.186)				(0.189)
EDP	b7 > 0					0.617*			0.292
						(0.317)			(0.326)
Elections	b8 > 0						-0.137		0.174
							(0.265)		(0.293)
Left-wing Government	b9 > 0							0.004*	0.001
								(0.003)	(0.003)
Fixed Effects		Period	Period	Period	Period	Period	Period	Period	Period
Observations		384	384	384	384	384	384	384	384
Pseudo R-squared									
McFadden		0.28	0.31	0.27	0.29	0.28	0.28	0.28	0.32
Adjusted McFadden		0.16	0.19	0.15	0.17	0.16	0.16	0.16	0.18
Cox-Snell		0.34	0.38	0.34	0.35	0.35	0.34	0.34	0.39
Log likelihood		-210.10	-199.53	-209.22	-207.24	-208.49	-210.02	-209.19	-195.39

*The table shows the estimates for the determinants of political rhetoric that is undermining the SGP. The symbols ***,**, and * represent statistical significance levels of 1 per cent, 5 per cent, and 10 per cent respectively. Numbers in brackets denote Huber/White standard errors.*

Table 4: EcoFin Statements, NB Regression

		Negative Binomial Estimates							
EcoFin Statements	**Hypothesis**	**Model 1**	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 6**	**Model 7**	**Model 8**
Economic Variables									
Budgetary Balance	b1 < 0	-0.188***	-0.089	-0.196***	-0.298***	-0.158**	-0.187***	-0.173***	-0.227*
		(0.066)	(0.082)	(0.067)	(0.084)	(0.067)	(0.069)	(0.065)	(0.102)
GDP Growth Differential	b2 < 0	-0.463***	-0.317**	-0.432***	-0.425***	-0.434***	-0.464***	-0.446***	-0.223
		(0.138)	(0.131)	(0.138)	(0.140)	(0.143)	(0.138)	(0.136)	(0.155)
Long-term Interest Rate	b3 < 0	-0.819***	-1.037***	-0.886***	-0.832***	-0.905***	-0.819***	-0.846***	-1.178***
		(0.163)	(0.207)	(0.198)	(0.178)	(0.204)	(0.163)	(0.160)	(0.263)
Political Economic Variables									
Economic Power	b4 > 0		0.075***						0.076***
			(0.014)						(0.019)
Peer Pressure	b5 > 0			1.582**					1.833*
				(0.705)					(0.804)
Institutional Veto Players	b6 > 0				0.414**				0.514*
					(0.196)				(0.216)
EDP	b7 > 0					0.410			0.014
						(0.327)			(0.351)
Elections	b8 > 0						0.045		0.327
							(0.297)		(0.310)
Left-wing Government	b9 > 0							0.004*	0.000
								(0.003)	(0.003)
Fixed Effects		Period	Period	Period	Period	Period	Period	Period	Period
Observations		384	384	384	384	384	384	384	384
Pseudo R-squared									
McFadden		0.45	0.47	0.44	0.45	0.45	0.45	0.45	0.47
Adjusted McFadden		0.32	0.34	0.31	0.32	0.32	0.32	0.32	0.32
Cox-Snell		0.46	0.48	0.46	0.46	0.46	0.46	0.46	0.48
Log likelihood		-144.22	-137.74	-143.23	-142.88	-143.75	-144.22	-143.54	-135.01

*The table shows the estimates for the determinants of political rhetoric that is undermining the SGP. The symbols ***,**, and * represent statistical significance levels of 1 per cent, 5 per cent, and 10 per cent respectively. Numbers in brackets denote Huber/White standard errors.*

