

Has the Difference between Left and Right Vanished in the EU?

Fiscal Policy Analyses of the EU Member Countries

By

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Abstract

Different governments tend to have different budget deficits, what is an important macroeconomic indicator measuring the performance and health of the public finance. The deficits are the European Union's Stability and Growth Pact major point of concern, as too big deficits do increase the countries' debts and put additional constrain on the common currency, the Euro. This paper researches the impact of the political orientation of the government on the budget deficit and its development. In the quantitative research part, the regression models and the analysis of variance show the dependence on the governmental orientation, furthermore, the regional aspect plays a role in the development of the deficits. The empirical part analyzes Germany and Austria in two different periods, shows evidence for the vanishing, of the differences between the right and left.

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1 Introduction

The crisis, which started in 2007 in the US, has already affected all spheres of the economic life: production, trade, inflation or labor market, also in Europe. One of the consequences is the lower income for the countries, and partially higher costs related to the unemployment. This challenges the fiscal policies, which are handled by each country differently. We can observe problems in the countries around Mediterranean, Spain or Greece, or relatively calm situation in Germany or Austria. Subsequently, we can see, different rhetorics of the politicians, parties and interest groups.

In my paper, I focus on the economic performance of the original 15 member countries of the European Union (EU15). The general indicators of countries' economic performance are the GDP per capita, unemployment rate, inflation and the fiscal indicators: the deficit and the public debt. I will focus on the fiscal policy indicator, which is the deficit. The reason why the focus of this work is on the fiscal policy, rather than monetary, is because of the power and legal possibility of the governments to influence the deficit. For example, in the UK, the fiscal policy has more power than the monetary policy, it is decided in advance and has more influence on steering the economy. On the other hand the monetary policy is based on built in stabilizers and inflation targeting, which is easier to predict and therefore it can be said, that "fiscal policy sets the conditions within which monetary policy has to respond in order to achieve its objectives"(Hallett 2007, 68). The deficit is closely connected with the creating of the budget and tax system. I will focus on the budget deficit. My analysis will be based on comparison of these deficits, based on quantitative methods.

The research will analyze the impact of the governmental political orientation on

the fiscal policy. The difference in the government orientation is connected with fiscal policy. The right oriented governments were traditionally more fiscal orthodox, while the left oriented governments tend to implement a fiscal expansionist policy. That leads to higher deficits in the left government then in the right ones.

A common currency in the EU has been under discussion since 1970's. In the 1990's, the EU member countries signed two important documents, one introducing the common currency, the second one putting boundaries on their fiscal policy. Therefore I put as the next important feature of my research the Stability and Growth Pact and the Maastricht Criterion for joining the European Exchange Rate Mechanism 2 (ERM II). These two agreements limit the public spending deficit, with some more details discussed later, on the 3 percent of the country's GDP. As the Maastricht Criterion is for countries adopting Euro as their currency only, I added also the SGP as it got the general guideline for the fiscal policies in the EU. The official adoption of Euro was in 1999, the SGP was signed in 1997. The year 2008 is already affected by the financial crisis and therefore not taken into consideration. Therefore, the period of the observation will be divided into two 10 year periods. The first period will be the 1981 – 1990 and the second in the period 1998-2007. The period 1981-1990 was chosen as a control period before the Maastricht and SGP were discussed on an official level.

These features will enable me to create a hypothesis: “There is a difference in the deficit increase between left and right government in the 15 member countries of the EU in the period 1980 till 1990 and in the period after the adoption the Stability and Growth Pact, 1998-2007.”

The topic is relevant for the political economy studies, to investigate, if an

institutional intervention is correlated with the unifying of the fiscal policy in Europe. Furthermore it will test the theories about the left and right influence on the fiscal policy. The next contribution will be the study of the SGP and to see whether the countries are in fact keeping the limits, or if the legal framework of the pact allows countries to obey the restrictions. Lastly, my quantitative work will simulate different situations and built in geographical component, where will be investigated, whether Northern or Southern, Western or Eastern Europe has a different approach towards the EU guidelines.

My first chapter is divided into two parts. In the first one, I conduct a deep review among various theories and studies with similar problematic. Firstly, I briefly describe, why the parties are differentiating each other between left and right. Secondly, I demonstrate various issues on this agenda with several findings among scholars. The scholars have tested the relation on the economic performance besides the governmental orientation, also with the effect of the political business cycles and the European Monetary Union.

I dedicate the whole second part of the first chapter to the Stability and Growth Pact review. In the beginning, I put a major a basic overview, what the Stability and Growth Pact aim for. Afterwards, the major point of my SGP review is based on the observations of experts from the financial and political sphere, whose works offer an insight and a different view on the need and functionality of the pact. I describe the possible weaknesses and the drawbacks that allow the governments not to keep the pact. Next, I summarize the views on the centralization and the SGP, where the justification of the pact with the co existence of the EMU is questioned. Lastly, I will outline the opinions on the new SGP reforms, which followed after the first years of the pact. The

aim of the paper is not to describe fully the methods and targets; however, I put the major arguments in question.

The second chapter forms different theories into numerous models, and tests them. I use single regression models in the first part, and the analysis of variances in the second part to see the possible differences in the different deficit outcomes. The chapter uses the information from the University of Bern dataset, the Comparative Political Dataset I.

The last chapter of the paper elaborates the theories on two selected cases. I have chosen for each particular period one case, and described detailed the economic performance with the relation to the deficit. For the first period, it is Austria, and for the period after the adoption of the SGP, it is Germany. I analyze the official documents issued by the departments of state or department of finance, journal articles related to the period and countries and publications. Furthermore, as I look for the relation between the governmental leaning and the fiscal performance, I screened the documents issued by the political parties. To avoid one side of the stories, I always checked for relevant information on the side of the ruling parties and on the side of the parties in the opposition.

According to political economy theories, the business cycle, political leaning, structure of the government and also the building of the legislative body is in some cases in a relation with the deficit. In my case studies, I focus mainly on the governmental leaning and the election years. I use the data from the local statistical offices, as they are better interpretable with the information available to the particular cases. The case studies are structured in such a way, that the reader will get a basic overview of the political and

economic situation in the beginning, and then, the governments are deeper analyzed.

Finally, in my conclusion, I summarize the main findings from all the three chapters and suggest the possible field for a deeper research.

2 Theories and Background

2.1 Governmental Leaning

The right and left division of the parties, was done in the history by various scholars and with various typology. The one I take into the consideration is Kitschelt. The division was made on different personal perception on the issues, which the politics have direct effect on. The labeling was done from the “conception of libertarian extreme, featuring personal autonomy, tolerance for difference, multicultural expressiveness, what is considered as being left...up to authoritarian extreme, what is seen as right“ (Kitschelt 2003, 127). When talking about the political orientation and its policy, an important feature we have to think of is the preference of the voter. The fast development of the society, with the changing trends and needs of the citizens has an enormous effect on the changing political leaning definitions.

The society in the past was easily classified between these two blocks. The first class, the blue collar workers with a big trust in the trade unions, was in a need for social benefits from the state, having social protectionist views. They libertarian perception of the economy created space for the left parties to make their policy. On the other hand, the white collar middle class, with market liberal tendencies, less affiliated with labor unions, became the basis of the support for the right politicians. It is necessary to keep it mind that the uneducated working labor, may not have voted on economic background, but on some other perceptions. Issues as immigrants, gender equality or environment, became part of the policies, creating a mixture in the political manifestos (Kitschelt 2003, 129).

The basic assumption, where the left governments are spending more money in the relation to their income, was developed in the Haan, Sturm 1993 studies. Their analysis is concluded in findings, where the more frequent changing governments tend to spent more in the relation to their budget. Their regression model, developed on the twelve member countries in that period, showed a result, where the governments with social-democratic and other left parties have a budget output generally higher. Their testing was focused as well on the parliaments, where the relation between the budget spending and left orientation was even higher then in the relation with the government (Haan and Sturm 1994, 161-162). The research was done in the period 1981-1989. In that time, the vision of a common fiscal policy guideline was to far away from the reality.

Despite the higher spending in the left governments, the state as the social planner, tries to keep its level of expenses in line with the income. The so called tax smoothening is described in the Alesina Perotti 1994. They see the deficits as a buffer, when the spending is temporarily high and surplus low (Alesina and Perotti 1994, 5).

By searching for the correlation, I have to be aware of various facts, which are known for many years. One of these is the theory of the political business cycle elaborated by Nordhaus. It expects the government, to fight the unemployment in the second term of their government to gain more popularity and to secure its reelection in the next vote. The Nordhaus model expects the voter to vote according to the past performance of the government and the expectation of the money surplus in the upcoming period. Therefore the government is using the monetary and fiscal issues to secure more money in the circulation. Although the primary point of the business cycle theory is the monetary policy, the study of Allan Drazen states that explanations based on

fiscal policy, much better fit the model of electoral influence on the economic performance (Drazen 2000, 77). The business model has been by time elaborated into two separate models, the opportunistic and the partisan one. Whereas the first one sees the expansionary monetary policy followed by inflation as the tool of the government to influence the election, the rational or partisan model by Alesina, sees a regular difference between the first and second half of the electoral term. The second half, depending by the official term is always more economically active. Drazen's paper did not show significant evidence on the partisan theory in the case of the USA; however, it showed different economic activity after the elections between the democrats and conservatives, with higher economic performance on the side of the democrats. Secondly, the US voters are affected by their economic and living conditions. However, outside the USA, Drazen did not find significant results for the Nordhaus opportunistic model. The study of Allan Drazen recognizes the growing deficit in the end of a political cycle, as it has observed that in Gonzales study about Mexico (Drazen 2000, 98). The study on business cycles, done on fiscal transfers solely, was provided by Trufle, where he shows several pre-electoral fiscal manipulations, although the Alesina and Roubini 1990 work did not find evidence on fiscal transfer cycles (Drazen 2000, 96).

The political business model was studied by Mark Kayser from the University of Oxford. His model based on the opportunistic business model examined two factors, the manipulation of the economies and the shifting of the elections by the government. These two factors are in his model a tool for gaining more power for the governments. His model resulted into finding, that there is a negative correlation between a good economic conditions and manipulation of the economies, what seems logical. However, there is a

positive correlation between a positive economic performance and shifting of the elections (Kayser 2005, 25).

The Barro-Ricardo equivalence proposition says that the current government does not put importance on where to find cover for their expenses. The possibility is to raise taxes, or to issue bonds and let off the country. The problem, that occurs, is the covering of the debts in the future, which will high possibly be done through increased income tax in the future (Briotti 2004, 10). Although the theory is primary related to the stable aggregate demand, which has been anyhow questioned by various authors afterwards, I do recognize a direct connectivity with the deficit problem and stability and growth pact.

The model of Hibbs sees correlation between the inflation and the party orientation. The right oriented parties prefer low inflation; whereas the left oriented governments prefer the higher inflation to higher unemployment (The Social Sciences Summary Database, 2008). The Phillips curve shows, how the unemployment is in correlation with the inflation. Several studies focused on the relation between the inflation and deficits, as Bruno and Fisher in 1990, see the way of financing deficit by issuing more money what causes the inflation. Here we can observe a correlation between the cycles and the deficits (Bruno and Fischer 1990, 353).

The business cycles and budget spending was observed in the later literature in the book written by Hallerberg, von Hagen and Strauch, focused on the fiscal policy of the European Union. It offers broad analyses on the determinants of the fiscal policy in the European Union. Their finding in the EU countries, made in the 90's, came with interesting conclusions. As Haan and Sturm in 1993 found out, the more frequent changing government is correlated with higher budget spending and deficits. On the other

hand, surprisingly, the election years did not have an impact on the spending itself. This finding is not in line with the previously mentioned political business cycles. My research will be therefore focused to determine, how the European governments are behaving. Further determinants having influence on the budget spending, according to Hallerberg et al., is the homogeneity of the government and the number of parties involved in the governing. These variables will play role in my research, and I will try to build a model on these findings, related to the strength of the government as well. In my paper, I will be aware of the possible crises in various countries, which might had been a reason for higher budgetary spending. However, Hallerbrg et al. tested the crisis in the Nordic countries in 1991 and found no actual correlation. The period I have chosen is free of any significant crisis (Hallerberg et al. 2009, 20).

My topic, in various modifications, was studied by several scholars. Bayer and Smeets in 2009 researched the relevant studies, and found in Perotti and Kontopoulos 2002 paper, that the political ideology influences the expenditure side of the budget only; however, the deficit as such is not dependent on that. In Mulas-Granados 2003 paper, they found evidence that the left governments have better fiscal adjustments in the second half of the 1990's. The reason behind is seen in the implementation of the Maastricht criterion and SGP. The paper tested various models with different variables on the deficit. It concluded, that the deficit is a case to case problem, where the political ideology does not play role. However it found out that the fiscal policies has moved all in one way after the Maastricht and SGP (Bayar and Smeets 2009).

A party influence on the fiscal policy and distribution was published by Iversen and Soskice. They concluded, that the distribution is the result of the “electoral system

and the class coalition they engender” (Iversen and Soskice 2006, 178). Their finding did not have any influence on the deficit building, however, the important contribution to the topic is in the real influence of the budget building by the political composition of the parliament. In its meaning, they showed evidence that if there is a majoritarian parliamentary system, there is a higher possibility of a right government, whereas center left governments are more likely in a proportional representation system (Iversen and Soskice 2006, 178). Their finding argues that a PR system redistributes the money more than the majoritarian system. The redistribution flows towards the poorer part of the population, what is the basis for the left popularity in the PR system.

The Iversen and Soskice's conclusion about the different budget building connected to the government party orientation, was the topic of the research for Huber et al. Their work is based on the Kersbergen argument. It says that Christian democratic parties tend to have different kind of welfare state than the social democratic welfare state, and the Christian democrats have higher expenditures, but smaller redistribution. Their testing brought one very important issue. There is a huge co-linearity between more factors, such as corporatism, or trade unions or higher number of older persons (Huber et al. 1993, 726-743).

Both papers, Huber and Soskice, have one in common; different parties in government have different effects on the budget composition. Therefore I see relevance in my hypothesis testing, to see whether the different party composition of right or left contributes to different deficit of the budget.

Budget deficit, as one of the macroeconomics indicator, clearly and without doubts depends on other figures characterizing the economy. One of that is the GDP

growth. As stated in the work of Lambertini and Rovelli, the fiscal and monetary policy have the impact on the aggregate demand, as a total output component, what is one of the indicators of the GDP. Despite the claim, that the fiscal policy is aimed according to the GDP development, the authors further stress that the fiscal and monetary authorities differ in their motivation, and there is a lack of coordination. I want to remind, that the monetary authorities in the EU 12 are the independent Central Banks and the ECB, the fiscal policy is done by the government. Their argue, that the absence of the explicit commitment of the fiscal authorities and in many times ex post decision at the fiscal level on the GDP change may be harmful (Lambertini 2003, 7).

Within the testing, I will research the possible geographical influence on the dependent variable. The question will be if the Nordic countries perform better then the Mediterranean's. The regional differences were tested in the Hallerberg et al; however their work does not include the comparison of the regions with the effect of the European Union fiscal policy tools. The country differences in the fiscal matters were observed as well in the Haan Sturm 1993 studies. Their approach was comparing the public debt of the EU member countries to the EU public debt average. Their country difference was however not based on regions. My second hypothesis will be: There is a significant difference in the delta deficits between the regions, which did not occur by chance.

The regions I want to compare will be: Mediterranean, Scandinavia, Benelux, Germany & Austria. There are several other categorizations of the countries, based on the welfare state categorization, production regimes or corporate governance.(Kitschelt 2010) However, I want to show evidence that a pure regional location may be correlated with the deficit. The result might be important for further studies of the fiscal policy spill over.

2.2 Stability and Growth Pact

According to the rules, as mentioned in the 1998 Buti, Franco and Ongena article, the SGP allows exceeding the 3 per cent of the government budget deficits only in exceptional cases. In the 1997 first SGP rules, as the revision followed in 2005, the exceptional cases were not exactly formulated in the treaties, what may have caused obeying of the rules (Buti et al. 1998). My quantitative research will be dealing with the exceptional spending, to guarantee objectivity and fair results.

The objective of my paper is to investigate, whether the implementation of the Stability and Growth pact has impact on the government leaning effect on the fiscal policy. The SGP was originally signed by the member countries of the EU to prevent extraordinary spending and stabilize the economies in the EU in 1997. The more concrete goal is specified as the medium-term budgetary objective. The countries were offered a “safety margin” with 3 per cent of their annual budget deficit, guarantying space enough for budget actions in a case of an unfavorable economic development. The 3 percent were however case exemptions, which had to be judged by the European commission. In case of a normal cyclic development, the GDP deficit should be hold in the frame of plus/minus 1 per cent, depending from the cyclical development (Gali and Perotti 2003, 3).

I have to mention, that there is a lack of theoretical approaches towards the government leaning and the SGP. However, the previous explanations, mainly by Peroti and Kontopoulos 2002 indirectly imply that left government would have difficulties to meet the criteria of 3 per cent budget deficit.

The Fritz Breuss edited book about the Stability and Growth Pact summarizes in complex the views of various experts on the advantages and disadvantages of the SGP and tries to see the reasons behind the adoption of the pact. There are several reasons to mention. The most mentioned reason is the preventing and the corrective goals. As Louis stated, the SGP was invented by the German authorities to the European Union, to guarantee, that the stability of the new currency Euro, will be on the same level as the stability of the German Mark, which had been internationally recognized as one of the most trustworthy currencies. The affiliation to the German National Central Bank demonstrates among others the vocabulary of the text, where it refers to “solidarity in society”, what has been characterized for the German position (Breuss 2007, 4).