Table 5: EU Heads of Government Statements, NB Regression

		Negative Binomial Estimates							
Heads of Government Statements	**Hypothesis**	**Model 1**	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 6**	**Model 7**	**Model 8**
Economic Variables									
Budgetary Balance	b1 < 0	-0.167*	-0.063	-0.170**	-0.289***	-0.104	-0.178**	-0.151*	-0.201**
		(0.074)	(0.073)	(0.074)	(0.095)	(0.076)	(0.075)	(0.067)	(0.085)
GDP Growth Differential	b2 < 0	-0.669***	-0.582***	-0.660***	-0.636***	-0.626***	-0.650***	-0.658***	-0.506**
		(0.221)	(0.201)	(0.220)	(0.219)	(0.225)	(0.214)	(0.211)	(0.207)
Long-term Interest Rate	b3 < 0	-1.189***	-1.581***	-1.228***	-1.267***	-1.482***	-1.186***	-1.222***	-1.933***
		(0.349)	(0.384)	(0.378)	(0.352)	(0.404)	(0.363)	(0.343)	(0.461)
Political Economic Variables									
Economic Power	b4 > 0		0.083***						0.070***
			(0.018)						(0.021)
Peer Pressure	b5 > 0			0.721					0.903
				(0.787)					(0.986)
Institutional Veto Players	b6 > 0				0.477*				0.597**
					(0.248)				(0.248)
EDP	b7 > 0					0.780*			0.522
						(0.412)			(0.445)
Elections	b8 > 0						-0.574		-0.206
							(0.388)		(0.428)
Left-wing Government	b9 > 0							0.006	0.001
								(0.004)	(0.004)
Fixed Effects		Period	Period	Period	Period	Period	Period	Period	Period
Observations		384	384	384	384	384	384	384	384
Pseudo R-squared									
McFadden		0.46	0.49	0.45	0.47	0.47	0.46	0.47	0.49
Adjusted McFadden		0.32	0.34	0.31	0.32	0.32	0.32	0.32	0.32
Cox-Snell		0.44	0.46	0.44	0.44	0.44	0.44	0.44	0.46
Log likelihood		-129.77	-122.81	-129.58	-128.20	-128.12	-129.05	-128.87	-120.32

*The table shows the estimates for the determinants of political rhetoric that is undermining the SGP. The symbols ***,**, and * represent statistical significance levels of 1 per cent, 5 per cent, and 10 per cent respectively. Numbers in brackets denote Huber/White standard errors.*

Appendix 3

Table 6: All Statements, OLS Regression

		OLS Estimates							
All Statements	Hypothesis	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Economic Variables									
Budgetary Balance	b1 < 0	-0.070* (0.037)	-0.053* (0.022)	-0.075* (0.041)	-0.091** (0.036)	-0.052* (0.029)	-0.072* (0.039)	-0.074** (0.038)	-0.091** (0.045)
GDP Growth Differential	b2 < 0	-0.151* (0.084)	-0.106 (0.068)	-0.156* (0.087)	-0.140* (0.083)	-0.132* (0.078)	-0.152* (0.083)	-0.147* (0.076)	-0.090 (0.064)
Long-term Interest Rate	b3 < 0	-0.501*** (0.175)	-0.488*** (0.182)	-0.546*** (0.187)	-0.528*** (0.141)	-0.622*** (0.171)	-0.501*** (0.178)	-0.493*** (0.176)	-0.601*** (0.157)
Political Economic Variables									
Economic Power	b4 > 0		0.040*** (0.006)						0.038*** (0.006)
Peer Pressure	b5 > 0			0.769** (0.367)					0.842** (0.410)
Institutional Veto Players	b6 > 0				0.092 (0.085)				0.128 (0.079)
EDP	b7 > 0					0.298** (0.143)			0.042 (0.130)
Elections	b8 > 0						-0.096 (0.156)		-0.090 (0.150)
Left-wing Government	b9 > 0							0.003 (0.003)	0.002 (0.002)
Fixed Effects		Period	Period	Period	Period	Period	Period	Period	Period
Observations		384	384	384	384	384	384	384	384
R-squared		0.31	0.37	0.31	0.31	0.32	0.31	0.32	0.38
Adjusted R-squared		0.24	0.30	0.24	0.24	0.25	0.24	0.25	0.31

*The table shows the estimates for the determinants of political rhetoric that is undermining the SGP. The symbols ***, **, and * represent statistical significance levels of 1 per cent, 5 per cent, and 10 per cent respectively. Numbers in brackets denote White standard errors.*