2.2.1 SGP and its Weaknesses

The SGP has been designed to prevent the downfall of the EMU financial systems, however as we see in the case of the Greek crisis in 2010, there has been some leaks, how to prevent an efficient control.

Brück and Stephan took the period after adoption of the SGP under research. They did look for possible cheating on the budget deficit forecast. They compared the forecast with the real numbers, in combination with the political business cycle in and outside the Eurozone. They came to a conclusion that the SGP itself creates a better environment for the governments to cheat, especially in the voting period. The way how to cheat, is the objective of the pact itself. The aim to decrease yearly the deficit by 0.5 per cent and to keep the budget deficit under the 3 per cent level makes the prediction on the deficit look uniformed, and all the predictions look alike. The macroeconomic shocks measured by

the unexpected GDP changes were perfectly correlated with the deficit. They researched the impact of the right or left government, with their conclusion, that left governments tend to be more optimistic with their budget forecast. Lastly, they did a country by country model, showing, that from the country set of EU 15 with Japan and USA. USA and Luxembourg tend to have more optimistic early budget forecast, what means, they more likely finish over the predicted budget deficit (Brück and Stephan 2009, 1-8).

The efficient control of the budget by the member states faced various problems. The problem itself was keeping the limit of the deficit. The problem with the population ageing leads many countries to the fiscal hazard, therefore, in some way, many countries see the SGP and Euro as the healing mechanism how to overcome the problem. Never the less, it were the politicians itself, who set the conditions to the SGP so it is expected they should handle their situation also without it. However, the existence of the SGP works as a “pedagogical” tool to show the politicians what to do. (Sapir 2007, 88)

The burden on the spending set on 3 per cents is considered by the majority of the EU ministers as the correct way of leading the public finance. However, the government may consider in some times, that more money is needed to effectively cover the needs of the country. I distinguish between two types of possible overspending, based on the published articles, and not being violating the SGP.

2.2.1.1 Possible way outs

The first one is the legal way of overspending and not being penalized. It is partially institutionalized by the SGP itself. There is a rule, the so called provisions on structural reforms. It takes into account spending over the limit, in case of a structural

reform, connected with the multiple pension pillar reform, or other structural reform. Considering the pensions reform as one of the must of these days because of the human population increase and the sociological changes, the current overspending of the budget deficit, is having a moral background.

However, there are other non specified areas, as the structural reforms, which leave a relatively large open playground for the financial adjustments of the budget. The investments into the infrastructure, the private partnership projects, and the state co financed projects are one of the possibilities, where the state delegates its responsibility and the financial coverage to private companies, in exchange for higher payment burden for the citizens.

The second possibility, as identified by Paul van de Noord is where government can meet the deficit requirements directly. This can be also done in several ways. Privatization of the state companies increases the state income, cuts in spending and investment projects, connected to the delegation of the responsibility towards the enterprises. Van Noord highlights the shifting of the expenditures over time to the next budget period and eating out the pensions, where the state borrows money form the pension funds (van Noord 2007, 40).

A justification for the special classification of the costs on the infrastructure and pensions is shown in Nowotny's work, which states an effective contribution to the fiscal policy, only in less than two circumstances. First, it has to be lead from one point, and secondly, it has to be planned for a bigger time horizon (Nowotny 2007, 95).

The second way how to make the numbers look acceptable, thus not doing for them a lot is lying, creative accounting, or the cyclical adjusted number reporting

methods. An official way, how the European countries actually reported their numbers within the desired level and not breaking the 3 per cent burden is cyclical adjusted reporting (Van den Noord 2007, 42-48).

2.2.1.2 Centralization

An argument questioning the SGP, highlighted by Kohler, is the advantage and disadvantage of the centralization. The SGP itself means the centralization of the budget procedures around the EMU member countries. The centralization, according to Kohler brings more spillover from country to country, where we can see the rise in deficits in the same years in the countries of the Eurozone region. Questionable is also the fiscal decentralization in the member countries. He points out the research done by Hagen and Eichengreen 1996, where a negative correlation between the fiscal decentralization and SGP rules in the member countries (Kohler 2007, 110). Kohler brings the argument from the study of van Rompuy and Moesen, where the fiscal decentralization with monetary centralized policy brings space and incentives for fiscal less responsible actors. Therefore, by already existing EMU, the argument makes one not sure about the relevance of the SGP (Kohler 2007, 111). Next argument that makes my work relevant is the fact that the governments tend to decrease expenditures rather than increase taxes.

A totally different argument was brought by Marco Buti, where the pact requires a increased political accountability at national level, stronger role of parliaments, whereas the SGP itself suffers from non coordination for the national parliaments (Buti 2007, 177).

Kohler brings argument that a similar pact to the SGP existed before, during the

Bretton Woods. The abolishing of the Bretton Woods had led the countries to the period of no real control, what was hit by several crises in the past. Therefore the SGP should act as a new Bretton Woods in order to bring order and stability into the economies (Kohler 2007, 122). He argues, that the Conventional theory of currency unification does not see a need for EMU to have a common fiscal centralized policy; on the other hand, it needs flexible and unrestricted national fiscal policies (Kohler 2007, 139).

The problems of spill over were studied by Breuss and Roeger, where their result on the effect of a big country scrutinized economy on a small one. In the case study Germany and Austria, the effect is there, however the SGP in their simulation helped Austria to perform 0.2 percents better in the GDP growth (Breuss 2007, 218).

2.2.2 SGP Reform

The initial problems with the pact were followed by a major revision, as it did not bring satisfactory results. A requirement has been set with the necessity, in a case of a budget deficit, to improve the deficit on an annual basis on 0.5 per cent, to reach the plus/minus 1 per cent ratio (Breuss 2007, VI). Furthermore, related to the budget deficit, a sustainability of the overspending has to be guaranteed.

The mentioned problem with the creative accounting was one of the drivers to launch the SGP reforms, which led to the point, where the European Commission started to collect its own data. The second driver is connected with the general/capital account dispute. Governments argue that leaving the 3 per cent deficit on the capital account would prevent country from investments into the infrastructure, what is in many cases

costly. Therefore, a balanced general account is a must in the SGP, however, a deficit in the capital account, where the capital investments is aimed towards the infrastructure, which will be paid off and used by the future generation has been allowed (Van den Noord 2007, 52). The allowed investment into the infrastructure above the limit is definitely something the government welcome, as their deficit can actually be higher.

Secondly, besides the investments into infrastructure, the reformed pact reform did count on issues with financial crisis. Its latest version contains an exemption, that in a case of a “exceptional circumstances” the deficit may exceed 3 per cent. However, as pointed out by van den Noord, the classification of this circumstances and areas of possible funding lacks definition (Van den Noord 2007, 53) although, in a view of the ECB, it is clear enough (European Central Bank 2005).

3 Analysis

3.1 Methods

Next issue is the statistical method. The mentioned articles were built on simple regression models, whereas I will try to incorporate besides the regression the multivariate methods.

The SGP will be a dividing line in my research. I will put the deficits of the countries into two groups, one in the time period from 1981-1989 and the second one in the period 1998-2007. The first group is not expected to be influenced by the EU treaties, whereas the second one is.

My method will use the deficit numbers as well as the changes in deficits, what may bring more significant results. The deficits itself might be low thanks to countries' good shape of economy. Therefore the comparing of the differences of the deficits might be more explanatory as the deficits itself. Furthermore, the European fiscal guidelines do not explicitly say how the deficit should behave if it is under the limit. Although, there is a general recommendation to be in a budget balance between the income and outcome, the threshold of 3 percents is the key feature of the SGP. The samples will be countries deficits and deficit changes in each year. I will test it the effect of the election year.

For my research I will use statistical datasets provided by the University of Bern. The Comparative Political Data Set I contains political and economic data from 1965 to 2004 for the OECD countries as well as for the CEE region.

According to the results, I will add a comparative case study of two countries from

different sections. The details will be known after the quantitative methods. The case studies will be focused on the direct reasons of the budget deficits, fiscal policy and political orientation. To conclude, the government orientation, as well as the parliament orientation will be taken into consideration, as the parliaments tend to approve the budgets.

3.2 The Quantitative Model

The first point of my quantitative analysis focuses on the difference of the deficits before and after the adoption of the stability and growth pact. Based on the theory, stated before, I created the following hypothesis:

H1: There is a difference in the deficit increase between left and right government in the 15 member countries of the EU in the period 1980 till 1990 and in the period after the adoption of the Stability and Growth Pact, 1998 till 2007.

Using the Comparative Political data Set, I have selected the following variables for the research:

The Dependent variable: The Delta Deficit. I have created by calculation the variable as a yearly absolute change on the base of the Annual deficit (government primary balance) as a percentage of GDP (Y), provided by the dataset. Delta deficit: $D = (y - (y - 1))$. The Deficit itself would not be relevant enough as the one year of deficit impacts the other year. We can say that it is less likely that a country's government primary balance would drop from 5 per cent in one year to 1 per cent in next year.

I used several explanatory variables. The first one is the period of time. I created a nominal variable, dividing the cases into two groups. My first group of cases consists of

the delta deficits of the EU 15 in the years 1981-1990 and the second group of the countries delta deficits in the period 1998-2007.

The second one is the Cabinet Composition. Cabinet Composition (Schmidt-Index) as appeared in the dataset is dividing governments into five categories based on their political orientation as government with: (1) hegemony of right-wing (and centre) parties; (2) dominance of right-wing (and centre) parties; (3) balance of power between left and right; (4) dominance of social-democratic and other left parties; (5) hegemony of social-democratic and other left parties. This variable, for the purpose of the research and for easier result interpretation, was recoded into variable with three categories as follows: (1) right-wing parties government (RIGHT) was computed as combination of hegemony of right-wing (and centre) parties category and dominance of right-wing (and centre) parties category; (2) neutral government (NEUTRAL) is consisting just from the original balance of power between left and right category; (3) left-parties government (LEFT) was computed as combination dominance of social-democratic and other left parties and hegemony of social-democratic and other left parties.

The next set of dependent variables is the deficit delta a year before the D_{y-1} and the delta the year after: D_{y+1} . I use this two variables to see the effect of the election year. The election year is a further explanatory variable.

I decided, to use the explanatory variable, the region. I created a dummy variable for each region. Approach based on countries was introduced by Brück and Stephan, by investigating the cheating on the deficit. (Brück and Stephan 2005,8) With this model I want to see, whether some region is more likely to have bigger or smaller differences in the deficit. I divided the 15 countries into separate regions: into the categories:

1. Nordic: Sweden, Denmark, Finland.
2. Center: Germany, Austria
3. West: France, Belgium, Netherlands and Luxemburg
4. Islands: Ireland, UK.
5. Mediterranean: Spain, Portugal, Italy and Greece.

To analyze the impact on the deficit, I ran several regressions, based on the theories to see the correlation. In the first model, I aimed to see the effect of the SGP and government orientation. Therefore I set the deficit delta as the dependent variable. As the explanatory variables, I have set the government orientation (G) and the SGP (S) dummy variable, that shows whether the cases were in the SGP period, or not. The model is not significant.

$$(1) \quad \Delta D = 0.28 - 0.282 S + 0.21 G$$

The Durbin Watson 1.68 can be interpreted, as there is no dependence between the variables, however the $r^2=0.08$ is showing very low number, what means there is no real explanatory power of the model.

My second model set the dependent variable the deficit itself. Leaving the independent variables as in the previous model, the government orientation (G) and the SGP (S), I added the control variable, the deficit of the year before (D_{Y-1}). The explanatory power measured by the r^2 , showed 0.534, what is with 3 independent variables a very solid number. Despite using the control variable, the Durban Watson at the level of 0.9 demonstrates dependence of the variables, autocorrelation. The model

shows significance at 95 %. The test resulted in standardized residuals, with no major outlayers.

$$(2) \quad D = -1.131 + 1.343 S^{***} + 0.507 G^{***} + 0.603 D_{Y-1}^{***1}$$

My third model has been set up to see the influence of the political business cycle on the deficit. The regression dependent variable is the delta deficit and the explanatory variables were besides the government orientation (G) and the SGP (S) the dummy variable for the election (E). The model shows significance at 99 per cent.

$$(3) \quad D = -1.705 + 2.793 S^{***} + 0.925 G^{***} - 0.654 E^{**}$$

Although the model is showing a high significance at 90 %, the $r^2=0.258$ means a small explanatory power of the model. On the other hand, the Durban Watson with 0.4 shows autocorrelation.

By exchanging the dependent variable for the deficit delta, we get more reliable numbers. With the Durban Watson of 1.9, we can say there is very low dependence of the variables. The r^2 is on the other hand very low, $r^2=0.074$, what gives us very small explanatory power. The F test equals 8. The model is significant at 99 per cent.

$$(4) \quad \Delta D = 0.55 - 0.315 S^* + 0.029 G - 0.906 E^{***}$$

Assuming from the theory, that the government cuts its expenses after the election, because of the overspending during the election ΔD_{y+1} , I ran a model with the dependent variable, what has been the deficit change one year after the election. The

1 *** Significance at 99%
 ** Significance at 95%
 * Significance at 90%

explanatory variables were government orientation (G) and the SGP (S) and the dummy variable for the election (E) in a year before. This model shows significance of 95 %. The only significant variable in this model is the election year variable, with 99 per cent significant. We can interpret the result that the deficit in the year after the election decreases of 0.631 percent. However the whole model is again of a smaller explanatory power, 0.041, what on the other hand is expected as there might be other factors having influence on the deficit. The model however shows evidence, that the election year thus has an impact on the deficit. The residual mean, equaling zero, means the result is equally distributed.

$$(5)^{**} \quad \Delta D_{Y+1} = 0.52 - 0.270 S + 0.76 G - 0.631 E^{***}$$

The next step is to show there is a correlation between the country and the deficits. I assume that some countries have in time bigger deficits than the others. A regression put as the dependent variable the deficit. The explanatory variables were the SGP, governmental leaning and the countries. This model did not show significant result.

As the countries did not have correlation with the different deficit deltas, I have built a model putting the deficit as the dependent variable, putting the regional dummy variables as the explanatory, with SGP as the control variable.

The model showed significant result at 99%, with $r^2 = 0.3$. The significant regression is at the Nordic Region, with 1.478 and Mediterranean with -1.476. However, the Durbin Watson, with 0.5 means strong autocorrelation.

3.3 Multivariate Models

In my second part of the analysis, I have decided to use the analysis of variance.

The analysis of variance is used to see the difference in variance between more groups. For the purpose of observing the difference between groups, the t test may be used; however, it works only in pairs. In case, I have more than 2 groups, the analysis of variance offers a suitable tool to see any significant variances.

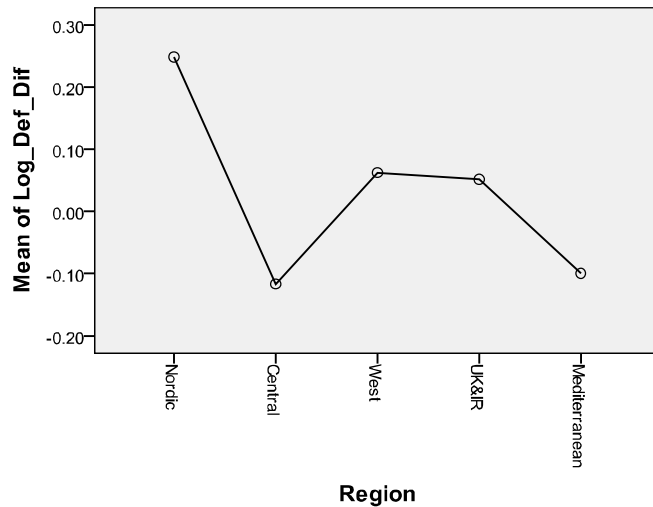
My first model, analyses the different variations of the Delta Deficit among the regions.

My hypothesis:

H1: There is a significant difference in the delta deficits between the regions, which did not occur by chance.

In the first model, I selected only the period 1980-1990. The Levene's significance level was $P < 0.05$; therefore I transformed the data with the logarithmic function, what is recommended in a case with this problem (Medcalc). In my result, the Levene's test of homogeneity was 0.452, what means the groups are approximately homogenous, what is a condition to do the analysis of variance test.

The analysis of variance shows significance at 90 percent, what allows us to reject the null hypothesis. It means at least 2 out of the 5 groups have different deficit differences because of the region they are in. However, due to the low case number, caused by the logarithmic function, which is defined only for positive numbers, the test can not guarantee the type I error level, what means, we can not claim that the rejection of the null hypothesis is right.

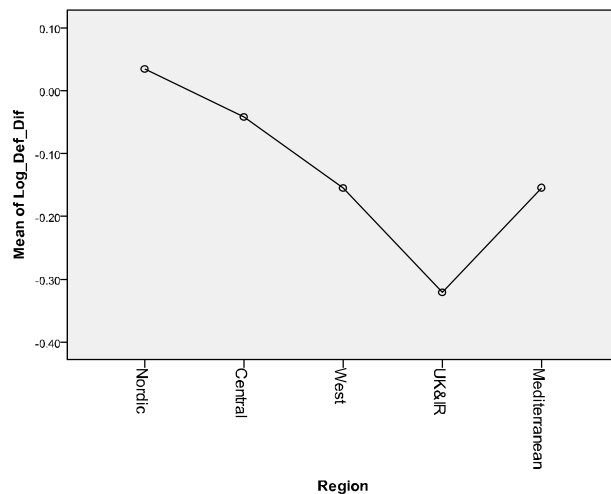


1980-1990

Region	N	Annual Deficit Change Mean
Nordic	15	0.248
Central	10	-0.117
West	16	0.062
UK&IR	11	0.051
Mediterranean	24	-0.100

Significance 0.096

I performed the same test with the SGP period. The Levene's test of homogeneity met the necessary criteria, to perform the analysis of variance test; however, there was no significance to reject the null hypothesis.