Table 7: EcoFin Statements, OLS Regression

		OLS Estimates							
EcoFin Statements	Hypothesis	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Economic Variables									
Budgetary Balance	b1 < 0	-0.041* (0.021)	-0.031** (0.013)	-0.044* (0.023)	-0.050*** (0.019)	-0.032** (0.016)	-0.040* (0.022)	-0.043** (0.022)	-0.049** (0.024)
GDP Growth Differential	b2 < 0	-0.072* (0.043)	-0.046 (0.035)	-0.073* (0.044)	-0.067 (0.044)	-0.063 (0.039)	-0.071* (0.043)	-0.069* (0.037)	-0.038 (0.035)
Long-term Interest Rate	b3 < 0	-0.241** (0.095)	-0.234*** (0.081)	-0.272*** (0.101)	-0.253*** (0.090)	-0.298*** (0.095)	-0.241** (0.095)	-0.236*** (0.091)	-0.283*** (0.075)
Political Economic Variables									
Economic Power	b4 > 0		0.023*** (0.003)						0.023*** (0.003)
Peer Pressure	b5 > 0			0.565*** (0.210)					0.631*** (0.211)
Institutional Veto Players	b6 > 0				0.042 (0.042)				0.056 (0.049)
EDP	b7 > 0					0.140 (0.096)			-0.013 (0.082)
Elections	b8 > 0						0.016 (0.084)		0.026 (0.091)
Left-wing Government	b9 > 0							0.002 (0.002)	0.001 (0.001)
Fixed Effects		Period	Period	Period	Period	Period	Period	Period	Period
Observations		384	384	384	384	384	384	384	384
R-squared		0.31	0.37	0.31	0.31	0.31	0.31	0.32	0.39
Adjusted R-squared		0.24	0.30	0.24	0.24	0.24	0.24	0.25	0.31

*The table shows the estimates for the determinants of political rhetoric that is undermining the SGP. The symbols ***,**, and * represent statistical significance levels of 1 per cent, 5 per cent, and 10 per cent respectively. Numbers in brackets denote White standard errors.*

Table 8: EU Heads of Government Statements, OLS Regression

		OLS Estimates							
Heads of Government	**Hypothesis**	**Model 1**	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 6**	**Model 7**	**Model 8**
Statements									
Economic Variables									
Budgetary Balance	b1 < 0	-0.029* (0.017)	-0.022* (0.011)	-0.031* (0.019)	-0.041** (0.018)	-0.020 (0.015)	-0.032* (0.019)	-0.031* (0.017)	-0.042* (0.023)
GDP Growth Differential	b2 < 0	-0.080* (0.045)	-0.060 (0.038)	-0.082* (0.047)	-0.074* (0.043)	-0.070 (0.042)	-0.081* (0.045)	-0.078* (0.043)	-0.051 (0.035)
Long-term Interest Rate	b3 < 0	-0.260*** (0.098)	-0.255** (0.112)	-0.275*** (0.100)	-0.275*** (0.071)	-0.324*** (0.092)	-0.261** (0.101)	-0.257** (0.101)	-0.318*** (0.089)
Political Economic Variables									
Economic Power	b4 > 0		0.017*** (0.004)						0.015*** (0.005)
Peer Pressure	b5 > 0			0.204 (0.190)					0.212 (0.236)
Institutional Veto Players	b6 > 0				0.050 (0.053)				0.072 (0.045)
EDP	b7 > 0					0.158*** (0.055)			0.055 (0.053)
Elections	b8 > 0						-0.112 (0.093)		-0.116 (0.087)
Left-wing Government	b9 > 0							0.001 (0.001)	0.001 (0.001)
Fixed Effects		Period	Period	Period	Period	Period	Period	Period	Period
Observations		384	384	384	384	384	384	384	384
R-squared		0.21	0.25	0.21	0.21	0.22	0.22	0.22	0.26
Adjusted R-squared		0.13	0.17	0.13	0.14	0.14	0.14	0.14	0.18

*The table shows the estimates for the determinants of political rhetoric that is undermining the SGP. The symbols ***,**, and * represent statistical significance levels of 1 per cent, 5 per cent, and 10 per cent respectively. Numbers in brackets denote White standard errors.*

Appendix 4

Table 9: The revised Stability and Growth Pact (SGP): key provisions with respect to fiscal policy coordination

Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area:

- Articles 4(2), 5(2), and 6(2) strengthen the possibility to impose gradual financial sanctions (interest-bearing deposits, non-interest-bearing deposits, fines) on members that failed to take action after non-compliance with budgetary objectives or recommendations to a member state that is concerned to take the necessary adjustment measures.
- The Council can still dismiss European Commission recommendations by qualified majority. Exceptional circumstances may apply (an event has a major impact on the financial position of the general government or a major impact on member states' financial position resulting from a severe economic downturn (see Regulation (EC) No 1467/97).
- Decisions on sanctions are quasi-automatic now: decisions on deposits and fines shall be deemed to be adopted by the Council unless the Council decides by a qualified majority to reject the Commission's recommendation within 10 days of the European Commission's adoption thereof (qualified reversed majority voting).

Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies:

- Aims to give the European Commission a stronger role in the enhanced surveillance process including monitoring, on-site missions, recommendations and warnings.
- In case a member state significantly deviates from the adjustment path towards a medium-term budgetary objective (MTO), the European Commission is encouraged to issue a warning directly to the member state.
- Escape clauses apply (unusual events outside the control of the member state, severe economic downturn, structural reforms)

Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure:

- Specifies the provisions for speeding up and clarifying the excessive deficit procedure (EDP).
- Article (2b) requires that the ratio of government debt to gross domestic product shall be considered sufficiently diminishing and approaching the reference value of 60 per cent at a satisfactory pace (one twentieth per year).

Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States:

- Aims to establish complete and reliable public accounting practices, including common rules on accounting systems, forecasting practices, budgetary planning and statistics.

Note: As part of the "Six Pack" two further regulations were made dealing with the prevention and correction of macroeconomic (excessive) imbalances. See Regulation (EU) No 1176/2011 and Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011.

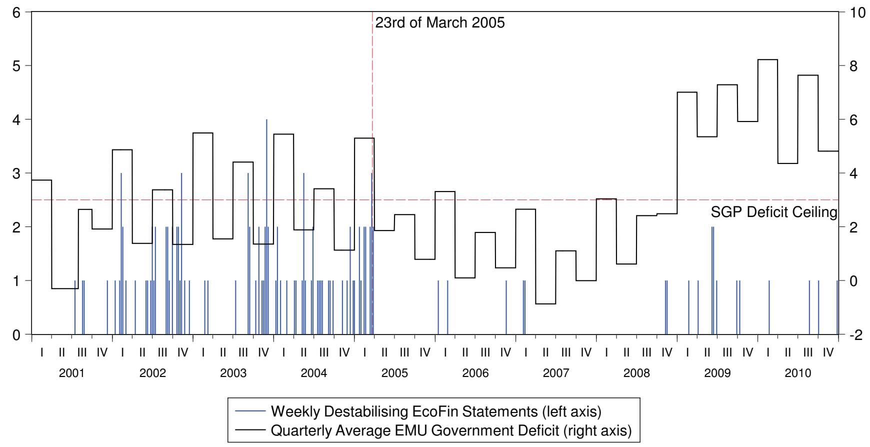
Table 10: The Treaty on Stability, Coordination and Governance on the Economic and Monetary Union (TSCG): key provisions with respect to fiscal policy coordination