1998-2007

Region	N	Annual Deficit Change Mean
Nordic	16	0.035
Central	12	-0.042
West	22	-0.155
UK&IR	13	-0.321
Mediterranean	16	-0.154

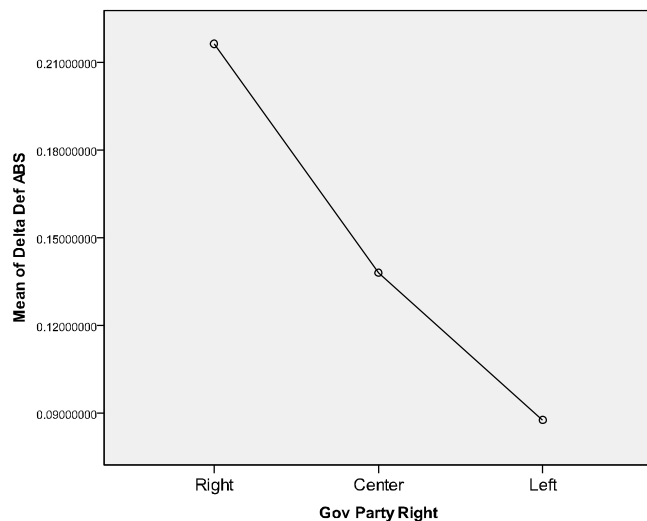
Significance 0.357

In my second analysis of variance measurement, I did the test, on the deficit differences among the government groups. As stated earlier, the dataset provided the Schmidt indexed political parties, and the composition of the government was counted as a weighted average, where the final number set the condition for the categorization of the government. The governments were coded from right to left on a scale from 1- 5, recoded

from 1-3, for an easier interpretation. My hypothesis:

H1: There is a significant difference in the deficit delta across the governments, which have not occurred by chance.

The result for the both periods, before, and after the SGP could have been processed due to Levene's test of homogeneity, which was higher then 0.05. The charts showed a very clear difference between the groups of right government, left and center. However, the results are not statistically significant, what does not allow us to reject the zero hypotheses that the differences occurred by chance.



Governmental Orientation	N	Annual Deficit Change Mean
Right	138	0.216
Center	74	0.138
Left	90	0.088
Significance	0.832	

To see the business cycle model theory in practice, I compared the variances on the deficits on cases in election year and in the year after election. I compared the three groups, government of right composition, of left and of the center orientation, as indicated with the Schmidt Index.

The model, where I compared the variances of the deficits in the election year, did not show any significant results. The model in the period before the SGP, and also in the period after the SGP did not show significant results.

1980-1990

Governmental Orientation	N	Annual Deficit Change Mean
Right	29	-0.161
Center	9	-1.097
Left	8	-0.708

Significance 0.354

1998-2007

Governmental Orientation	N	Annual Deficit Change Mean
Right	19	-0.464
Center	9	-0.436
Left	13	-0.646

Significance 0.220

The second set of models, based on the cases of the governments in the years after elections, was as well not of significant results. The model in the both periods are therefore not interpretable and we can not reject the null hypothesis., that the difference in the deficits on the post election year between the left, center and right governments, did occur by chance. The attached graph shows how the left governments tend to have smaller deficits in the year after the election.

1980-1990

Governmental Orientation	N	Annual Deficit Change Mean
Right	23	0.778
Center	8	0.917
Left	11	0.762

Significance 0.763

1998-2007

Governmental Orientation	N	Annual Deficit Change Mean
Right	15	0.156
Center	8	1.153
Left	14	0.353

Significance 0.249

4 Case Study

Based on the graphs, showing the delta deficits on a time frame for each country, I have chosen Germany as a case study. Germany shows in the period of SGP, in the first phase a high increase of deficits, and suddenly a fast decrease. Furthermore, the literature review pointed on Germany, as on the country that initiated the Stability and Growth Pact. As the initiator of this idea, it should be exactly the country, where the criterion is met, and the deficit does not exceed 3 percent. Therefore, for my case study, I have chosen Germany, to see how the inventor of this idea is following its own rules.

On the other hand, there is Austria, which had relatively high increase in deficits in the first period. Austria is furthermore a close neighbor to Germany; with relatively often change of governments. My case study selection is done with the purpose, to see what is being done in a country during the SGP and to see what had the biggest fiscal issues been in the period before. Additionally, both, Austria and Germany are in a so called Welfare state countries group according to Kitschelt. (Kitschelt 2010)

4.1 Germany

Among all the observable countries, Germany showed the lowest deficit (government primary balance) change in the period 1997-2007. The study of Germany is aimed to show why the German government succeeded in their efforts. I will analyze the budget creating and the conditions, under which the German cabinet achieved the result.

The numbers I used for my quantitative method have their origin at the OECD and are the deficit of the primary balance. This excludes the interest payments on

consolidated government liabilities. However, for my qualitative part, I use the numbers provided by the German Statistical office, as they are more in debt and provide more information. The deficit in their numbers follows the methodology set up by Maastricht, includes the interest payments on consolidated government liabilities, what makes slightly a difference. However, the trend and the research on the political influence is not affected.

4.1.1 Politics in Germany

There are two major political parties in Germany: CDU and SPD. Besides them there is the FDP, The Greens and PDS. CDU, Christian Democratic Union, used to be a party of the center right, is now moving into the center. The parties major economic program is focused on fiscal orthodoxy thus having a healthy welfare state with a support of the sick, unemployed, disabled and the elderly. The SPD, Social Democratic Party, similar as the CDU is for a welfare state with the protection of the social weaker ones. Its economic program, is focused on sustainable budgeting without putting burden on the future generations, is similar to that one of the CDU. The major characteristic of the party is the social market economy. The country is generally considered as left. The FDP is a liberal party, with the idea of Laissez-faire (Facts about Germany 2010). The Greens, putting focus on the state support of the environment, is in the fiscal policy focused on just in the tax system and in indebting country (The Alliance 90/The Greens 2010). The PDS is the youngest among the parties. It represents the far left on the political measurement. Their idea is simply a progressive taxation and special taxation for the rich and corporations (Die Linke 2010).

4.1.2 The Welfare State

Before analyzing, I need to highlight the specifics of the German Economy. The unification of Germany in 1990 was followed by a shock therapy for the east, by fast implementation of the market economy. The country, which lived for more than 40 years under planned economy, was not ready for such a change. After the change, many workers feared of losing their jobs, and became the supporters of the left (Kitschelt 2003, 131). The support of the left parties in the eastern part is generally higher as in the western part.

Germany, considered as the welfare state, is one of the most competitive economies in the world. The trade surplus rises annually thanks to the leading position as the biggest exporter. Germany held the export leading position until 2009. High skilled labor, excellent infrastructure and relative good working environment guarantees for Germany despite high wages big inflow of investments. Germany itself got one of the biggest investors, thanks to its big multinationals (Facts about Germany 2010).

Despite the positive characteristic of the country's economy, there is one major drawback that did not allow the country even more dynamic development in the past decades. The relatively stable digit for unemployment (Streeck and Trampusch 2005, 174), has not been accompanied by a high number of employment. On the opposite side, the German generous system of social welfare transformed part of the country's labor force into social help dependent citizens. As showed in various empirical evidence, the Bismarck style welfare state “depresses the level of employment by inflating the costs of labor” (Streeck and Trampusch 2005, 175)The high price for the employment, due to high social insurance costs, lead many employers to increase the productivity of labor, to

be competitive. This was supported by earlier retirement age, which needs more money from the pension system. Streeck and Trampusch called it the vicious circle.

The system was well working in the time of economic expansion, however, after the reunification and opening of the markets, Germany suffered a period of recession. The system, as it worked for several decades in the western part was not ready for these kinds of rapid and sudden changes. Furthermore, the ageing population and the outsourcing of various kinds of position within the EU meant a need for a rapid change in the German Welfare state.

Where does the fiscal policy meet with the Welfare state? The German welfare system consists of four different social insurance elements. They all work as independent budget entities, however, in case of a shortage, money flows from one part to another one. In case of a shortage in all four, the federal budget puts money into the system to make it work (Streeck and Trampusch 2005, 177) . The pension insurance, unemployment insurance, health insurance and long-term care insurance often though need money from the general budget, which puts a lot of stress on the fiscal planning. Furthermore, as stated in the document “Bemerkungen 2007” issued by a state department for budgeting, the “Bundesrechnungshof”, more then 75 per cent of the tax income is actually connected to the social help and interests’ payment (Bundesrechnungshof 2007, 88).

4.1.3 Election 1998

Before analyzing the impact, it is necessary, to introduce the political situation in Germany in the year 1997-2007. In 1997, seven years after the country unification, the

unemployment rate was reaching the highest figures (9.4 % from 4.2% in 1990), and the general satisfaction was on decline especially in the eastern part. The following year, 1998, the country was holding elections into the parliament. The country has been generally unsatisfied with the governing of Helmut Kohl, who has been in power for 16 years. His attitude to overlook the daily problem, and focus more on the European integration, together with the deadlock situation between the two chambers of the legislation power, the Bundestag and Bundesrat on his proposal towards the social insurance, (Pulzer 1998, 242) meant that the CDU party lost its governing power after 16 years. The election result was heavily influenced by the campaign, where the Social democratic party was offering so called third way, as Tony Blair's Liberals in the UK. The CDU was offering stability instead of risk. (Pulzer 1998, 250) However, many voters outside the rich regions of Germany preferred risk to their bad situation.

Other why the government has changed, was the threat for the social weak citizens of cutting the social spending. The German tax income went down from 1993 till 1997 by 30 Bil. Euro, 13 percent, just in 4 years (Bundesrechnungshof 2007, 101). The situation outlook was pessimistic; therefore the German Chancellor Helmut Kohl tried to implement tax and welfare reform. The reform was focused on the reduction of pension and sick pay entitlements, together with tax relief for the better earners (Pulzer 1998, 244). The poorer east did favor this measure, and through a difficult implementation process, it became the weak point of the CDU government.

It is remarkable, that although the election year was just ahead, the CDU did not bother not to forward the proposal on the reduction of pension and sick pay entitlements. The social spending cut during the election year is against the opportunistic Nordhaus

Political Business Model. The right government tried to reduce the deficit cause, what went through in the Bundestag (Majoritarian system), but was stopped by the Bundesrat (PR System). This kind of procedural problems with two chamber parliaments have been claimed in the paper of Iversen and Soskice (Iversen and Soskice 2006, 178). The right government of Helmut Kohl managed, in the time of the decreased tax income to lower the deficit to 2.2 percent from 2.6 percent in 2007 (Bundesrechnungshof 2007, 119).

4.1.4 1998-2002

After 16 years of right party government, Germany experienced a huge change, when the social democrats took the seats in the cabinet. The government followed the trend of decreasing the state deficit, down to 23 B Euros in 2000, from 42 B Euros in 1998.

The government lost its majority in the Bundesrat in April 1999. Thus the proposed tax reform and pension system reform had to be passed. As Ganghof and Braeuniger discuss, the German government often escaped the possible collapse because of the possible pay off to political party opposition by “offering concessions to some state interests” (Ganghof and Braeuniger 2006, 533). Merkel’s article showed evidence for that claim, saying the pension reform, as the tax reform has have been passed in the mixed government only thanks to the side payments (Ganghof and Braeuniger 2006, 533). By adding special side payments, the financial plan is already losing some of its goals, to be the most efficient one. This puts additional constraints on the deficit creating and threatens the financial health of the state.

In 2000, the public spending deficit in Germany reached its lowest point, with

1.3 per cent number, when the financial plan for the period 2001-2005 has been adopted (Finanzplan des Bundes 2001 bis 2005). The plan, accepted by a social democratic government based of the Social democratic party and of the liberal Green party had an overall aim to make the federal household healthy. The aim was not achieved till 2003, when the deficit rose up to 4 percent (Bundesrechnungshof 2007, 109).

The Financial plan for the period 2001-2005 was set up on two basic premises. The first one, the annual GDP growth has been predicted to be approximately 2-2.25 per cent. The second one, the yearly increase in government spending should not exceed 0.8 percent and the spending of all levels: cities, states (Bundesland) and the federal state should have the annual growth of maximum 2 percent. Taking into consideration, the higher predicted GDP growth, the governments plan was about to decrease slowly the deficit (Bundesrechnungshof 2007, 112).

From the theoretical point of view, Hahn and Sturm claim that the social democratic governments tend to spent more in their budget. We can not show evidence against or for, as we are not comparing the period of the left government with another one, however, we can see the attempt of the government, to spend each year less, so the deficit would slowly decrease. The decrease was connected with the plan's long-term goal to build up a reliable frame, for the political decisions. It incorporates the decreasing of the public debt, and implementing a just and working tax system. The new available resources from the successful recovery of the public finance were aimed for the future investments to guarantee and enable economic growth in the future period (Bundesministerium der Finanzen 2001, 2). The Plan was adopted in a time of the 3G UMTS mobile network launch, which license purchase meant for the federal budget an

additional income of 51B Euros. This amount was successfully used to reduce the state debt, which decreased on a yearly basis towards the year 2001 by 20B, however, went up to the same level again in the following year (Bundesrechnungshof 2007, 116).

The financial plan 2001 had its target, to stabilize the public finance. On the other hand, it had the aim, to build a stronger social state, to continue in the path of the Bismarck state. The government adopted the so called Second Law for the Support of the Family, to strengthen the financial security of the families. The plan was to save 2.2B Euros annually for the families. (Bundesministerium der Finanzen 2001, 4-6)

The plan introduced a more beneficial system. Its major points were focused on the kids and the social care help. The increase of the financial benefit for the first three kids, the increase since of more than 10 percent from 1999, is one of the most remarkable. Following the family care reform, a pension system reform has been introduced. The pension system is working on the pay as you go principle, however, due to the lower income into the system as the costs, the state is taking part in the financing. The plan counted with increasing state payments, from 72B Euros in 2002 up to almost 80B Euros in 2005. The reform put the development of the retirement money more into correlation with the national salary, and set the system in a way to equalize the salaries among the dependent population. (Bundesministerium der Finanzen 2001, 7) . Germany, as a country focused on increased environmental sustainability, introduced the environmental tax “öko-steuer“, which income has been transferred completely to support the lacking money in the pension insurance system. Nine per cent of the state subvention in 2002 and already 12 per cent of the 2005 state help to the pension system originated in the environmental tax.

The government predicted a decrease in unemployment with 200 000 unemployed less till 2005, to the figure of 3.5 Mil (Bundesministerium der Finanzen 2001, 8). As discussed in the welfare state part, the problem with Germany is, that despite the lowering number of unemployed people, the number of employed does not have to increase. The early retirements is one of the way how to decrease the unemployed thus not increased the employed. (Streeck and Trampusch 2005, 175) In the finance plan, despite the planned decrease in unemployment, no decrease in the unemployment funds was noticed. (Bundesministerium der Finanzen 2001, 8)

The increased child benefits together with the announced increased public spending on the retirement, a year before the election, makes strong evidence, about the partisan political business cycle. On the other hand, I have to admit, that the planed increase on social spending was in line with the proclaimed maximal 0.8 percent increase on the state expenditures. Never the less, as said by Brück and Stephan, the left governments are more optimistic to the budget income (Brück and Stephan 2009, 1-8).

The true is, the expected yearly increase into the state budget did not happen. In the following years, from 2002-2004, the state income decreased from 220B to 211B Euros, but the expenditures rose as planned, and the deficit reached 4 per cent (Bundesrechnungshof 2007, 90/119).

The financial plan has been adopted in the time after the Lisbon Agenda 2000, what has been the EU framework to make the EU the world most competitive area. The main objectives were to increase the employment number over 70 per cent and to put more money into research and development. German budget handled the technology support together with the support of the business environment. The support has been

diversified into all branches of industry, offering 30 percent of the technology and business support budget to the small and medium businesses and 30 per cent to the local governments to improve the business environment. The research and development budget increased significantly, up to 8.4B Euro, what is a year to year increase of 47 per cent. (Bundesministerium der Finanzen 2001, 10)

The financial plan counted with an increased spending into the infrastructure and housing, what took the highest share out of the federal budget. With annual share of 13.5B Euros (2002), the number had an increasing tendency. Increased investments followed into the railway system and into the highways.

Although the red – green government aimed not to increase the spending more than the income, we can see that it planned additional expenditures in almost all spheres of the public spending.

4.1.5 2002 - 2005

The tax and pension reform, putting additional pressure on the 1998 government, turned out, to be a very unpopular treatment, among the left voters. The reforms were considered to be a mixture of left and right measures, with corporate tax cut, wealth tax and tight fiscal policy. The result of the reforms was the decreasing popularity of the governing SPD. Furthermore, the not positive macroeconomic results in the last period of the government were giving more trust into the previous government, which lead Germany in the time of a big growth. However, the Chancellor's popularity was still relatively high, mainly because of his negative position towards the war in Iraq and because of the well managed 2002 floods rescue coordination. The 2002 election

finished with a very tight win of the left coalition, SPD and The Greens (Kitschelt 2003, 138-142).