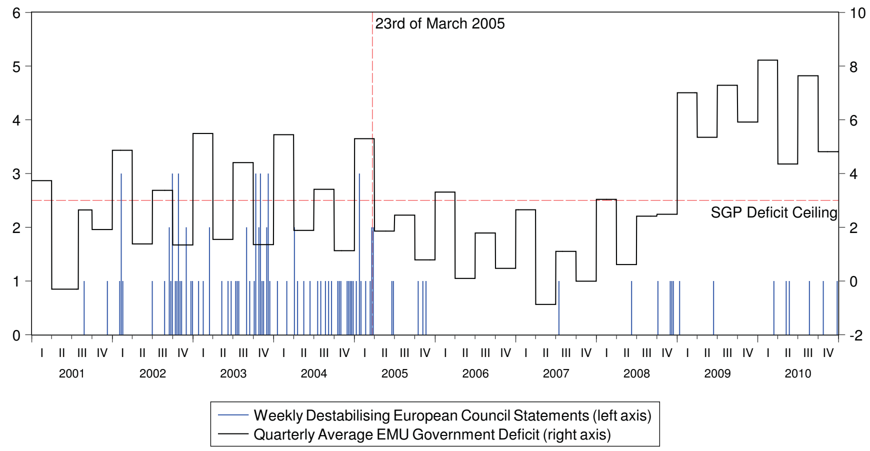
Article 3(1)a: The budgetary position of the general government of a Contracting Party shall be balanced or in surplus. Article 3(1)b: The lower limit of a structural deficit of the gross domestic product at market prices shall be 0.5 per cent. Article 3(1)c: Exceptional circumstances may apply. Exceptional circumstances refer to unusual events outside the control of the contracting parties as set out in the reinforced SGP. Article 3(1)e: In case of significant observed deviations from the MTO, the correction mechanism shall be triggered automatically.
Article 3(2): In order to increase the binding and permanent character of the treaty's provisions, rules shall be transposed into national law, preferably at national constitutional level, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes. The Contracting Parties shall put in place corrective action on the basis of common principles as proposed by the European Commission.
Article 4: Contracting Party's general government debt levels that exceed the 60 per cent reference level relative to gross domestic product need to be reduced at an average rate of one twentieth per year. Article 6: Contracting parties shall report ex ante on their public debt issuance plans. Article 7: Stronger Commitment under the excessive deficit procedure (EDP): Contracting Parties whose currency is the euro commit to supporting the proposals or recommendations submitted by the European Commission. A qualified majority may oppose decisions proposed or recommended. This does not apply to the debt criterion.
Article 8: One or more contracting parties can bring matters to the Court of Justice of the European Union in case a contracting party failed to comply with Article 3(2) of the treaty. Contracting parties may also request the Court of Justice to impose financial sanctions (lump sum or a penalty payments appropriate in the circumstances and that shall not exceed 0.1 per cent of its gross domestic product) on the contracting parties that failed to comply with Article 3(2).
Article 12: EU heads of state or heads of government whose currency is the euro shall have an informally summit twice a year.

Note: Similarly to the provisions of the "Six Pack" further articles of the Treaty include provisions dealing with enhanced economic policy coordination in order to foster the proper functioning of EMU with respect to economic growth, economic convergence and enhanced competitiveness (see Article 9, 10, and 11).

Appendix 5

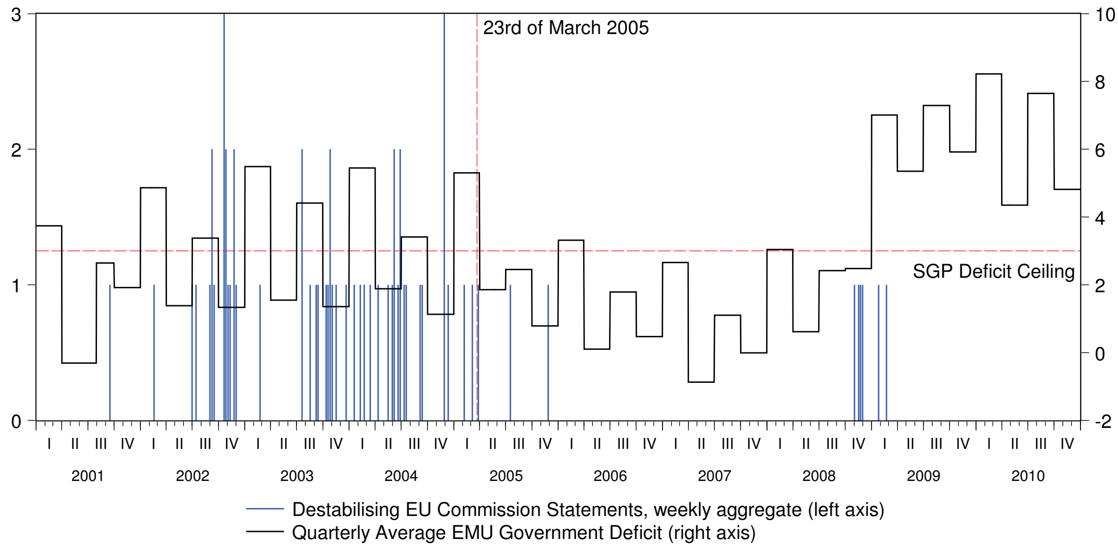
Figure 1: Development of Political Aversion to the SGP, 2001 *to* 2010





Source: Eurostat, own calculations based on FACTIVA news data over the period 2001 to 2010 following the definition specified in section III.

Figure 2: Development of European Commission Officials' Statements Undermining the SGP, 2001 to 2010



Source: Eurostat, own calculations based on FACTIVA news data over the period 2001 to 2010 following the definition specified in section III.

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