When talking about the changing party popularity, we have to think about the change of the electorate. The traditional support groups for the left governments in the areas of high unemployment were still a reliable support; however, with a lower share of votes than expected. The overall profile of the SPD voter, except Bavaria, was a voter from higher unemployment region with a strong service or public sector as the main employer. On the other hand the CDU got a relatively strong support in the areas of high manufacturing employment. In the 2002 elections, the SPD lost important 7 per cent among workers, what gained the CDU and FDP. However, as Kitschelt explains, the movement among the workers was not based solely on the political/economic reasons. The socio cultural reasons, as education and gender played surprisingly an important role in the vote division, when women and high educated people did vote for the SPD (Kitschelt 2003, 147).

4.1.6 Elections 2005

The 2002-2005 deficits increased dramatically, and in 2004 it was reaching 4 per cent. The unemployment was still rising. The more libertarian steps of the Gerhard Schröder government were not in favor of its electorate, and the fear of the party break led to early election, after 3 years of governing (Proksch and Slapin 2006, 541). Generally the process of calling new election is not common in Germany and was accompanied by the decision of the Federal President and the Constitutional Court. The Chancellor asked his own party to vote against the government they formed, as he was

not eligible alone to dissolve the parliament (Proksch and Slapin 2006, 542). The elections, as mentioned, were heavily influenced by the intro-party problems of SPD and the economic situation. The results brought a surprising situation.

First of all, none of the traditional blocks: SPD and Thee Greens, or CDU and FDP were able to form a government coalition by itself. Each of the big parties, CDU and SPD needed at least two smaller ones to get the majority. Secondly, the problems in SPD caused that the far left party the PDS achieved the best result in heir history, with almost 9 per cent. The coalition talks lasted for more then two months, and were lead by the leader of the second party in the election, SPD. The final government was as surprising as it could be; the Social democrats formed a big coalition with Christian democrats. Despite being second, Schroeder showed skilled negotiations tactic, firstly gaining the most important departments of the state, finance, justice, social and external relations; secondly , gaining the departments with the bigger share, two thirds from the federal household. (Proksch and Slapin 2006, 543) After the negotiations were closed, the CDU got the Chancellor seat with Angela Merkel, ad the leader of the SPD stepped down.

On the first sight, coalition, that could not co exist. Proksch and Slapin work focuses in deep on the coalition building after these elections. They used a “wordscore” methodology to determine the party orientation in the two main important aspects of the governing, the social dimension and the economic dimension. Their typology showed that the Christian democrats were leaders on the social scale, followed by the FDP and only on the third place, there was the SPD. Secondly, the economic dimension was lead by the FDP, and the CDU with the SPD had a very close score. This analysis shows us,

that the CDU was exactly in between the SPD and the FDP, far away from the Greens. (Proksch and Slapin 2006, 546-549) Furthermore, a coalition of two parties tends to be more stable than that of three. Therefore the coalition, that emerged, was from the theoretical point of view pretty much likely.

The deficit in the government of the big coalition was managed well. According to the German Federal bank, the deficit was decreasing annually, with the target to meet a balanced household till 2010. Till 2007 they managed to decrease the household down to 0.5 per cent.

4.1.7 Left or Right

The German party system, based of the left SPD, the Left or PDS and the Green party, further from the CDU, marked as a center party by Schmidt Index and as right party, according to Kitschelt and the FDP, which is undoubtedly right, was going through a change, where the left and right started to lean through.

On the Congress of CDU in 2004, half of the Union voters were for a more social welfare state and one third was for a radical change (Clemens 2007, 234) towards left. In 2004, before the election, Angela Merkel, the leader of the party in that period, agreed on a reform, with moving the unemployment compensation from the pay roll dependence on the federal budget, subsequently she agreed on rising the VAT to offset the lost revenue for the unemployed and a flat tax of 25 per cent on income, and to the third, she was for the reduction of some social benefits. (Clemens 2007, 236) In general, we can claim that her policy was a liberal right reform with the parts of left steps. The reason for her reform was the expensive welfare state, with aging population and the

unemployment. However, after reaching the big coalition, many of her right proposed measures, as the flat tax or the lower labor costs stayed untouched.

The SPD, as many other social democratic parties around Europe, saw its possibility to succeed in the adapting its policy towards the actual needs of the country.(Paterson and Sloam 2006, 234) The failure of the SPD in the 1980's and 1990's was according to Kitschelt the lack of mobility to adapt to the changing environment (Paterson and Sloam 2006, 235). After 1998, the party took a different approach, and leaned back from its traditional program, by trying to effective “manage the capitalism” (Paterson and Sloam 2006, 236). This need lead the party, together with its coalition partner, the Greens, to adopt a reform package in 2002, which, as already mentioned, was far away from the typical left values. Paterson and Sloam try to identify the policy of SDP as the “New Labour” or “New Center”. The losing of identity as a left party had been expensive, causing the electoral lost in 2005 (Paterson and Sloam 2006, 237). The Agenda 2010, adopted in 2001, considered as neo liberal act, lead to defection of the party’s ultra left wing to the new Left party, which gained its maximum in 2005. The party changed its opinion on the German welfare state, often seen as a safety net for the social weak ones. Instead of a safety net, the leader of the party called it the “trampoline” and cut spending for the people living an independent live (Paterson and Sloam 2006, 240). The left party started to argue with social investment, mostly into the public sector. The lowering of social standard was quite obvious with the sentence “low paid job is better then a no job” (Paterson and Sloam 2006, 242).

From the description of the party behavior, one common goal is obvious, tight budget. Both parties, CDU and SPD are focused and aim for one goal. Although there is

still distinction in the tax policy, as the CDU aimed for the flat tax. The cutting of the expenses on one side towards the unemployed, equaling the pensions and unifying the social budgets, is characteristic for both parties. The political programs of both parties contain numerous references towards the Maastricht criteria and the SGP that the direction set by the EU equals the final output of both policies on the fiscal side. Thus, the structure of the expenses and priorities are still not equal, but also thanks to the Lisbon Agenda, they are getting closer.

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Deficit	-2.2	-1.5	-1.2	-2.8	-3.7	-4	-3.7	-3.2	-1.6	-0.5
Govern	CDU	SPD	SPD	SPD	SPD	SPD	SPD	SPD	CDU	CDU
	FDP	GREENS	GREENS	GREENS	GREENS	GREENS	GREENS	GREENS	SPD	SPD

Table 1: Germany: The Governmental Parties and Budget deficit (Bundesrechnungshof 2007, 114)

The deficit numbers of the German government do not show strong political business cycle, as the deficit increased in the left government of Gerhard Schröder carried on till the end of his second term. We observe an increased deficit on the second half of his first term, what is identical with his reforms to support families. However, the world experienced generally a small crisis in 2001, caused by the 9/11 attacks and the bankrupt of several large multinational companies in the US.

The change of the government in 2005 is connected with a rapid decline in the deficit number, from 3.2 to 1.6, what is a 50 per cent improvement. We can see how the expense cutting policies started immediately after center right party came to power, and followed until 2007.

4.2 Austria

The analysis of Germany showed us, how the welfare state goal often dominates in the social democratic party government in good times, and how the possible threat to the economy makes even the social democrats adopt some libertarian steps to prevent the economy from a downturn. Furthermore, the path, which has been set by the SGP, is followed clearly by parties, left and right.

In my second case, Austria, I will analyze, how the Austrian followed the fiscal policy and how big priority was it for the government in the period 1980-1990.

4.2.1 Politics in Austria

The Austrian two major political parties are the SPÖ, the social democratic party and the ÖVP, the conservative people's party. These parties were the only parties taking part in the government since the Second World War (WW2). As Anton Pelinka mentions, it turned almost to a Westminster style of Government. In 1983 a new party got into the government, the FPÖ. The party acted as a liberal party till 1986, when its new leader transformed the party orientation to a nationalistic one. The same year, 1986, the Green party got into the parliament. (Pelinka 2009, 3-5).

4.2.2 Situation in 1980's

The situation in the early 1980's was still influenced by various factors from the turbulent period of the 1970's. The first factor was the collapse of Bretton Woods. The collapse of Bretton Woods put many currencies in a risk. The Austrian Schilling could have become vulnerable, as a small country currencies were the easiest to be

manipulated. To prevent that happen, the Austrian Central Bank linked the Schilling closely to the German Mark, by following its interest rates policy. (Katzenstein 1987, 38)

Secondly the political economy in the 1970's, characterized by the first oil shock and subsequent crisis suffered a big hit by the employment. The whole Austrian economy has been strongly interconnected with the trade unions, which had their ties in the governments, among all the parties. The unions were strongly centralized, what made them to a serious player in the formation of the political economy. For the unions, the state was the biggest partner for a dialogue, because, the state was actually the biggest employer in Austria, as the majority of the companies were state owned (Katzenstein 1987, 38-42). According to Belke, Schneider, relatively the biggest privatization of the state owned companies followed in the year 1994-1997, with 1.7B USD income, whereas in the whole period 1960-1989, there was a privatization of 600 Mil. USD (Belke and Schneider 2004, 54).

The state ownership of the major enterprises has logically several advantages but also numerous disadvantages. Whereas in Germany, the large companies were mostly private or the state took only a small share, in Austria it was different. Whereas in Germany the bankrupt of a company could have been saved by the good will or need of the government, in Austria, the state was expected to keep the companies alive even in possible crises in the industry. The 1970's crisis showed how the state can cope with economic downturns. The threat of the unemployment was managed by active labour policy. The tools used by the Austrian employers, to keep the unemployment low, were such as a borrowing of the employees in a case of need, fast shifting the workers from declining sectors into the growing ones and use of the early retirement provision scheme

to lower the unemployed numbers. The fall of the local companies was prevented by a large scheme of bail outs from the banks to the threatened companies. (Katzenstein 1987, 38-45)

The government of the left SPÖ, had shortened the working week, public servants number has been increased and the vacation time prolonged. The costs meant a higher budget deficit. This higher deficit followed after years of fiscal constraint policy, which was aimed to pay off debts caused by the high infrastructure investments in the 1950's and 1960's. The high deficit in the 1970's was financed by a smart debt policy, with high interest rates on state bonds and generally better conditions for foreign investors than in the neighboring, investment attractive Switzerland. Austria presented in the 1970's anti cyclical policy, where the wage restraint was set in the time of expansion and in the time of depression was set to wage increases, in order to foster the inflation and prevent high deficits (Katzenstein 1987, 38-45).

Two of the government's goals in the late 70's and early 80's were to strengthen the Austrian export in the world markets and active labour policy. Thanks to its geographical preconditions and developed infrastructure, a useful way how to boost the economy and guarantee high living standard, was in the 1980's the tourism. The tourism accounted in the 1980's up to 50 per cent of the, national product, and its nationwide spread meant no significant regional discrepancies (Scharpf 1987, 83-90).

4.2.3 The Governments and Deficits

The national elections in 1979 won the SPÖ, with Bruno Kreisky, who continued the policy from the late 1970's. His steps in active monetary policy showed effect and the

economy started to recover. The deficit was kept on a low level. However, the monetary effect on export did not take long and soon the economy started to lose its speed. The deficit rose, up to 4.5 percent in 1983. The not positive economic development, marked by the second oil shock did benefit for the 13 years-in office chancellor.

The election year 1983 meant change of the government and the stop for 13 years of the SPÖ self-governing. The election were a lost for the SPÖ, however, the winning ÖVP could not built up the government by itself, therefore a coalition made of the two parties SPÖ and FPÖ took over the rule (Kirchenbaumer 2008, 1). The FPÖ presented itself in 1984 as a liberal party, without ultra nationalistic view (Sozialdemokratische Partei Oesterreich 2010). The chancellor became the leader of the SPÖ, Fred Sinowatz. (Pelinka 2009, 4) By some authors called the “small coalition” The coalition was struggled with financial problems, the major one, the high debited state owned companies. Although the budget deficit declined with the new government in 1984 to 4 per cent of the GDP, it rose till 1986 up to 4.7 per cent. (Austrian Statistical Office)

The development of the Austrian public finance did not follow the development in the world economy. In 1985, the word interest rates started to decline, what was a signal for new expansion of the economies. However, the Austrian economy public debt exceeded 50 percent and did not allow the economy to rise faster.

In 1986, two important political events happened. First of all, the presidential elections were a total failure for the ruling SPÖ. The presidential elections 1986 were marked with question about the history and continuity of the officials from the WW2 time. The rising nationalists’ movement, with the not positive economic results caused the election of a member of the WW2 Nazi party (Sozialdemokratische Partei Oesterreich

2010). After this result, the SPÖ prime minister stepped back, and his successor became Vranitzky, who was strong opponent of the Nazi era. The strong movement of ex-Nazi party members joined the FPÖ and transformed it with the election of Jörg Haider to a nationalistic party. Vranitzky's immediately suspended the whole government. The 1986 parliamentary elections resulted in a government of the social democrats with the conservative ÖVP (Pelinka 2009, 7). This coalition lasted until 1999, and it was a remarkable government of the social democratic party with the right conservative party (Pelinka 2009, 6).

The big coalition government of the social democrats and conservative party managed to slowly decrease the deficit annually, what was caused by the positive economic development. Vranitzky, who held the position of the finance minister during the Sinowatz government, started the privatization process of the state industry that was causing problems in the first half of the decade (Sozialdemokratische Partei Oesterreich 2010). The government introduced various saving programs, to stabilize the public finance, followed by a tax reform.

As we can from the chart below, there is an obvious case for the business cycle model. In the first case, there is a deficit in the election years, as described in the opportunistic model. The election years 1983 and 1986 are having significant higher deficits, then the years without the elections with 4.5 and 4.1 per cents of the GDP. That indicates on higher state spending, more expansionary fiscal policy, to make the citizens feel better off.

Secondly, we can see the clear Alesina model of different behavior in the first and second election period. As we see the, 1986 and 1987 deficit is much higher then the

deficit in the first two years of the 1983 government. The original elections were scheduled for the 1987. The 1986 deficit is remarkable, also because of the relatively high GDP growth of the years 1985 and 1986 with more than 4 per cent. (Austrian Statistical Office)

Year	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Deficit	-2.1	-2.1	-3.6	-4.5	-2.9	-3.1	-4.1	-4.7	-3.5	-3.1	-2.6
Govern	SPÖ	SPÖ	SPÖ	SPÖ	SPÖ	SPÖ	SPÖ	SPÖ	SPÖ	SPÖ	SPÖ
					FPÖ	FPÖ	FPÖ	ÖVP	ÖVP	ÖVP	ÖVP

Table 2: Germany: The Governmental Parties and Budget deficit (Statistik Austria 2010)

The political leaning and deficit number cannot be put into correlation, as the deficit oscillates regardless the political orientation of the government. However, we see that the first coalition government of the liberal and social democratic party is connected with the higher figures for the deficit, as the solely social democratic left government. The 1983 government, however, started in the time after the second oil crisis, as already mentioned before.

The government of the two major parties started economic reforms, however they were known, to be launched by the social democratic leader.

Due to the problems with the state owned companies, and the second oil chock, we cannot put a simple conclusion to the governmental leaning and deficit in Austria in this period.

5 Conclusion

This paper was looking for the answer, if there really exist a difference between the left and right political orientation of the government in the area of fiscal policy across Europe, before and after the adoption of the stability and Growth Pact. The question is important, especially before the parliamentary election, as the promises of the political representatives are often not fulfilled.

The reviewed literature showed several examples in favor of the theory, however, not as obvious as expected. Most authors noticed higher general spending or higher spending on social issues, but a significantly higher deficit was not the case in the cross country comparisons. The analysis of the Stability and Growth Pact showed distrust of it, because of its imperfect formulation and many loopholes, that allow the members to legally spend more than agreed in the pact.

The analytical part brought one significant finding, when the differences in the different annual deficit changes are related to the region. This finding corresponds with the findings of Breuss and Roger, where Germany's economic performance had an effect on Austria.(Breuss 2006, 218). The governmental leaning did not show significant impact on the fiscal policy in the quantitative analysis, in neither of the periods.

The last part of my paper, the case study, was looking for evidence to support the proposed theories. The case study of Germany showed a convincing empirical evidence for the different impacts of the social democratic and a right government on the development of the deficit, in the era of the SGP. Although, the government of Gerhard Schröder was facing harsh economic conditions, the high numbers in deficit just after the

change of the government are a clear indicator for the massive overspending by the leftist Social Democratic Party. Nevertheless, I have to add, that the new, rightist Chancellor of Germany in 2005, was heavily focused on the stabilizing of the fiscal policies across Europe. The Austrian case before the time of the SGP showed primary, that the fiscal policy was not experiencing so much attention as in the period afterwards.

A common mark for both cases is the building of big coalitions of parties from different corners of the political spectrum. This brings support for the claim, that the traditional differences between the right and left parties such as fiscal and monetary policy are getting smaller, when a government can build up a program and sustain. The SPÖ and ÖVP government in Austria or the SPD and CDU government in Germany are clear evidence for this.

My paper aimed to see whether the difference between left and right has vanished from the member countries of the EU 15, after the adoption of the Euro, in the fiscal policy. The fiscal policy and the deficits are a very hot topic in the time of creating this paper, spring 2010, because of the obvious breaking of the constraints from the social democratic government in Greece and Spain. A further study on this particular case, with the positions of the other EU countries and their proposals to reform the Stability and Growth Pact again, together with the steps taken by the governments across the Eurozone is a very important topic to elaborate, and a significant challenge for the future research, in order to be able to see the coming threat in advance.

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